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### European Model Companies Act

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**EUROPEAN MODEL  
COMPANIES ACT  
(EMCA)**

**2017**

**1<sup>ST</sup> EDITION**







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## INTRODUCTION

### 1. The Aims of the EMCA

While harmonization or convergence of European Company Law can be achieved by a toolbox of measures, until now the tools have been confined largely to Regulations, Directives, Recommendations and Corporate Governance Codes. It is submitted that there is a need to provide new measures to develop future European company law and that a European Model Act (EMCA) would be a useful tool for European integration in this area. The objective of the EMCA project thus is to establish, on a solid scientific foundation, a new way forward in European company law inspired by the US Model Business Corporation Act (MBCA).

The EMCA is designed as a free-standing general company statute that can be enacted by Member States either substantially in its entirety or by the adoption of selected provisions.

This approach differs from previous European company law initiatives, as it is a general settlement of the debate on which of the two regulatory approaches is superior – regulatory competition or harmonization. The EMCA offers the Member States a harmonized company law, but leaves it to each Member State to decide whether it will offer its businesses the advantages given by harmonization. The major benefit from an integrated company law framework is that it establishes similar conditions for company shareholders and third parties all over the EU, thus facilitating cross-border investment and trading by ensuring shareholder rights and rebuilding investor confidence. The EMCA is not a mandatory harmonization instrument, as Member States are not bound to follow the Model Act. Thus the EMCA can promote regulatory competition, but can also act as a tool for a harmonization of, and convergence between, Member States' company laws.

At the same time the EMCA allows for special local considerations and for experimentation with new or different ideas, as Member States are free to opt out of parts of the Model Act in order to implement national company law innovations.

The EMCA can be regarded as a tool for better regulation in the EU since it provides a coherent, dynamic and responsive European legislative framework. Member States can benefit from using the Model Act as a company law paradigm, as it will be a modern competitive Companies Act. Moreover, the project allows the EU Commission the opportunity to take part in, or to support, a continuous modernization of the Model Act, without forcing legislation on the Member States.

The EMCA may be viewed as a dynamic piece of legislation capable of being continuously developed in response to the changing environment and market conditions that modern businesses face. The EMCA may thus overcome some of the criticism of traditional inflexible law-making, as it will offer a more informal and organic convergence of European company law.

### 2. The European Model Act Group

The implementation of the project is coordinated by the European Model Companies Act Group (the EMCA Group), which was officially formed at a meeting at Aarhus University (Denmark) in September 2007. Since then additional members joined and the Group currently consists of prominent company law scholars from 22 Member States. The group members have been almost consistent during the period of preparation, see the list of members below.

Information on the EMCA group and the EMCA project can be found here:

<http://law.au.dk/en/research/projects/european-model-company-act-emca>

The Group is independent from business organizations as well as from the governments of the Member States and the European Commission. It was financed exclusively through academic funding. The EMCA does not have – nor is it intended to have – political authority. Its impact will thus ultimately depend on its quality and usefulness. In this sense, the EMCA is close to the MBCA but also, as noted, to the “Principles of Corporate Governance: Analysis and Recommendations” (ALI Principles), written over a 15-year period beginning in the late 1970s by a committee of academics and practitioners, under the auspices of the American Law Institute (ALI).<sup>1</sup>

The European Commission has expressed its support for the project, and the representatives of the Commission were invited to attend the meetings of the Group as an observer and discussion partner.<sup>2</sup>

Although designed mostly for Member States, a clear decision was taken at the outset however that the EMCA would not be restricted by existing EU-legislation. Thus, where the Group considered that provisions of existing EU law are not appropriate or efficient, the EMCA reflects the preferred alternative.

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<sup>1</sup> M. Klausner, *A US view of the European Model Companies Act*, ECFR 2015, p. 363; C. Teichmann, *Modellgesetze für Kapitalgesellschaften in den USA (MBCA) und Europa (EMCA)*, Festschrift für Theodor Baums, 2017, p. 1227.

<sup>2</sup> See also the Report of the Reflection Group on the Future of European Company Law ([http://ec.europa.eu/internal\\_market/company/docs/modern/reflectiongroup\\_report\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf)), 5 April 2011, p.12 (recommendation 4).

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The members of the Group are recognized and experienced company law professors with extensive experience in drafting company regulations at national and EU levels.

The work of the Group has been coordinated by a chairman: Professor Paul Krüger Andersen from Aarhus University (Denmark). Aarhus University also hosts the secretariat. Since the publication of the EMCA in 2017, Professor Pierre-Henri Conac from the University of Luxembourg is the chairman.

*The Authors of the EMCA:*

Due to the fact that the EMCA took 10 years to be drafted, not all Members of the EMCA Group could take part from the start to the end of the project. Therefore, there is a difference between the Members and the authors.

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### 3. Theory and Methodology

#### 3.1. Legal Theory on Different Legal Tools for Regulation

In its 2003 Action Plan, the European Commission called for “alternative tools for regulation”, in other words alternatives to EU Directives implemented in national company laws.<sup>3</sup> One alternative is “soft law”, such as corporate governance codes and other self-regulatory measures.

Usual Companies Acts and soft law are sources of law placed in the hierarchy of national sources of law.<sup>4</sup> Companies Acts as well as soft law are both aimed at the authorities applying the law and at the persons, legal or otherwise, applying them. Model Acts are different, but it is not quite clear how to categorize them. They may contain “principles” in the way used, for example, in the Definitions and Model Rules of European Private Law (DCFR)<sup>5</sup>, defined as “principles [...] intended to be applied as general rules (on contract law) in the European Union.” As such, principles can have a normative function in the Member States. Partly the EMCA conforms with such a view: The EMCA seeks to promote basic principles of European company law, such as equal rights for shareholders, and other rules on minority protection, principles on directors’ duties of loyalty and care and principles of creditor protection.<sup>6</sup> A number of basic principles are defined in the EMCA Chapter 1 on General Company Law Principles.

However, the EMCA also seeks to provide a model for a full text Companies Act, which can be used as a model for future or partial legislation in Member States, for candidate countries to the European Union (especially currently in the Balkan area) and, if interested, to other European or neighbouring countries (Norway, Russia, Switzerland, Ukraine...).

As mentioned above, the purpose of the EMCA is to offer Member States and all European countries, at a low cost, a tool for the convergence of European company legislation that is simultaneously flexible and capable of allowing Member States and all European countries to deal with new developments in the economy. Being inspired by the best solutions in each Member States, the EMCA should contribute to the circulation of models and legal transplants in the EU.<sup>7</sup>

Beyond this goal, the purpose of the EMCA is also to offer a source of inspiration to all countries in the world that are looking to modernize their company law. The EMCA represents an European vision of company law and offers an alternative to countries who do not wish to only refer or be influenced by the United States approach to corporate law, whether the MBCA (Model Business Corporation Act), the Delaware General Corporate Law (DGCL) or the ALI *Principles of Corporate Governance: Analysis and Recommendations*.<sup>8</sup>

#### 3.2. Some Fundamental Problems and Approaches

When analyzing company regulation in Member States and developing the EMCA, a number of fundamental problems appeared and a number of approaches had to be clearly defined.

As a superior criterion for the choice of the regulatory method, the Group has accepted that the EMCA should be based on an appreciation of the following policies:

- Simplification of regulation,

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<sup>3</sup> Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward (COM(2003) 284 final). See also the Commission’s follow-up consultation on future priorities for the Action Plan on Company Law and Corporate Governance, available at: [http://ec.europa.eu/internal\\_market/company/docs/consultation/final\\_report\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/consultation/final_report_en.pdf).

<sup>4</sup> See e.g. R. Nielsen and C. D. Tvarnø, *Retsskilder & Retsteorier*, 2<sup>nd</sup> ed. (2008), p. 56; P. Craig and G. De Búrca, *EU Law: Text, Cases, and Materials*, 4<sup>th</sup> ed. (Oxford University Press, 2008), Chapter 3; D. Chalmers, G. Davies and G. Monti, *European Union Law - Text and Materials*, 2<sup>nd</sup> ed. (Cambridge University Press, 2010), Chapter 3.

<sup>5</sup> C. von Bar, E. Clive and H. Schulte-Nölke (eds.), *Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference (DCFR)*, Outline Edition (2008), p. 9.

<sup>6</sup> E. Ferran, *The Place for Creditor Protection on the Agenda for Modernisation of Company Law in the European Union*, ECFR 2006, pp. 178-221.

<sup>7</sup> See H. Fleischer, *Legal Transplants in European Company Law – The Case of Fiduciary Duties*, ECFR, 2005, pp. 378-397.

<sup>8</sup> See M. Klausner, *A US view of the European Model Companies Act*, ECFR, 2015, pp. 363-369.

- Flexibility of regulation,
- Reducing agency and transaction costs.

These same policies have also been accepted by the EU Commission as part of its 2006 Strategic Review of Better Regulation.<sup>9</sup>

In recent years, the Commission has worked on assessing initiatives within the area of Company Law. Among others, this has resulted in a report of the Reflection Group “On the Future of EU Company Law” (April 5 2011), the Commission’s Green Paper (COM(2011) 164 final), and the Commission’s 2012 Action Plan (COM(2012) 740 final).

In the Commission’s 2012 Action Plan, three main lines of action are identified; enhancing transparency, engaging shareholders and supporting companies’ growth and their competitiveness.<sup>10</sup>

The Commission’s work and plans have been taken into account by the EMCA Group’s assessment and design of the Model Act. Thus, for example, the Group has emphasized recommendations stating that regulation should promote the company’s long term planning and an increased weighting of the management’s observation of risk management. Dealing with national differences in company regulation and legal traditions, the EMCA takes a functional approach, meaning that the starting point for the analysis is company problems regardless of whether a problem is, for example, dealt with in the national Companies Act or the national insolvency act. For example, the duty of a director to ensure that a company does not continue to operate once it is foreseeable that the company cannot survive is regulated in the Insolvency Act 1986 as wrongful trading in the UK and in the Companies Act 2009 under the law of liability in Denmark. Further, the regulation of private companies (AG/SA/Plc. etc.) vs. public companies (GmbH/Sarl, Ltd. etc.)/traded companies is based on how typical companies of each type function. Among other things, this is reflected in the Chapter on management which allows different management structures.

In line with the principles on simplification, flexibility and reduced agency costs, there are some necessary considerations on

- the choice between mandatory and non-mandatory (default) rules,
- the use of disclosure rules vs. substantive rules,
- the choice between codes/self-regulation and substantive (Model Act) rules.

In general, prior to the 2008 financial crisis, non-mandatory rules, EU Recommendations and codes/self-regulation were considered preferable, but the Group examined in detail, if and how these general principles should be used in the EMCA, and whether the 2008 financial crisis has altered the formerly preferred general view on this question.

With respect to simplification, the Group took the view that the EMCA needs to contain rules on all relevant company law matters. The various Companies Acts of the EU Members States vary in size. For example, large and detailed regulation can be found in France, Germany, Sweden and the UK, while shorter and less detailed regulation can be found in Denmark, Greece, Luxembourg and Poland. The EMCA aims to reach a balance between general and detailed regulation. In reaching this balance, the Group has taken into consideration the Member States’ practical experience of their domestic legislation as well as the huge theoretical work, history and cultural influence behind the different Companies Acts. However, those aspects of the Acts which were too closely related to national traditions (and not of widespread application) were not considered. The intention thus was to avoid overly detailed regulation in the EMCA.

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<sup>9</sup> See COM(2006) 689.

<sup>10</sup> K. Hopt, *Corporate Governance in Europe: A Critical Review of the European Commission’s Initiatives on Corporate Law and Corporate Governance*, NYU Journal of Law & Business 12 (2015), pp. 139-213.

The Group gave particular consideration to the choice between mandatory and non-mandatory (default) rules. The EMCA proceeds on the accepted European tradition in company law that an important goal of the EMCA is the protection not only of outside shareholders but also of creditors. This remains the case even if this goal is supplemented with new goals, such as the use of company law as a tool for economic efficiency and competitiveness or a tool to promote other societal goals (see Section 3.4 below). Thus, rules on creditor and shareholder protection are mandatory rules. These include for example a large number of the rules on capital protection which are contained in the Chapters on formation, companies' capital, general meeting and minority protection. However, the approach of the Group is to avoid drafting overly burdensome and costly rules.

Other rules, in particular with respect to the organization of the company, take the approach of non-mandatory rules allowing companies to organize themselves with flexibility according to their actual needs, within the framework provided by the EMCA.

Generally, there is a need for a proper mix of mandatory, default and soft (i.e. comply or explain) rules with more room for default rules applicable to private companies. Corporate scandals and the recent financial crisis neither justify a radical deregulation nor a hastily adoption of burdensome and untested formalities.

Special consideration is taken with respect to the division between private and public companies (see Section 6 below).

In determining whether an issue should be regulated in the EMCA or dealt with by Member States in the form of self-regulation, a number of issues were considered. An examination of national corporate governance codes indicated that the codes differ in many ways. Some are very detailed and others are shorter and focus primarily on principles. Also, standards of what is considered as good corporate governance vary. Furthermore, EU Recommendations, such as the Recommendation on Directors' Remuneration in Listed Companies (2009/385/EC), have been implemented differently in the various Member States. There is no short answer or formula as to how to deal with these issues. In the EMCA the approach is considered Chapter-by-Chapter and Section-by-Section, see below Section 3.4.

Finally, the EMCA, as a model Companies Act, does not purport to deal with securities regulation/capital markets law, nor with all kinds of regulatory rules that can be seen as flanking measures of corporate law and that are often intended to combat abuses in the area of tax or social security or economic crime.

### ***3.3. Use of Comparative Method***

The most important working method to be used during the preparation of the EMCA was the comparative method. Since the members of the Group have solid knowledge – both as academics and in practice – of the Companies Acts of the various Member State, it was possible to use a combination of the “*Länderbericht*” (national report) method and the analytic method.<sup>11</sup>

The comparative process started with questionnaires on each topic in order to gain a general view of similarities, differences, new ways to deal with problems and recent issues. At the same time, a collection of Companies Acts was established for specific analyses of problems and solutions. The analyses were carried out by working groups, chaired by one member, and representing more than one Member State (old/new Member States, common law/civil law countries etc.). The chair and members of each working group was also chosen considering that their national law, could serve as references for the EMCA on this topic. The reasons were the success of the national Member State law in this area, or its modernity. However, all national Companies Acts were analysed when drafting the chapters in order to have a blend of national traditions (civil law countries/Nordic countries etc.). It was considered also that using national law on certain issues would allow courts and practitioners in Member States adopting parts or the whole of the EMCA, to easily refer to the case law developed under the provisions which served as inspiration.

In certain circumstances, external company law experts were invited by the Group.

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<sup>11</sup> See e.g. K. Zweigert and H. Kötz, *An Introduction to Comparative Law*, 3rd ed., (Oxford University Press, 1998), p. 32; and O. Lando, *Kort Indføring i Komparativ Ret*, 3<sup>rd</sup> ed., (DJØF Publishing, 2009), pp. 206-207. The *Länderbericht* method compares national legal systems to each other. When applying the *analytical method* one parameter at a time is dealt with from the perspective of the two or more legal settings.

The working groups prepared the first drafts of the respective Chapters. The drafts were discussed, revised and agreed on in meetings (at least twice a year) by the entire Group.

### 3.4. Use of Law and Economic Theories

Over the last decade or two there has been a paradigm shift in European company law. In short, under the influence of the US, the aim of company legislation/regulation has shifted from being exclusively shareholder and creditor protection to explicitly including the promotion of economic efficiency.<sup>12</sup> The former is reflected primarily, but not exclusively, in the maximization of profits for shareholders (see further below). Use of economic theory and law and economy studies have become a natural part of the development of company regulation<sup>13</sup> particularly in the areas of corporate governance, financing of companies and takeovers.

The project aims to ensure that the contribution, which law and economics have made to company law and corporate governance in recent years, is incorporated and exploited in the EMCA.

As noted earlier, traditional company law is aimed at protecting a company's shareholders and creditors. The shareholders must be ensured influence and profit, and creditors must be protected against losses which are not a result of taking reasonable commercial risks. These goals remain important for any Companies Act.

In order to ensure that the shareholders are able to play an active role in the company's decision-making process, a growing number of measures have been adopted both at national and EU levels. For example, the EU Shareholders' Rights Directive (2007/36/EC) provides new rights for shareholders of listed companies to attend and vote at general meetings remotely, to raise questions and to gain access to relevant information. The amendments to the shareholders' rights directive adopted in 2017 reinforce this approach, for instance on the issue of compensation of directors and managers ("say on pay").<sup>14</sup> Similarly, the Directive on Takeover Bids (2004/25/EC) regulates takeovers of public listed companies and provides for the protection of minority shareholders by implementing a mandatory bid rule as well as requiring the disclosure of adequate information to the shareholders of the target companies. The purpose of these measures is to ensure an improvement of the corporate governance system. In its 2011 Corporate Governance Green Paper, the Commission stated that shareholders need to take a more active role and concludes "It therefore seems useful to consider whether more shareholders can be encouraged to take an interest in sustainable returns and longer term performance, and how to encourage them to be more active on corporate governance issues".<sup>15</sup> To underline that the Group shares this view, Chapter 1 of the EMCA contains a provision on the principle of shareholder democracy.

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<sup>12</sup> See e.g. the Lisbon Treaty and several revisions of national Companies Act, such as Denmark, Finland, the Netherlands, and the UK. The overall purpose of the regulation is described as "*the tandem of improving the competitiveness of EU Company and better regulation*".

<sup>13</sup> See e.g. the Danish "*Debatoplæg om Aktivt Ejerskab*" from 1999, drafted by the *Ministry of Trade and Industry*. In the Commission's Action Plan 2003, the main objectives are 1) strengthening shareholders' rights, and 2) to foster efficiency and competitiveness of business. The words efficiency and competitiveness are the basic principles in Company Law reforms, e.g. in Denmark, Finland and the UK. The tracks that were laid down with the 2003 Action Plan has been continued and developed with the Commission's 2012 Action Plan, the 2011 Reflection Group's Report and the Commission's 2011 Green Paper. The Green Paper cites the Commission's Communication "Towards a Single Market Act" as saying that "[i]t is of paramount importance that European businesses demonstrate the utmost responsibility towards not only their employees and their shareholders but also towards society at large." The 2011 Green Paper further cites that these elements "*also contribute to the competitiveness of European business, because well run, sustainable companies are best placed to contribute to the ambitious growth targets set by 'Agenda 2020.'*"

<sup>14</sup> Proposal of Directive of the European Parliament and the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, COM(2014) 213 final.

<sup>15</sup> Green Paper on *The EU corporate governance framework* (COM (2011) 164 final), p. 3.

The debate has dealt with the possibility of constructing company law rules that encompass incentives for more active involvement by shareholders. In particular, recent experience of the lack of control of directors' remuneration in the form of share options and bonus schemes has illustrated the importance of shareholders' activism. According to Recommendation (2009/385/EC), the structure of directors' remuneration should promote the long-term sustainability of the company and ensure that remuneration is based on performance. As this Recommendation can be implemented into national Companies Acts or corporate governance codes building on the experiences in the Member States, the Group considered whether the Recommendation should be implemented legally in the EMCA or if it is sufficient to deal with the problem in the national corporate governance codes. Some basic principles of the Recommendations are implemented in Chapter 8 of the EMCA on management of the company.

The economic theory which arguably has had, and still has, the largest impact on company law is the principal/agent theory.<sup>16</sup> The main focus of this theory is on the company's organization. The theory concerns the interaction between owners and managers and, in particular, how the owners can control the managers. The shareholders must expend time and resources to control the managers and defray the so-called "agency costs". The EMCA seeks to improve shareholders' opportunities to control managers and to reduce agency costs. (see Chapter 9 on directors' duties and Chapter 11 on general meetings.)

The traditional principal/agent theory focuses on shareholders as principals; however, especially in continental Europe it is recognized that there are additional principals such as employees, creditors and the society as a whole. Following that trend, the EMCA also encompasses the relationship between companies and such stakeholders.<sup>17</sup> (see Chapter 9 on directors' duties).

Another economic theory, which has had a great impact on the regulation of takeovers, is the theory on "market for corporate control".<sup>18</sup> This theory suggests that takeovers, and the threat of a takeover, have a disciplinary effect on managers and thus incentivize them to operate their companies more efficiently. The EU's Takeover Bid Directive (Directive 2004/25/EC) is based in part on an acceptance of this theory. While the theory is not without its weaknesses, the EMCA also acknowledges the importance of this theory. While the Takeover Bid Directive (the 13<sup>th</sup> Directive) was considered as a part of company law directives it is now considered as a part of securities regulation. Thus, the EMCA only considers issues that are of importance with respect to company law matters (see Chapter 13).

Recently, questions have been asked about the economic foundation of takeover regulation and, in a broader sense, on the fundamental objectives of European company law. It has been argued that European companies should have further legal obligations such as taking into account human and environmental interests, corporate social responsibilities and sustainable development.<sup>19</sup>

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<sup>16</sup> See M. C. Jensen and W. H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, *Journal of Financial Economics* 3 (1976), pp. 305-360.

<sup>17</sup> Cf. J. Armour, L. Enriques et. al., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 3<sup>rd</sup> edition (Oxford University Press, 2017), p. 22: "the appropriate goal of corporate law is to advance the aggregate welfare of all who are affected by a firm's activities, including the firm's shareholders, employees, suppliers, and customers, as well as third parties such as local communities and beneficiaries of the natural environment." See also G. Roth and P. Kindler, *The Spirit of Corporate Law*, 2013, p. 7, stressing the importance of protecting creditors and shareholders by mandatory rules.

<sup>18</sup> H. G. Manne, *Mergers and the market for corporate control*, *Journal of Political Economy*, (1965), p. 110.

<sup>19</sup> See e.g. D. E. Merrick, *For whom are corporate managers trustees?*, *Harvard Law Review* 45 (1932), p. 1145; M. C. Jensen, *Value maximization, stakeholder theory, and the corporate objective function*, *Journal of Applied Corporate Finance* 14 (2001), pp. 235-256; M. Blair and L. Stout, *A team production theory of corporate law*, *Virginia Law Review* 85 (1999), p. 247; J. Parkinson, *The legal context of corporate social responsibility*, *Business Ethics: A European Review* 3 (1994), pp. 16-22; P. K. Andersen and E. J. B. Sørensen (2011): *The Principle of Shareholder Primacy in Company Law from a Nordic and European Regulatory Perspective*, in: Neville, Mette et al.: *The European Financial Market in Transition* (Kluiver Publishing, 2012).

Many of these interests have been safeguarded by Member States in their own domestic legislation. An example of this would be the “enlightened shareholder value” perspective of directors’ fiduciary duties in Section 172 of the UK Companies Act 2006.<sup>20</sup> The Group has further examined in which way these objectives should be implemented in the EMCA. Generally, the Group agreed that companies must take developments in society and changes in society’s goals into account. Securing environment, sustainable development (CSR) is not considered as the fundamental and mandatory objective of company law but should primarily be considered by special regulation in the various fields. However, there is a clear tendency that such goals are also recognized in company law, accounting law and corporate governance codes. See in particular Chapter 8 on directors’ duties and Chapter 13 on reorganization of companies.

Corporate finance theorists have since the 1960’s developed a series of models, the aim of which is to develop an optimal capital structure of companies. This theory has also had a considerable influence on company law. These theories have also been considered and taken into account by the EMCA Group. Company law rules must facilitate a flexible adjustment of the company’s capital. The Group shares the view that companies should be allowed wide discretion in deciding how to organize the capital structure of the company. Such rules must at the same time secure shareholder influence and control without ignoring the interests of creditors. (see Chapter 6 on financing the company and Chapter 7 on companies’ capital.)

Economic theories represent a necessary foundation for the configuration of single provisions of the EMCA. A main theme of the EMCA project is to consider the effect which the 2008 financial crisis has had on the aforementioned theories. For example, the financial crisis gives rise to questions as to whether the previous trend to “optimize” the optimal capital structure needs to be corrected. The trend in the ten or so years before the financial crisis was to operate companies with less equity capital and more debt. A predominant view held by economic theorists has justified that approach. In some Member States thus company law as well as accounting regulation is built on economic theory which has underlined the advantage of a high debt ratio. However, it is appropriate to re-examine this balance between risk and return on the one hand, and the protection of creditors and other constituencies in company law and accounting rules on the other. Risk management, focusing on directors’ duties, provides for an example of this view (see Chapter 8).

The group is aware of the fact that particular types of conflicts may arise within private companies.<sup>21</sup> A private company usually is composed by a small number of shareholders. Agency problems in relation to the directors are thereby reduced, in most cases there is no clear separation between ownership and management. Instead, conflicts amongst shareholders become more important with particular attention to be paid to the conflict between minority and majority shareholders. The EMCA is following the one-law model (see Section 8 below) aiming at both public and private companies thereby taking into account the particular needs of typical private companies (see Section 7 below).

#### 4. Comments to the Act

Most chapters include general comments as an introduction which explain the rationale behind the choices made. Also, after each provision of the EMCA, a description and explanation is given of the content of the provision. The existing EU regulation on each particular issue is described, and where the Group agreed to deviate from the EU position, the rationale for doing so is set out clearly in the Comments.

The Comments to the Sections also identify and explain important differences in national rules among Member States. The Comments also include sometimes references to key judicial decisions in Member States, which had an influence on the provisions adopted in the EMCA.

Further, the Comments make it clear, if necessary, whether single provisions of the EMCA are mandatory or non-mandatory.

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<sup>20</sup> Explanatory comments on Section 172 of the UK Companies Act 2006 are given by B. Hannigan, *Company Law*, 4<sup>th</sup> ed. (Oxford University Press, 2016), pp. 220–227 and P. L. Davies, *Gower and Davies’ Principles of Modern Company Law*, 9<sup>th</sup> ed. (London, Sweet & Maxwell, 2012), p. 540.

<sup>21</sup> See for example G. Bachmann, H. Eidenmüller, A. Engert, H. Fleischer and W. Schön, *Regulating the Closed Corporation* (De Gruyter, 2013) as well as J. McCahery, E. Vermeulen, *Corporate Governance of non-listed companies*, 2008.

## 5. International Aspects of Company Law

The EMCA addresses the international dimension of company law. According to the EMCA Chapter 1 Section 13, the EMCA reflects the principle of freedom of movement within Europe. Thus, the EMCA contains chapters on cross-border mergers and divisions and further on cross-border transfers of seat and branches.

## 6. Output and Working Method

### 6.1. Output

As noted above, the Group believes that the EMCA can be a tool for better regulation in the EU. Member States will benefit from using the Model Act as a company law paradigm. The EMCA will be easy to use as an alternative to drafting national Companies Acts, not least for newer Member States which may more easily adopt the European standard. Individual Member States can also benefit from the comparative dimension of the project, and the project can allow all Member States to take advantage of the experiences of the individual States and newest regulatory practices.

The EMCA will contribute to disseminating standards of best practice throughout the Member States as well as fundamental principles of European Company Law. The EMCA is not to be understood a simple restatement of the prevailing legal solutions found in the majority of the EU company laws. It embraces innovative concepts found only in some jurisdictions or legislative proposals which work well.

An EMCA drafted and continuously developed by the Group will, as mentioned above, be able to respond rapidly to the changing circumstances and market conditions that modern businesses face.

Thus, the EMCA has the potential to prove as an effective catalyst to improve European company law. The success of the US Model Business Corporation Act (MBCA) in improving the single states' Companies Acts supports this expectation.<sup>22</sup>

### 6.2. Working Method

The project was broken down into a number of sub-projects based on the different areas of company law. Thus the project covers all parts of company law issues regarding public as well as private companies (see below Comments to Chapter 1, Section 3).

The EMCA regulates the following issues:

- general company law principles
- the formation of companies
- the duties of directors, the organization of companies (corporate governance issues)
- Shares
- Shareholder meetings and protection (including minority protection)
- The financing of companies
- Share capital structures (capital protection)
- The re-structuring of companies (mergers, divisions, conversions)
- Liquidation, bankruptcy, etc.
- Liability of directors, shareholders and others
- Cross-border issues
- Accounting and auditing
- Employee representation

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<sup>22</sup> See on Model Acts in the United States Th. Baums and P. K. Andersen, *The European Model Company Law Act Project*, Essays in Honour of Eddy Wymeersch, 2009, p. 12-14 (ECGI Working Paper Series in Law, p. 9) with references.

- Groups of companies
- Branches
- Registrar and the registration process

The approach to each sub-project is the same. Each sub-project started with a comparative analysis of the existing company laws of the Member States in the given area. The comparative analysis considered the harmonization that had been carried out at EU level and included studies of how EU company law had been implemented in each Member State, as well as studies of national law on non-harmonized areas. The analysis also included studies of special national, legal and/or business considerations.

Members of the Group prepared national reports for the comparative study. The national reports were analyzed with a view to establishing trends and original solutions and establishing what EU law requires as a minimum standard in each area. The reports served as working material for the drafting of the EMCA. Special working groups were formed for drafting different parts of the Model Act. A Postdoctoral researcher and a number of ad hoc company law experts were also involved in research which supported the project.

The Group met biannually for two days in various places in Europe and drafts were continuously discussed and approved by the Group during these meetings. The progress of the Group was published on the EMCA website:

<http://law.au.dk/en/research/projects/european-model-company-act-emca>

The goals of the EMCA and the progress of the Group were also published in international and national journals.

It has also been an aim of the project to generate research on different parts of the EMCA and some of the more fundamental issues raised such as the impact of model acts, the choice of regulatory methods, law and economics of the suggested model acts etc. For that purpose, the Group presented the EMCA at a number of international seminars and conferences. Furthermore, after the first draft was finished in 2015, the public was invited to comment on the draft chapters (see Section 8 below).

The first draft was presented at an international conference in September 2015 at the *Wirtschaftsuniversität* in Vienna hosted by Professors Martin Winner and Susanne Kalss. The goal of the conference was to receive comments from high-level experts from Europe and the United States in order to improve the draft. Several colleagues from the United States were invited in order to provide comments from the US and MBCA perspectives:

- Ron J. Gilson, Columbia Law School, Stanford Law School, EMCA Associated Company Law Expert
- Jill E. Fisch, University of Pennsylvania Law School
- Mike Klausner, Stanford Law School
- Hillary A. Sale, Washington University Law, Member of the ABA Corporate Law Committee

The nature and results of the discussions was published in the European Company and Financial Law Conference (ECFR) in order to ensure transparency of the adoption process.<sup>23</sup>

After the presentation of the first draft of the EMCA in Vienna in September 2015, the Group revised the published draft in order to take into account all comments and drew up the final Act. After this, the EMCA was officially disclosed at a ceremony in Rome, as a symbolic place of European unity and construction, at the University La Sapienza on the 30st of March 2017. This date was chosen to take place on the same month of the 60<sup>th</sup> anniversary of the Treaty of Rome. The Ministries of Justice of Italy and of Lithuania were represented and delivered speeches.

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<sup>23</sup> See ECFR 2016, pp. 193-374.

The EMCA is available for download on the SSRN (<https://www.ssrn.com/en>) and on ECGI (<http://www.ecgi.org>).

The EMCA Group will continue as an organization on an on-going basis to meet to discuss legal developments, review and offer proposed revisions to various parts of the Model Act, take into account comments received and expand the comment sections. This is similar to the mission of the Corporate Laws Committee of the American Bar Association (ABA) in the US which is to adopt amendments to and provide expert commentary on the MBCA.

Therefore, the EMCA Group calls academics, young researchers, companies, business associations, judges, notaries, experts and the general public to make comments to this edition. Comments can be sent to any member of the EMCA. In each chapter, the main reporter and members of the working group have been indicated so that comments relating to specific chapters should be sent to them. Comments will be taken into account in the next edition.

## 7. The EMCA covers both private and public companies

The Companies Acts of almost all EU Member States divide companies in two categories: public companies (AG/Plc. etc.) and private companies (GmbH/Ltd. etc.), with sometimes sub-categories. The distinction is not based on the size of the company but primarily on the fact whether its shares can be offered to the public/be publicly traded.<sup>24</sup>

The private company is the dominant company form in all Member States. Thus, the Group is aware that the EMCA must be designed in a way that recognizes the need for a flexible regulatory framework covering private companies.

The current EU regulation covers only some of the issues that are regulated in the Companies Acts of the Member States. For example, most of the issues relating to company management structure and directors' duties are not covered by EU Directives and the draft for the 5<sup>th</sup> Company Law Directive on company structure has been abandoned.<sup>25</sup> In addition, like most of the other EU Directives, the proposed 5<sup>th</sup> Directive only dealt with public companies, and in general the regulation of private companies is left to the Member States.

Some Member States have decided to keep the regulation of private companies close to that of public companies, by for instance extending the application of EU directives to them. This applies especially to mandatory rules protecting creditors and shareholders. Other Member States have implemented the Directives to apply to public companies only. Since the EMCA prefers a simple and flexible framework, a number of rules contained in the EMCA apply to both public and private companies.

In particular, as concerns the management structures of small and medium sized companies (SMEs), there is a need for simple and flexible provisions. Such provisions can be freely implemented by the individual Member States, and the EMCA as well is free to choose which regulation is preferred, to the extent that the private company form is chosen.

Even if flexibility is an overall aim for private companies as well as for public companies, it is appropriate to provide for different requirements regarding management systems as for private and for public companies. With respect to the choice of a management system, there should be even more flexibility provided for private companies. However, it seems possible to formulate provisions on directors' duties which are equally applicable to SMEs as well as large companies (see Chapter 9).

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<sup>24</sup> See, for example, the Danish Companies Act, paragraph 6, Swedish Companies Act, Chapter 12, Sections 7-8. The former Danish Act on private companies (*anpartsselskaber*) aimed at regulating companies with only a little capital and few members. The Danish *White Paper 1498/2008 on Modernizing Company Law*, p. 32 states that both the public company form and the private company form are used by small and medium size companies. The committee therefore decided not to use a distinction based on the criterion of size. See also the SPE proposal, Article 3(1)(d).

<sup>25</sup> Proposal for a Fifth Directive on the coordination of safeguards which, for the protection of the interests of members and outsiders, are required by Member States of companies within the meaning of Article 59, second paragraph, with respect to company structure and to the power and responsibilities of company boards, COM(1972) 887 final. The proposal was officially withdrawn in 2001. Also a preliminary draft of a Directive on groups of companies has been abandoned.

With its 2008 proposal for a Regulation on the Statute for a European private company (*Societas Privata Europaea* – SPE)<sup>26</sup>, the EU Commission started an initiative in the field of small and medium sized companies. The SPE proposal aimed to create a new European legal form, which was intended to enhance the competitiveness of SMEs by facilitating their establishment and operation across the single market. If the SPE Statute had been adopted, the SPE would have been an alternative to establishing and carrying on businesses by means of national companies. The proposals in the Statute were not limited by restrictions in the company law Directives. For example, the provisions on capital (minimum capital/distribution) did not need to follow the requirements in the Second Council Directive. The draft SPE Statute would thus have put pressure on national lawmakers to establish company legislation that could match the SPE Statute. A main problem with drafting an SPE Statute was however that it remained necessary to refer to the different national company law legislations. Therefore and also for other reasons such as the issue of the real seat and co-determination, the SPE Statute was not adopted. The fact that Regulations must be adopted by unanimous vote also prevented the adoption of the SPE which underlines the limits of EU harmonisation. The 2014 proposal of directive on the single-member private limited liability company, creating the *Societas Unius Personae* (SUP) tried to achieve a more limited harmonisation.<sup>27</sup> The SUP is targeted only at private companies.<sup>28</sup>

As said, the recommendations of the EMCA provide for a complete text covering both public and private companies. Thus, the EMCA makes another attempt to achieve European convergence in this area.

Even though most small companies in fact choose the private company form, there are also some SMEs that are public companies. There are also large companies organized as private companies. However, the *raison d'être* for having two different company forms is to allow each company to choose a form which works best for the company. Thus, in certain areas more flexible rules are needed for small companies and/or companies with few shareholders (close companies). On the other hand, there are special demands for shareholder protection in close companies compared to public companies (especially listed companies). This is for example the case regarding minority protection (see Chapter 11 on general meeting and minority protection).

Although public companies can offer shares to the public, most large companies have only a few shareholders and are not financed by the market. If such companies prefer a more flexible company form it is possible for them to adopt the private company form as an alternative.

The general view taken in the EMCA is that the provisions covering private companies are tailored to fit the needs of typical private companies as they exist in the different Member States. Even if the distinction between public and private companies generally is not based on size or number of shareholders, this will not exclude the possibility that certain provisions would apply depending on the size of the company or the number of shareholders as a criterion. The Group considered, with respect to each provision, whether the provision should apply to private companies and public companies respectively.

The following method of interpretation of the EMCA should therefore be used: unless otherwise stated, a provision applies to both private and public companies. The EMCA is constructed in a way which draws very clear lines between provisions which apply to private, public and publicly traded companies (see Section 8 below).

## 8. The EMCA uses a one law model

Almost all Member States have two company forms but the legislations vary.<sup>29</sup>

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<sup>26</sup> COM(2008) 396 final, p. 4.

<sup>27</sup> COM(2014) 212 final.

<sup>28</sup> See P.H. Conac, *The Societas Unius Personae (SUP): A "Passport" for Job Creation and Growth*, ECFR 2015, pp. 139-176; J. Lau Hansen, *The SUP Proposal : Registration and Capital*, *idem*, pp. 177-190; V. Knapp, *Directive on Single-Member Private Limited Liability Companies: Distributions*, *idem*, pp. 191-200; C. Teichmann, *Corporate Groups within the Legal Framework of the European Union: The Group-Related Aspects of the SUP Proposal and the EU Freedom of Establishment*, *idem*, p.202-229; S. Harbarth, *From SPE to SMC: The German Political Debate on the Reform of the "Small Company"*, *idem*, pp. 230-237; C. Malberti, *The relationship between the Societas Unius Personae proposal and the acquis: Creeping Toward an Abrogation of EU Company Law?*, *idem*, pp. 238-279.

<sup>29</sup> E. Wymeersch, *Comparative Study of the Company Types in Selected EU States*, ECFR 2009, pp. 71-124.

From a formal perspective, a number of Member States have two-law-systems such as Austria, Germany, Italy and Spain. A large number of Member States such as Denmark, Finland, Ireland, Lithuania, Luxembourg, the Netherlands, Sweden and the UK use a one-law model. Other Member States have adopted a Commercial Code or a general Act on Business Associations, regulating all types of companies, such as is the case in the Czech Republic, France, Hungary, Latvia, Poland and Slovakia. The structure of these Acts takes both the form of a division into special subjects or a division into a general and a special Section.

The Group has considered whether to draft a one-law or a two-law model. Arguments in favor of a one-law model are that the distinction between the two traditional company forms (private and public companies) is becoming less significant and is being replaced by a more apt distinction which differentiates between companies whose shares are traded on regulated or alternative market (listed companies) and companies that are not. A large number of provisions should therefore be directed at all limited liability companies or only at listed companies. Further, experiences in some Member States have shown difficulties with the interpretation of two company laws with similar -but not exactly the same – regulations covering private companies and public companies respectively. Especially, in smaller Member States, it can take time before courts decide on the interpretation of a single provision. Therefore, it is more cost effective that the interpretation applies to both public and private companies.

Arguments regarding interpretation can, however, be used both in favor or against the drafting of a one-law model.

Arguments against a one-law model are that the overwhelming majority of the EU legal systems regulate public and private companies independently (both those influenced by the German and French traditions). Moreover, main EU directives and national company law regulations regulate the two types of companies independently.

The Model Law Group has decided to use a one-law model in the first place, for the sake of simplicity, to increase flexibility as the private company law model would be the default one, and to anticipate current development that private and public companies are becoming closer in terms of substantive regulation in the Member States.

The EMCA therefore contains regulation on three categories of companies:

- the private company
- the public company
- the publicly traded company

Definitions and Comments to these different categories are stated in Chapter 1, Sections 1.02 and 1.03. Regarding public traded companies, there is a borderline between securities regulation and company law. The EMCA does not deal with securities regulation in general, but since public traded companies are public companies, certain parts of the regulation are a natural part of Companies Acts. This is in particular the case concerning directors' duties, general meetings and minority protection.

## **9. The EMCA is largely enabling**

As noted from a US perspective, the EMCA contains some mandatory terms but is largely enabling.<sup>30</sup> If the EMCA is adopted by a Member State or any country, partially or fully, it provides companies operating with a wide range of choice with respect to either adopting the EMCA's terms or customizing provisions to suit their circumstances. Therefore, the EMCA is flexible enough to be adapted to the unique needs of each country.

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<sup>30</sup> M. Klausner, *A US view of the European Model Companies Act*, ECFR 2016, p. 363.

#### 10. The EMCA consists of broad standards.

Key provisions of the EMCA consist of broad standards as opposed to specific rules. The issue of whether to have specific rules or broad standards was discussed intensively in the EMCA Group as both provide advantages and disadvantages. Specific rules provide legal certainty but reduce the flexibility of the Act which was a key goal of the EMCA. Broad standards make protection of minority shareholders and creditors very dependent on the quality of the judiciary in each country, which may vary considerably. Also, ex-post protection is less effective than ex ante protection if the judiciary is not effective. As Professor Paolo Giudici (whose roots are from Sicily) remarked, any rule contained in the EMCA should take into account business practices and court capabilities from Helsinki and Aarhus to Palermo. This was dubbed by the Group as the “Palermo Rule”. Indeed, the issue of the judiciary is key and it has been advocated for Member States who would adopt the EMCA to adopt also a Model Corporate Court.<sup>31</sup> This is unlikely to occur in Europe despite the fact that their track record is excellent, as proved by the Delaware Chancery Court in the US and the Amsterdam Enterprise Court in the Netherlands.

Therefore, in the EMCA itself and in each chapter a balance was struck. Overall, it was decided that flexibility should prevail so that specific rules would only apply if imposed by company law directives or because of the risk of having a too broad standards. However, a Member State, or any country, might adopt more specific regulations in order to fit its unique situation and historical legal background and to compensate for a weak judicial system. Therefore, again, the EMCA is flexible enough to be adapted to the unique needs of each country.

#### 11. IT

The EMCA recommends the use of IT as much as possible. This is in line with the Commission’s Action Plan and Directive (2009/101/EC)<sup>32</sup> on the exercise of certain rights of shareholders in listed companies. The EMCA contains pertinent provisions, for example on formation by online registration, electronic communications between companies and shareholders and electronic general meetings. However, it is also taken into account that the opportunities to use information technology vary between the Member States.

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<sup>31</sup> R. Gilson, *A Model Companies Act and A Model Company Court*, ECFR 2016, pp. 351–362.

<sup>32</sup> Directive 2009/101/EC of the European Parliament and of the Council on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent (codified version). The purpose of this Directive is to undertake a codification of First Council Directive of 9 March 1968 on co-ordination of safeguards which, for the protection 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.



# CHAPTER 1 GENERAL PROVISIONS AND PRINCIPLES

## PART 1 GENERAL PROVISIONS

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## General Comments<sup>33</sup>

### 1. EU law

Chapter 1 includes a differentiation between the different types of companies, regulated by the EMCA and some general principles which are explained in this Chapter.

Most of the EU company law Directives deal with public companies and listed companies. However, as stated in Section 3, the EMCA deals with public and private companies.

Generally, the EMCA deals with limited liability companies as outlined in Article 2(1)(a) of Directive 2005/56/EC (cf. Article 1 in Directive 2009/101/EC).

Chapter 1 contains a number of General Principles which echo certain fundamental principles of company law set out in Directives including Directive 2009/101/EC on coordination of safeguards which, for the protection of the interests of members and third parties (originally the 1<sup>st</sup> Company Law Directive), the Takeovers Bid Directive (2004/25/EC), the Cross-border Merger Directive (2005/56/EC), the Shareholders Rights Directive (2007/36/EC) and Directive 2012/30/EU. An example is the principle of equality.

### 2. National law

Most directives, except Directive 2009/101/EC, only apply to public companies. The national company laws of the Member States take different positions to the question whether the rules provided for by the company law Directives should apply to private companies as well. In Belgium, Denmark, Finland and Sweden, the company law Directives for the most part also apply to private companies, whereas the UK, Netherlands (since the 2012 Flex BV) and Luxembourg for example, which are economically liberal countries, have taken the opposite position and hence do not apply the company law Directives to private companies. In most of the other countries, the regulation of private companies is only to some extent inspired by the EU Directives applying to public companies.

### 3. Considerations

The EMCA contains rules for both private and public companies, including listed companies. The EMCA is organized such that the sections, if not otherwise indicated, deal with both private and public companies. It is made clear in the specific sections and the appertaining comments whether there are special rules concerning private companies and listed companies. The Group does not have a clear-cut stance on whether the Directives concerning public companies should also concern private companies. This matter is dealt with in the specific parts of the EMCA. Generally, the Group aims to draw up a flexible and not too onerous Model Law. Hence, it is continuously considered whether the rules concerning public companies could be more flexible, for example by exploiting the Directives' possibilities of derogation. Within a number of legal areas, the difference between the regulation concerning public and private companies will be smaller, which partly explains the structure of the Model Law.

The Group has found it suitable to commence the EMCA by establishing a number of general principles, which partly define the overriding purpose of the regulation in the EMCA, and partly serve as a means for interpretation of the specific rules of the EMCA.

In this respect, the EMCA Group has been especially inspired by the Finnish Companies Act.

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<sup>33</sup> The working group on Chapter 1 was chaired by Professor Paul Kruger Andersen (University of Aarhus, Denmark).



PART 1  
GENERAL PROVISIONS

*Section 1.01*  
**Short Title and Scope**

- (1) This Model Act shall be known and cited as the European Model Companies Act (“EMCA”).
- (2) The EMCA applies to companies as indicated in this Act.

*Comments*

Re 1) The short title provided by Section 1 creates a convenient name for a European Model Law applying to companies. See the Introduction for a general description of the development of this Act, the purposes it is intended to serve and the principles under which it was prepared.

Re 2) See comments to Section 3 in regard to the type of companies covered by the EMCA.

*Section 1.02*  
**Definitions**

- (1) “*Company*”: A limited liability company formed and registered under the EMCA.
- (2) “*Offer to the public*”: A communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities. This definition shall also be applicable to the placing of securities through financial intermediaries.
- (3) “*Management board*”: In countries with a one-tier board system, the board of directors; in countries with a two-tier board system, the management board being responsible for the management of the company.
- (4) “*Supervisory board*”: the body being responsible for the supervision of the management body in countries with a two-tier board system.
- (5) “*Director*”: A member of the management body or of the supervisory body of a company.
- (6) “*Board*”: The single board of directors in the one-tier system and the supervisory and management board in the two-tier system if not stated explicitly otherwise.
- (7) “*Subscription price*”: The price to be paid to the company for each share issued by the company.
- (8) “*Securities*”: Transferable financial instrument as defined by Article 4(15) of Directive 2014/65/EU.
- (9) “*Traded Company*”: A publicly traded company whose securities are listed or on traded on a regulated market or a multilateral trading facility, as defined respectively by Article 4(21) and (22) of Directive 2014/65/EU, in one or more Member States.
- (10) “*Registrar*”: The natural or legal person responsible for receiving the documentation set out in Chapter 3 of the EMCA and issuing the certificate of incorporation.

*Comments*

Re 1) Section 1 determines which company forms are covered by the EMCA.

A limited liability company is a company in which the liability of members is limited by its instrument of incorporation. The definition of *limited liability company* should be understood in accordance with the definition in Article 2(1)(a) of Directive 2005/56/EC on cross-border mergers of limited liability companies, i.e. a company as referred to in Article 1 of Directive 2009/101/EC, see Section 3 of Chapter 1.

The EMCA deals with public and private limited liability companies. Private companies are typically small or medium companies that require limited liability and legal personality but do not require access to public funding through the general capital markets although they can sometimes sell bonds by private placement. Usually, financing comes from contributions by the members themselves or alternatively by bank finance. Therefore, the disclosure requirements for these companies are less onerous and the regulation is generally more flexible, see Introduction point 3.1 of the EMCA.

Public companies exist in all EU Member States. This company form is designed for larger enterprises, which generally have access to the capital markets in order to raise finance, both in terms of equity capital from shareholders and loan capital from bondholders. These companies are genuinely capital companies in that they usually have a large and diverse number of shareholders. Such companies often give rise to agency problems as a result of the perceived separation of ownership and control.

However, large companies are not restricted to the public company form and small companies are not restricted to the private company form. Thus, the legal distinction between public and private companies stated in the EMCA is not based on the company's size, but rather on whether shares can be offered to the public and be publicly traded.

The distinction is consistent with the proposal for the European Private Company (SPE) Statute Article 3(d) and the Companies Acts of a number of Member States, among them Belgium, Czech Republic, Denmark, Finland, Germany, Ireland, Lithuania, Poland, and Sweden.

Re 2) The definition of the term "offer to the public" is derived from the Prospectus Directive 2003/71/EC, Article 1(d).

Re 3 and 4) The comments to EMCA Chapter 8 on management refer in detail to the definitions of the terms "director", "managing body" and "supervisory body".

Re 5) As discussed in greater detail in Chapter 8, Member States operate on the basis of a one-tier system, a two-tier board system or a variant. This organisation applies for public and sometimes also for private companies. In Ireland and the UK, each company has only one board of directors which may comprise both executive and non-executive directors. In these Member States, the term "director" refers to members belonging to this board. In other Member States, like Germany, there is both a management board charged with carrying out executive functions and a supervisory board charged with supervising the former. In such jurisdictions, the managing director may not be a member of either board. In a growing number of Member States, among them Lithuania, Denmark, Finland, France, Italy, Luxembourg, the Netherlands and Portugal, companies can choose between different board models. When using the term director, the EMCA refers to the members of the management body as well as a supervisory body of a company. Thus, the term director is used in sections where the duties of directors rest with the management body as well as the supervisory body, for example in cases of conflict of interest.

Re 9) Traded companies can be further classified depending on where they are publicly traded. With respect to publicly traded companies there are two main categories regulated in the EU:

- a listed company is a publicly traded company whose securities are listed on or are traded on a regulated market as defined by Article 4(14) of Directive 2004/39/EC
- a listed company is a publicly traded company, whose securities are listed on or traded on a multilateral trading facility according to the definitions in Article 4(15) of Directive 2004/39/EC

Only a small percentage of public companies registered in EU Member States trade their securities on a regulated market and fall into the first category above. Companies traded on a regulated market are generally subject to the full application of EU Directives whereas companies trading on alternative markets are subject to the relevant (usually less onerous) regulations of the relevant exchange.

The various sections of the EMCA indicate whether they apply to *public companies trading on a regulated market* and also to *public companies traded on a multilateral trading facility (MTF)*.

Section 1.03  
**Private and Public Companies**

- (1) A company may be public or private.
- (2) The shares of a private company may not be offered to the public.
- (3) Unless otherwise prescribed, this Act shall apply to private as well as public companies.

*Comments*

The EMCA deals with public and private companies limited by shares, as these types of companies are the ones most commonly used within the EU. Other types of limited liability business structures such as limited partnerships, co-operative limited companies and European companies are not addressed by the EMCA.

The drafters of the EMCA had in mind the following types of companies (as enumerated in Directive 2009/101/EC) as a guide for legislators:

- in Austria:

*die Gesellschaft mit beschränkter Haftung; die Aktiengesellschaft;*

- in Belgium:

*naamloze vennootschap/société anonyme, commanditaire vennootschap op aandelen/société en commandite par actions, personenvennootschap met beperkte aansprakelijkheid/société de personnes à responsabilité limitée;*

- in Bulgaria:

*акционерно дружество, дружество с ограничена отговорност, командитно дружество с акции;*

- in Croatia:

*dioničko društvo, društvo s ograničenom odgovornošću*

- in Cyprus:

*δημόσιες εταιρείες περιορισμένης ευθύνης με μετοχές ή με εγγύηση, ιδιωτικές εταιρείες περιορισμένης ευθύνης με μετοχές ή με εγγύηση;*

- in the Czech Republic:

*společnost s ručením omezeným, akciová společnost;*

- in Denmark:

*aktieselskab, kommanditaktieselskab, anpartsselskab;*

- in Estonia:

*Osäihing, aktsiaselts;*

- in France:

*la société anonyme, la société en commandite par actions, la société à responsabilité limitée, la société par actions simplifiée;*

- in Finland:

*yksityinen osakeyhtiö/privata aktiebolag, julkinen osakeyhtiö/publikta aktiebolag;*

- in Germany:

*die Aktiengesellschaft, die Kommanditgesellschaft auf Aktien, die Gesellschaft mit beschränkter Haftung;*

- in Greece:

*ανώνυμη εταιρία, εταιρία περιορισμένης ευθύνης, ετερόρρυθμη κατά μετοχές εταιρία;*

- in Hungary:

*Korlátolt felelősségű társaság, nyilvánosan működő részvénytársaság;*

- in Ireland:

*companies incorporated with limited liability;*

- in Italy:

*società per azioni, società in accomandita per azioni, società a responsabilità limitata;*

- in Latvia:

*akciju sabiedrība, sabiedrība ar ierobežotu atbildību, komanditsabiedrība;*

- in Lithuania:

*akcinė bendrovė, uždaroji akcinė bendrovė;*

- in Luxembourg:

*la société anonyme, la société en commandite par actions, la société à responsabilité limitée, la société par actions simplifiée;*

- in Malta:

*kumpannija pubblika/public limited liability company, kumpannija privata/private limited liability company;*

- in the Netherlands:

*de naamloze vennootschap, de besloten vennootschap met beperkte aansprakelijkheid;*

- in Poland:

*spółka z ograniczoną odpowiedzialnością, spółka komandytowo-akcyjna, spółka akcyjna;*

- in Portugal:

*sociedade anónima, sociedade em comandita por acções, sociedade por quotas;*

- in Romania:

*societate pe acțiuni, societate cu răspundere limitată, societate în comandită pe acțiuni;*

- in Slovakia:

*akciová spoločnosť, spoločnosť s ručením obmedzeným;*

- in Slovenia:

*delniška družba, družba z omejeno odgovornostjo, komaditna delniška družba;*

- in Spain:

*la sociedad de responsabilidad limitada, la sociedad anónima;*

- in Sweden:

*privata aktiebolag, publika aktiebolag;*

- in the United Kingdom:

*companies incorporated with limited liability.*

The EMCA regulates both public and private companies within one Act but within its Chapters it distinguishes, where appropriate, between provisions dealing only with public companies or only with private companies. In the latter case, where justifiable, the EMCA relaxes the regulatory requirements and looks to formulate rules that take special consideration of the typical ownership structure of private companies.

The philosophy behind the implementation of the GmbH in Germany in 1892 was that the risk of misuse might be reduced if a company could not ask the public for financial support. As a consequence, a private company will usually have fewer shareholders than a public company. A decisive factor in private companies is the owners' personal relations among each other and the relations to the management rather than the number of owners. The same philosophy lies behind the Directive 2012/30/EU on capital – which is also reflected in most of the Member States classification of companies with respect to public and private companies. Section 3 carries on this tradition taking into account the special need of owners of a private company.

#### *Section 1.04*

### **Legal Personality and Limited Liability of Shareholders**

- (1) A company shall acquire legal personality upon registration.
- (2) Save as otherwise provided in the EMCA or in the articles of association, a shareholder shall not be liable for more than the amount of share capital for which the shareholder has subscribed or agreed to subscribe.

#### *Comments*

Legal personality means that a company is a legal entity distinct from its shareholders. A number of the EU Directives and Regulations refer to companies with legal personality and the acquisition of legal personality. For example, Article 8 of Directive 2009/101/EC provides for actions undertaken “before a company being formed has acquired legal personality”. Article 1(3) of Council Regulation (No 2157/2001) on the Statute for a European Company (“SE”) provides that an SE shall have “legal personality”. However, EU regulation does not provide for a definition or a definitive rule concerning the meaning of the term. Council Regulation (No 2137/85) on the European Economic Interest Grouping (EEIG) states in Article 1(2) that a formed group shall from the date of its registration have the capacity, in its own name, to have rights and obligations of all kinds, to make contracts or accomplish other legal acts, and to sue and be sued.

While EU legislation and the domestic legislation of a number of Member States such as Finland, Portugal and Sweden expressly provide that a company has legal personality, other Member States like Denmark, Ireland and the UK do not use the term “legal personality” in their Companies Acts.

In most Member States, the company is incorporated as a separate legal person upon registration. This is also the case in the SE Regulation (cf. Article 16(2)) and stated in the previous EPC proposal (cf. Article 9). In Luxembourg, the parties to the contract may decide to delay the acquisition of corporate personality and incorporation occurs upon the entering into of a contract for the formation of the company by notarial deed. Likewise, in the Netherlands, legal personality commences upon the execution of a notarial deed, which is to be registered later.

In some Member States such as Austria, Germany, Poland, Slovakia, Spain and Sweden companies (i.e. companies not yet registered, termed “Vorgesellschaft” in Germany) can enter into contracts, acquire/transfer property, sue and be sued upon signing the articles of association or upon granting the notarial deed (see further EMCA Chapter 2.). Hence, before registration, these companies enjoy legal status similar to a registered company. Registration remains relevant however for the purpose of determining the liability of the promoters and managers.

In the view of the EMCA Group, the deciding factor is not whether the law applies the term “*legal person*” but when certain provisions are applicable, such as in the case of signing the instrument of incorporation and registration.

In the EMCA, registration means that the company not only has full legal personality but also that shareholders and managers have no personal liability for the obligations of the company arising after registration. The concept of a company as a legally distinct entity in the EMCA means that the company has capacity to enter contracts, own property and sue or be sued (see Section 4). The company possesses these powers and duties in its own name.

Under the EMCA, the company does not exist as such before registration. However, the subscribers and shareholders become bound when they sign the instrument of incorporation, see Chapter 2, Section 3. In that sense, it can be said that the company is formed upon signing the instrument of incorporation (cf. the Swedish Companies Act 2005, hereafter Swedish Companies Act ,2:4). Thus, the fact that a company first receives legal personality on the day of registration does not mean that it may not start its activities before then. The instrument of incorporation must state the date when the formation of the company becomes effective, see Chapter 2, Sections 4 and 5.

The managers may carry out activities on behalf of the company in anticipation of registration. These activities are regulated by Chapter 3 (see Section 2) of the EMCA which sets out the legal consequences of measures taken on behalf of a company before registration. This provides an incentive to the persons who agree to form a company to complete the registration process.

The instrument of incorporation must identify the date at which the formation becomes legally effective. Legally effective means that the income from this date is the company's income and similarly the expenses are then the company's expenses. The company can choose a date before the date of the instrument of incorporation where the company's formation becomes legally effective. This is especially relevant when the company takes over an existing business. According to Chapter 2 sections 3 (2)(k) and 5, the company must state the date when the formation becomes legally effective. In the case where a company takes over an existing business, the company also needs to choose a date for which the formation starts regarding accounting. National accounting laws decide the companies' first accounting period and thereby the day of takeover. When choosing the date where the formation becomes legally effective, the company must respect the accounting rules. Similarly, national tax rules may limit the extent to which the company can be formed with retroactive effect. According to the EMCA it is also possible to choose a date ahead in time, see comments to EMCA Chapter 2, Section 3 (2)(k).

Off-the-shelf companies are permitted or at least not prohibited in all Member States. However certain Member States regulate their operation. For example, in Germany, the Federal High Court of Justice has required that rules on the formation of companies be applied *per analogiam* at the time the off-shelf company becomes active. Member States such as Luxembourg and Greece provide for the application of the judicial dissolution of dormant companies to off-the-shelf companies

Off-the-shelf companies can be used to avoid long registration procedures and the personal liability arising from activities before registration takes place (see above). The EMCA has no provisions on off-the-shelf-companies but assumes that they are legal according to national law. It should also be noted that if only a short period of time is required to register a company, for example because online registration is available, this obviates the need for such companies see Chapter 3, Section 34.

PART 2  
GENERAL PRINCIPLES

*Section 1.05*

**Capital and the Maintenance of Capital**

- (1) The company must have a share capital. The share capital shall be denominated in the company's accounting currency (which may be any currency).
- (2) The assets of the company may be distributed to the shareholders only as provided in this Act.

*Comments*

Re 1) In the UK, larger companies often have classes of shares in different currencies, usually dollars and euros in addition to sterling. However, in most Member States there may only be one currency and the Group prefers this. Some Member States, such as the Netherlands for the Flex BV, allow the use of the national of a single foreign currency. The EMCA also allows this possibility in order to increase flexibility.

Re 2) The fundamental principle of distribution of the company's capital is expressed in Section 5(2). Detailed provisions can be found in EMCA Chapter 7 on capital of companies. A distribution can take place in the form of: a dividend (EMCA Chapter 7), a reduction of share capital (EMCA Chapter 7), an acquisition of own shares (EMCA Chapter 7) and on a dissolution of the company (EMCA Chapter 14).

In many Member States, a concealed distribution is seen as an illegal circumvention of the rules on distribution, see further Chapter 7 on capital.

*Section 1.06*

**Purpose of the Company**

- (1) Unless otherwise provided in the articles of association, the purpose of the company is to increase its value.
- (2) A company may only be formed to pursue a lawful object.

*Comments*

Re 1) Normally, the purpose of the company is to maximize the value of the company. It is important to ensure that both investment in and management of companies is carried out with a long-term and sustainable view, which is essentially a question of perspective, whereas the actual duration of any investment or management effort is less relevant as it is possible to act with beneficial long-term consequences within a short-time frame just as it is possible to harm the long term prospects of a company by continued mismanagement or by remaining passive over an extended period.

It is also important to differentiate between the stakeholders. A long-term perspective from management and board members is particularly important for the viability of companies. This is consistent with the view of the EU Commission that the primary responsibility of a company is to promote long-term viability.<sup>34</sup> It is also the accepted position of all Member States. That is also why it is important for example that directors' remuneration schemes encourage this. On the other hand, it seems more difficult and less sensible to try to promote a long-term perspective from shareholders by simply focusing on the duration of their investment. The very act of selling their shares in a company encourages liquidity and may also be a very potent warning to incumbent management that it is failing and may ultimately help takeovers that promote a more efficient use of the resources. To reward shareholders simply because they endure may be a disservice to the company. Lock-in effects should therefore be avoided.

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<sup>34</sup> See 2011 Green Paper on 'The EU corporate governance framework' (COM(2011) 164 final) and the Report of the Reflection Group on the Future of EU Company Law (the report is available at [http://ec.europa.eu/internal\\_market/company/docs/modern/reflectiongroup\\_report\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf)). See further the "Action Plan: European Company Law and Corporate Governance – A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies" (COM(2012) 740/2).

A path to promote long-term viability could involve encouraging corporate social responsibility (CSR), transparency and active ownership, and developing tools to support a constructive dialogue between shareholders and companies. For that purpose, there is a need to reduce costs and remove legal obstacles and regulatory barriers that preclude shareholders from actively engaging in companies. However, it should be recognized that even prudent long-term planning cannot guarantee future success. Consequently, it seems that the law should foremost focus on providing companies the necessary flexibility to ensure their long-term viability under rapidly changing business conditions while taking into account the interest of stakeholders. It should not attempt to block the necessary failure of inefficient companies.

The exception in Section 6(1) provides for companies established for non-profit making or altruistic purposes. The Group considers that Section 6(1) is not inconsistent with the view that companies at the same time can contribute to social and environmental objectives, through integrating corporate social responsibility as a strategic investment as an integral component of their core business strategy, their management instruments and their operations. This is in line with the UN-Principles (UN Global Compact and UN PRI).<sup>35</sup> In Denmark, for example, the 2013 Companies Act covers companies that solely have altruistic purposes, and the requirement that companies should pursue economic profit has been removed.

There is an obvious connection between the purpose of the company and the powers and duties of the directors. Directors must exercise the powers granted to them for a proper purpose. They owe a duty of good faith to the company to act in the company's best interest. While these matters are dealt with in Chapter 9 of the EMCA on directors' duties, it is worth noting that wider factors are likely to be considered relevant to an assessment of proper conduct in this regard. For example, Section 172 of the UK Companies Act 2006 introduces wider corporate social responsibility into a director's decision-making process. See further Chapter 9 of the EMCA on directors' duties and Chapter 11 of the EMCA on general meetings.

In addition, accounting rules in Member States like Belgium, the Czech Republic, Denmark, France, Ireland and the UK demand that the annual accounts of traded companies include narrative reports which, while giving an account of the company's business and performance, also address broader environmental, social and community issues affecting the company. In other countries, like Austria and Germany, this obligation is confined to companies of a certain size.

Re 2) The purpose of a company is distinct from the objects which set out the parameters of permitted corporate activity. The latter is set out in the articles of association in accordance with Chapter 2, Section 4(e). A company may restrict the objects of the company in the articles of association but that is not a requirement. The objects of a company and economic profit will be discussed further in the comments to Chapter 2, Section 3(2) and Section 4 below.

#### *Section 1.07*

### **Transferability of Shares**

A share may be transferred and acquired without restrictions, unless otherwise provided in the articles of association.

#### *Comments*

Article 3(d) of the 2<sup>nd</sup> Company Law Directive 2012/30/EU provides that information on "the special conditions if any limiting the transfer of shares" must appear in the statutes, the instrument of incorporation or a separate document published in accordance with the procedure laid down in the laws of each Member State. This gives flexibility regarding the free transferability of shares. This is also reflected in Section 7. Any limitation on transferability will have to be expressly provided for in the articles, the memorandum or a separate document open to public inspection and is subject to the requirement of Chapter 5 on shares. A subscriber for shares of limited transferability should thus have full knowledge of this fact at the time the company is formed.

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<sup>35</sup> On United Nations Global Compact see <http://www.unglobalcompact.org>.

In a number of Member States the Companies Acts may provide for the option that transfers of shares in private companies require board approval or even shareholder approval. Transfers of shares are substantially less restricted in public companies. This reflects the fact that in practice, restrictions are more needed in close companies. As a common principle, the EMCA provides for a principle of transferability.

According to securities regulation, shares which are traded on the regulated market must be freely transferable (see Article 45 of Directive 2001/34/EC on the admission of securities to listing and on information to be published on those securities).

Chapter 5 deals with different kinds of restrictions on the transfer of shares.

Chapter 11 deals with the possibility of introducing restrictions on transfer after the formation of a company.

### *Section 1.08* **Equality of Shares**

All shares shall carry equal rights in the company, unless otherwise provided in the articles of association.

#### *Comments*

Section 8 concerns private as well as public companies.

Section 8 concerns the question of issuing various classes of shares. There has been a widespread discussion in recent years about proportionality between risk and control. In 1990, the Commission came forward with a proposal to the 5<sup>th</sup> Company Law Directive<sup>36</sup> that aimed to remove a number of voting restrictions. This proposal was included as an amendment to the proposed 5<sup>th</sup> Company Law Directive dealing with the structure of the public company. The debate has primarily focused on the “one-share, one-vote” (OS/OV) system. The proposed Directive was withdrawn and Member States have the freedom to allow different classes of shares. Since then the Commission has given up on the attempt to achieve a “one share, one vote” system, but the debate has continued. The High Level Group of Company Law Experts on issues related to Takeover Bids (2002) proposed that proportionality between ultimate economic risk and control meant that share capital which has an unlimited right to participate in the profits of the company or in the residue on liquidation, and only such share capital, should normally carry control rights, in proportion to the risk carried.<sup>37</sup> Thus recommendations were made to deal with pre-bid defenses which led directly to Article 11 of the Takeovers Directive (2004/25/EC). Article 11 introduces the break-through rule which was designed to increase the number of takeovers in the EU by eliminating governance arrangements which might otherwise impede takeovers. This provision recognizes that disparate voting rights are a feature of European company law and gives Member States the option of making provision for them in the context of a takeover of a company.

There are substantial differences in the various Member States regarding the right to have share classes and voting limitations. Germany and Poland, for example, have chosen the system of “one-share, one vote” as a principle which however also admits non-voting preference shares.

The Group is of the opinion that systems which allow share classes and voting limitations are not less efficient than systems which do not allow such differentiation. In a number of cases the market can – and will – force companies to have only one class of shares. In general shares are financial instruments among others. Thus, investors must decide which kind of instrument they want to buy.

According to the EMCA, shareholders are allowed to opt into a system of share classes and voting limitations once this is provided for in the articles of association. In such cases, the articles of association must describe the rights of different classes of shares, see Chapter 2, Section 4(2)(j).

See further on shares, voting rights and economic rights in the EMCA Chapter 5.

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<sup>36</sup> The original proposal dates from 1972, OJ 1972, C7. Amendments: OJ 1983, C 240 and OJ 1991, C7.

<sup>37</sup> Final Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe (04.11.2002), p. 39.

*Section 1.09*

**Equal Treatment of Shareholders and Minority Protection**

All shareholders who are in the same position must be afforded equal treatment by the company.

*Comments*

In order to protect minority shareholders, particularly where decisions are made by a simple majority (see Chapter 11), it is essential that safeguards are introduced. Article 46 of the 2<sup>nd</sup> Company Law Directive provides that for the purposes of the implementation of that Directive, the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position. Article 33 of the same Directive provides an example of this principle in operation in its requirement that pre-emption rights apply whenever share capital is increased for cash consideration. The pre-emption right is found in the EMCA Chapter 6 on financing.

The equal treatment principle is also set out in the Shareholders Rights Directive (2007/36/EEC) Article 4 of which provides that companies that have their registered office in a Member State and whose shares are admitted for trading on a regulated market situated or operating within a Member State, must ensure “equal treatment for all shareholders who are in the same position with regard to participation and the exercise of voting rights in the general meeting”. In the EMCA, the term “equal” has the same meaning as the term “equality”.

In the shortest form the principle of minority protection is expressed, for example, in a general clause as formulated similarly in the Danish, Finish and Swedish Companies Acts: The general meeting, the board of directors and the managing body shall not make decisions or take other measures that are conducive to conferring an undue benefit to a shareholder or another person at the expense of the company or another shareholder. The German Stock Corporation Act (§ 53a), the Greek Law on companies limited by shares (Article 30), and the Polish Commercial Companies Code (Article 20) state explicitly that shareholders in the same position have to be treated equally.

EMCA Chapter 11 on general meeting provides for a general clause. A basic principle of equal rights can also be found in Chapter 5 (on shares).

The equal treatment principle is not absolute. For example, Article 33 of Directive 2012/30/EU itself sets out the circumstances in which pre-emption rights may be avoided. As will be clear from subsequent chapters, the EMCA also provides for circumstances in which deviations from the principle will be permitted. (see for example Chapter 6 on the pre-emption right.)

*Section 1.10*

**The Majority Principle**

The right of the shareholders to take decisions regarding the affairs of the company is exercised at the general meeting. Unless otherwise decided in law or in the articles of association, decisions shall be taken by simple majority of the votes cast.

*Comments*

It is necessary to allow a determined majority to manage the company’s business operations. But in order to prevent the majority from being able to oppress the minority, the EMCA also contains general and specific mandatory rules which limit the majority’s freedom of action. For example, it allows companies to have supplementary rules in the articles of association demanding super majority voting etc. It also establishes the principle of equal treatment in Section 9 above. Similarly, the majority principle and other provisions on minority protection are contained in Chapter 11 on general meetings.

The term “general meeting” in this Section does not require that decisions should always be taken at a physical meeting. On the contrary, Chapter 11 on general meetings allows the company to have electronic meetings, to make determinations on the basis of written resolutions etc. These decisions will be regarded as decisions made by a “general meeting”. Therefore, “general meeting” also designate collective decisions by the shareholders.

*Section 1.11*

**Directors' Duty of Loyalty and Care**

A director of a company has a duty of care and a duty of loyalty.

*Comments*

The duties of directors include mainly two general principles. Firstly, the directors must exercise care in avoiding harm to the company. And secondly, the directors have a duty of loyalty in placing the company's interests ahead of their own.

The two principles are broadly recognized in European company law, but most of the Member States' Companies Acts have no provision directly expressing the two principles. An exception is the UK Companies Act part 10, Chapter 2, which has a statutory statement of directors' duties. A statutory statement is also included in Ireland in the Companies Act 2014.

The precise contents of the principles of duty of care and duty of loyalty are explained in Chapter 9 on directors' duties.

*Section 1.12*

**Shareholder Democracy**

- (1) The general meeting is the highest authority of the company.
- (2) Shareholders may include provisions in the articles of association establishing the manner in which the company will operate. Provisions contrary to a mandatory provision of this Act or some other Act, or contrary to the rules of appropriate conduct, are void.

*Comments*

Re 1) As noted in Section 10, shareholders take decisions at the general meetings. The board of directors runs the company. The division of tasks between the general meetings and board of directors is found in Chapter 8 (Management of the Company) and Chapter 11 (General Meeting). The systems of division in various Member States are different. In some Member States, the general meeting may take any decision regarding company matters. This is in principle the situation in the Nordic countries. In other Member States such as Germany, however, there is a strong division between the power of directors and the general meeting. It is important, however, to understand that the ultimate power in companies belongs to shareholders at the general meeting. The provisions in the EMCA should support and promote shareholders' opportunities to monitor the management and to take decisions regarding the company. This approach is in line with modern corporate governance thinking.<sup>38</sup> Thus, the principle of shareholder democracy should be understood as an overall goal or direction when considering the individual provisions of the EMCA. To a large extent it follows the intention expressed by the EU Commission that there is a case for aiming to establish a real shareholder democracy in the EU. It should not be seen as a specific rule, for instance to follow the principle of "one share – one vote" – which has been abandoned by the Commission. Further, the principle is not a principle that all decisions should be taken by the general meeting. The EMCA aims at ensuring that the most fundamental and important decisions should be agreed on by the general meeting and that the shareholders have effective means to exercise their rights at the general meeting and to be active shareholders.

Re 2) The provision in Section 12(2) is inspired by the Finnish Companies Act (624/2006) Chapter 1 Section 9.

The principle indicates that Section 12 determines that shareholders have the freedom to design the company according to their preferences. Restrictions on this freedom arise due to mandatory requirements of shareholder protection, creditor protection and possibly other legislation in the fields of employment, safety etc. The principle can also be seen as a supplement to the majority rule described in Section 10. Section 12 determines that shareholders have the final say within the company.

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<sup>38</sup> See Green Paper on The EU corporate governance framework (COM(2011) 164 final).

The principle set out in Section 12 does not indicate that shareholder value in the narrowest sense is a mandatory aim for companies (see also comments to Section 6). What Section 12 does imply is that it is an overall principle and aim of the EMCA is that the EMCA should be designed and interpreted in a way as to allow and encourage shareholders to exercise their rights as shareholders.

The Commission has set about enhancing shareholders' rights particularly in listed companies. Thus, the Shareholders Rights Directive (2007/36/EC) and the Commission's Green Paper<sup>39</sup> and the 2012 Action Plan establish requirements in relation to the exercise of certain shareholder rights attaching to voting shares in general meetings of companies whose shares are admitted to trading on a regulated market situated or operating within a Member State. The reason behind the Directive is to reduce the problems for shareholders in companies with large numbers of shareholders and with (typically) a separation between shareholders and the management. In typical private companies it is even more obvious that it is appropriate for the shareholders to decide on company matters.

### *Section 1.13*

## **Freedom of Movement within Europe**

Unless otherwise prohibited in law, private and public companies are allowed to establish in or move their activities or seat, real or statutory, to other Member States of the EU without interruption of legal personality.

### *Comments*

Articles 49 and 54 of the Treaty on the Functioning of the European Union (TFEU) contain the principle of free establishment for persons and companies. Thus, private and public companies can establish branches and subsidiaries in other Member States.

Furthermore, EU case law (C-411/03, *Sevic*) states that restrictions on mergers between companies in different Member States are contrary to Article 49 TFEU.

The Cross-border Merger Directive (2005/56/EC) allows cross-border mergers. The Directive is implemented in most Member States and the implementation in a number of Member States also includes cross-border divisions.

The transfer of the main seat was included in the proposal of the 14<sup>th</sup> Company Law Directive. However, the adoption of this Directive is postponed. On 2 February 2012 the European Parliament adopted a resolution making recommendations to the Commission on a 14<sup>th</sup> Company Law Directive on the cross-border transfer of company seats.<sup>40</sup>

An alternative to cross-border mergers, the transfer of the main seat etc. would be the formation of a European Company (SE) and a European Private Company (SPE). The SE has only been of limited interest in most of the Member States. In addition, the project on the SPE has not yet been realized.

Access to cross-border business activity, including cross-border corporate mobility, is at the core of the fundamental freedoms provided to companies by the Treaty. It is also a fact that it is important for the integration of the European markets and the competitiveness of European businesses to have such access in an efficient way.<sup>41</sup> This cross-border framework cannot be completed sufficiently by contract, soft law or national legislation alone. A common EU-framework is needed to facilitate cross border activity and mobility, and to reduce costs and increase legal certainty when conducting business across borders.

A cross-border context normally calls for a common cross-border solution and this solution can be different from what applies to purely national settings. In a cross-border context the most important thing is to ensure that an appropriate degree of protection is found taking into account the cross-border element and taking into account already acquired rights.

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<sup>39</sup> See Green Paper on The EU corporate governance framework (COM(2011) 164 final).

<sup>40</sup> For a text of the European Parliament resolution see: <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2012-0019&language=EN&ring=A7-2012-0008>.

<sup>41</sup> Report of the Reflection Group on the Future of EU Company Law of 2012 (the report is available at [http://ec.europa.eu/internal\\_market/company/docs/modern/reflectiongroup\\_report\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf)).

Company law is rarely the decisive factor for a company in its considerations in relation to cross-border corporate mobility. The stakeholder responses to the Commission consultation on the results of the study on the operation and the impacts of the statute for an SE-Company showed that it is normally a combination of different factors that dictates where a company chooses to locate and relocate.<sup>42</sup> It should be acknowledged that corporate mobility is already possible, but the tools at hand are not as cost-efficient as they could be.

Thus, from a user perspective the most important contribution that company law can provide is a clear and cost-efficient framework to facilitate companies' cross-border mobility and restructuring needs. An appropriate degree of protection of relevant stakeholders needs to be included in the framework, balancing the interests of businesses with the interests of stakeholders.

The Group considers that there is a need – in support of the Treaty's principle on freedom of establishment – to formulate a principle on free movement of companies within the EU in relation to company law.

In addition, this principle should be given substance, for example, by means of rules on international mergers and divisions and by means of rules on transfer of seat (see Chapter 13).

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<sup>42</sup> The most important factors seem to include: efficient tax rules, flexible employment law, legal certainty, transparency and simplicity in company law as well as low registration costs and efficient and reliable regulatory authorities. The importance of an economic approach to location decisions was also stressed and some went as far as suggesting that company law has little relevance, as compared to the market itself. These views generally correspond to the majority of the views expressed at the Conference on the future of EU company law "European Company Law: The way forward" 16-17 May 2011, Brussels. Cf. also public consultations held by the European Commission, available at: [http://ec.europa.eu/internal\\_market/company/seat-transfer/2004-consult\\_en.htm#market](http://ec.europa.eu/internal_market/company/seat-transfer/2004-consult_en.htm#market).



## CHAPTER 2 FORMATION OF COMPANIES

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## General Comments

### 1. EU law

Directive 2009/101/EC (recasting the 1<sup>st</sup> Company Law Directive of 1968) includes provisions for the protection of the interests of members and third parties such as the disclosure of a company's registered office and its objects. Directive 2009/101/EC applies to private as well as public companies.

Directive 2012/30/EU (recasting the Directive 77/91/EEC or 2<sup>nd</sup> Company Law Directive) as amended by Directive 2006/68/EC coordinates national provisions concerning the formation of public companies, such as minimum capital requirements, distributions to shareholders, and increases and reductions in capital.

The requirements include the following:

- the articles of association must include certain information as stated in Articles 2 and 3 of Directive 2012/30/EU;
- the minimum subscribed share capital must not be less than €25,000, and
- shares may not be issued at a price lower than their nominal value, and where there is no nominal value, their accountable par as stated in Articles 8 of Directive 2012/30/EU.

The provisions of Directive 2012/30/EU apply exclusively to public companies and as there are no equivalent EU provisions applying to private companies, the EMCA Group is free to decide whether to adopt the provisions stated in Directive 2012/30/EU to private companies. It considered this question on a section by section basis. Where such rules are imposed on private companies in the EMCA, modifications may have been introduced in order to avoid unnecessary burdens being imposed on private companies.

### 2. National law

Member States have taken different views regarding the implementation of secondary EU legislation. As to public companies, all Member States were obliged to implement the mandatory provisions of Directive 2012/30/EU. However, there are differences regarding the implementation of the non-mandatory provisions of the Directive. Directive 2012/30/EU, relaxes some of the capital rules, such as the rules on formation, own shares (see EMCA Chapter 5 on shares), shareholder loans and financial assistance (see EMCA Chapter 7 on companies' capital). Generally, the EMCA contains similar relaxations in respect of public companies.

As to private companies the situation is quite different in the various Member States. As noted above, Member States are free to apply concepts similar to those applicable to public companies or they may adopt their own national measures.

See further explanations in the comments to the sections of Chapter 2.

### 3. Considerations

As noted above, there are different positions in Member States regarding private companies. A number of Member States, among them the Nordic countries and Poland, apply most of the rules in Directive 2012/30/EU to private companies. This for example is the case regarding the rules on contributions in kind. Member States such as Ireland, the Netherlands and the UK, on the other hand, have moved away from the Directive. All Member States derogate from the Directive's requirement of minimum capital.

The objective of Directive 2012/30/EU is to provide various safeguards to protect the rights and interests of shareholders and creditors of public companies. This is achieved through clarification, codification and coordination of national provisions relating to the formation of public companies.

It should be noted that the amendments in 2006 and 2012 relax some of the original rules of the former 2<sup>nd</sup> Company Law Directive. The EMCA makes use of this trend to relax formal requirements. However, generally, it is the view of the Group that the fundamental principles of Directive 2012/30/EU should also apply to private companies.

Regarding the method of company formation, there are two different approaches: the *successive method* and the *simultaneous method*. The EMCA Group has decided to use the latter, see Comments to Section 3(5).

The EMCA Group has discussed whether it should be possible to use so-called real non-par value shares. There has been a degree of uncertainty as to whether non-par value shares comply with EU law. However, such shares have been introduced in the Finnish Companies Act and the Group considers that non-par value shares should be allowed, see below Section 8.

Further, the EMCA Group has considered the Directive's enumeration of the contents of the Instrument of Incorporation and the articles of association. The Group has chosen a simplified solution, which is connected with the fact that the EMCA is derogating from the Directive's rules on lapse of incorporation.

PART 1  
FORMATION OF COMPANIES

*Section 2.01*  
**Method of Formation**

A company may be formed by:

- (a) the creation of a company in accordance with the EMCA;
- (b) the transformation of an association or other legal entity if allowed by legislation applying to such entities;
- (c) the merger of existing companies;
- (d) the division of an existing company.

*Comments*

Section 1 lists the different means by which a company which is to be governed by the EMCA may be established. The most common way is to establish a company following the procedure described in this Chapter of the EMCA.

Article 15 of Directive 2012/30/EU states that pending coordination of national laws at a subsequent date, Member States shall adopt the measures necessary to require provision of at least the same safeguards as are laid down in Articles 2 to 12 in the event of conversion of another type of company into a public company (Section 1 (2)). The approach of the EMCA is consistent with this (see Chapter 4, Section 1 on transformation).

Formation by the transformation (Section 1 (2)) from a company without corporate status shall be governed by national law applicable to the transforming company.

In many Member States, there are restrictions on the type of entity which may become a private or public company (see EMCA Chapter 4, Section 1 on transformation).

In the event of a merger (Section 1(3)) or a division (Section 1 (4)), one or more new companies are created. Chapter 13 deals with mergers and divisions of companies established under the EMCA.

A private company can be converted to a public company and vice versa (“re-registered”). This will not give rise to the winding up of the company or lead to any loss or interruption of its legal personality, see Chapter 4, Sections 2-4.

*Section 2.02*  
**Subscribers**

A company may be formed by one or more persons, legal or natural. Persons who do not have a contractual capacity according to national law may not be subscribers.

*Comments*

A number of different persons are involved in the formation of a company. The term “promoter” is often used to refer to persons who undertake to form a company and to take the necessary steps to accomplish this task. The term would not normally include professional service providers such as lawyers, accountants and notaries. Promoters are considered to be fiduciaries and various duties and responsibilities are imposed upon promoters in different jurisdictions pursuant to common law and statute. Another group of persons who are crucial to the formation of a company is the “subscribers”. These persons subscribe to the Instrument of Incorporation thus agreeing to become its initial members on the company’s registration. Once the company’s shares are issued to them, they become “shareholders”.

In most Member States only one person is needed to form a company. Private companies are subject to the Directive 2009/102EC (12<sup>th</sup> Company Law Directive) on single-member private limited liability companies which require that Member States allow a private company to have a sole member when it is formed unless its legislation provides that an individual entrepreneur may set up an undertaking the liability of which is limited to a sum dedicated to a stated activity. As to public companies, Member States are free to decide on a minimum number of shareholders. In many countries, the requirement to have more than one subscriber in public companies reflects historical rules with seven being the usual number. This figure originates from the UK 1846 Companies Act. For example, in Belgium, seven persons are required. In Portugal, five persons are required, unless the State owns the majority of the share capital. France followed the UK model but reduced in 2015 the minimum number of shareholders for public companies, from seven to two. In Ireland, traditionally seven subscribers were required but the Irish Company Law Review Group noted that this requirement “originated in the early life of company law and has survived without analysis or review rather than as a consequence of analysis and review”. The new Irish Companies Act 2014 thus requires only one subscriber for private companies limited by shares which is the Irish model company (Irish Companies Act 2014, Section 17). The trend in Europe is clearly in eliminating any minimum number of shareholders. The Group also considers that there is no convincing reason to restrict the number of subscribers to a minimum number.

In a small number of Member States, there are further restrictions on the type of persons who may establish a company. In Poland, for example, private and public companies may not be formed solely by another single-shareholder (Polish Commercial Companies Code, Section 151(1) and Section 301(1)). No such limitations are imposed by the EMCA.

Some Member States require that subscribers must be domiciled within the EU. The EMCA does not contain such a requirement in Section 2(1). The subscriber’s domicile must, however, be disclosed to the registration authority, see Section 3(2)(a)).

National law may differ regarding the contractual capacity of persons such as minors, bankrupts etc. but this is considered to be a matter of contract law and not regulated in the EMCA.

### *Section 2.03*

#### **Instrument of Incorporation**

- (1) The subscribers are responsible for, and must sign, the Instrument of Incorporation.
- (2) The Instrument of Incorporation must contain at least the following information:
  - (a) the company’s proposed name;
  - (b) the name and domicile of the subscriber(s) ;
  - (c) the date of the Instrument of Incorporation;
  - (d) the number of shares subscribed for by each subscriber;
  - (e) the price to be paid by the subscribers to the company for each share;
  - (f) the terms of payment by the subscribers for the shares;
  - (g) the amount of subscribed capital and the amount of capital which will be paid up at the time the company is registered;
  - (h) the total amount, or at least an estimate, of all the costs payable by the company or chargeable to it by reason of the formation;
  - (j) any special advantage agreed or arranged, at the time the company is formed for anyone who has taken part in the formation of the company or in transactions leading to the grant of such advantage;
  - (k) the proposed members of the management body and, if a supervisory body is required, the supervisory body;
  - (l) the proposed auditors of the company, where auditors are required; and

- (m) the date the formation of the company becomes legally effective pursuant to Section 5.
- (3) Agreements on matters that are dealt with but not approved in the Instrument of Incorporation are not enforceable against the limited liability company.
- (4) The proposed articles of association shall be included in or attached to the Instrument of Incorporation.
- (5) By signing the Instrument of Incorporation or authorizing its signature, the subscriber subscribes for the number of shares indicated in the Instrument of Incorporation.
- (6) The term and duties of the proposed directors and, if already appointed, the auditors shall begin as of the signing of the Instrument of Incorporation. The formation of a company shall lapse where no application for registration has been made by the company within 4 weeks of the signing of the Instrument of Incorporation, or where the Registrar through a decision which has become final, has refused registration.
- (7) If the formation lapses the amount paid for subscribed shares shall be repaid. The subscribers and members of the management and supervisory bodies shall be jointly and severally liable for such repayments.

### *Comments*

Section 3 of the EMCA covers private as well as public companies.

The EU Company Directives do not define the term “Instrument of Incorporation” and Article 2 of Directive 2012/30/EU merely covers the contents of the instrument of incorporation, which is similar to the approach taken in this Section. The primary purpose of the Instrument of Incorporation is to evidence the intention of the subscribers to form a company and become members of that company on formation, see Section 3(5). The key information for investors and creditors regarding the internal allocation of powers between the directors and members of a company will be set out in one place, namely the articles of association set out in Section 4.

Re 1) In most cases, the promoters of the company will become subscribers of the company. However, this is not necessary. Their task is to prepare the Instrument of Incorporation and to identify subscribers, see below. However, individuals who wish to participate in the formation of a company must subscribe their names to the Instrument of Incorporation and they become the company’s founding members.

Re 2) Article 2 of Directive 2012/30/EU provides for a minimum amount of information to be disclosed in the Instrument of Incorporation thus allowing Member States to require other elements to be added to the documents to be disclosed. Since the EMCA provides for simultaneous formation, all the necessary documents including the articles of association must be prepared at the outset. Thus, there is no reason to duplicate the requirements in the Instrument of Incorporation and articles of association. Therefore, aside from the company’s name which is cited for identification purposes, the instrument of incorporation only includes issues which are not mentioned in the articles of association. The division between the contents of the Instrument of Incorporation and the articles of association is such that the issues that determine the company’s enduring organization are in the articles of association, while all the other information which is relevant to the company at the time of formation is in the instrument of incorporation. This is important as the articles of association will then provide shareholders and external stakeholders with a single accessible constitutional document. This is consistent with the approach taken in the UK and following the recommendations of the Company Law Reform Steering Group in its final report (paragraph 9.4).

The Instrument of Incorporation should indicate the price to be paid by the subscribers on formation for each shares. This includes information as to whether the capital should be paid in cash or in kind, see also Section 9 below. Further information can be found in the articles of association, see Section 4.

Article 2(c) of Directive 2012/30/EU provides that the Instrument of Incorporation should include the amount of the authorized capital or where there was none, the amount of the subscribed capital. The term “authorized share capital” refers to the amount of share capital stated in the Instrument of Incorporation with which the company proposes to be registered. Until this capital has been allotted, it will not show the assets of the company and could even serve to mislead investors. In practice, it acts more as a restriction on directors’ actions as directors need to seek shareholder approval to increase the authorized amount. The UK Companies Act 2006 removed this distinction upon the recommendation of the Company Law Review Steering Group (Final Report, paragraph 10.6). The Group believes that authorized capital is not necessary to protect shareholders and therefore the EMCA makes no reference to authorized capital.

Section 3(2) contains information about fundamental issues regarding the company structure. Further regulation on different issues can be found in the different Chapters of the EMCA: on share capital see Chapter 3, Section 7; on terms of payment see Chapter 3, Sections 7(5) and 10; on price to be paid for the shares see Chapter 3, Section 12; and on the need for auditors (a number of Member States do not mandate auditors in small companies in keeping with the 4<sup>th</sup> Company Law Directive (78/660/EEC)) see Chapter 12.

Re 3) The Instrument of Incorporation should constitute the complete basis for share subscription. Therefore agreements on matters that are dealt with but not approved in the Instrument of Incorporation should not be enforceable against the limited liability company. Section 3(3) is inspired by Section 27(4) of the Danish Companies Act and Chapter 2 Section 11 of the Swedish Companies Act.

Re 4) There may be one document or two depending on whether the articles of association are included in the Instrument of Incorporation or attached thereto. In any event, the articles of association must contain the information set out in Section 4 below.

EU law leaves it to national law to determine whether a company is “established” by the “simultaneous method” or by the “successive method”. The former means that the drawing up of the Instrument of Incorporation and other necessary documentation and the subscription for shares is accomplished at the same time. The subscribers may sign for the majority of the shares and they together with such other persons as may from time to time acquire shares become members of the company. The subscribers can stipulate the content of the statutes and the organization of the company. There is no need to arrange any further organisational meeting of subscribers. This method is adopted for example in Denmark, Finland, Sweden and in the UK. By contrast, with the “successive method” there are separate stages for the signing of the Instrument of Incorporation, the subscription for shares and the original general meeting. The EMCA provides for simultaneous formation.

As noted above there may be shareholders other than the original founding members. In public companies there may be an offer to the public and even in private companies it is possible to invite others to subscribe for shares to a limited extent.

According to the general principles of contract law, subscribers for shares are treated as offerors to the company and the company may subsequently decide whether to accept the offer and allot the shares or to reject the offer. In order to avoid the fact of the subscribers’ offers misleading future shareholders or creditors, the shares subscribed for must subsequently be allocated to the subscribers and they may not be allotted a lower amount of shares, see Section 7(4).

Re 6) Although the company does not possess a separate legal personality until registration (see Chapter 1, Section 4(1) and Chapter 3, Section 2), directors are appointed at the time the Instrument of Incorporation is signed (see Section 3(2)(j)) and thus their duties commence at this time (see Section 3(6)). Chapter 3, Section 2 deals with operations before registration.

If auditors have been appointed by the time the Instrument of Incorporation has been signed, their duties commence at this time. However, there may be no need for an auditor to be appointed at this point of time (see Section 3(2)(k)).

The complete status of persons as directors is achieved at the point of registration. For example, registration implies that they are able to bind the company by contracts (see Chapter 1, comments to Section 4).

Re 7) Section 3(7) is derived from Chapter 2 Section 24 of the Swedish Companies Act 2005. If the application is filed after the four-week period post signing of the Instrument of Incorporation or if an application does not fulfil the formation procedure, the Registrar will refuse registration and the registration process will be required to re-commence. In such a case, the share capital contributed will be repaid.

The time limit for application varies between the various Member States. For example, Section 40(1) of the Danish Companies Act provides for 2 weeks and Chapter 2 Section 22 of the Swedish Companies Act provides for 6 months. Other Member States such as France for example do not foresee a time limit for application. The necessity to have a four-week period has been questioned by some EMCA commentators who argued that it was excessive and this period may warrant shortening depending on the circumstances of the different jurisdictions.

#### *Section 2.04* **Articles of Association**

- (1) The articles of association must contain at least the following information:
- (a) the name of a company;
  - (b) whether the company is private or public;
  - (c) in so far as they are not legally determined, the rules governing the number of, and the procedure for appointing, members of the bodies responsible for representing the company with regard to third parties, the management bodies and the allocation of power among those bodies;
  - (d) the duration of the company, if it is limited;
  - (e) the objects of the company
  - (f) the share capital of the company
  - (g) the nominal value, if any, of the shares subscribed and the number thereof;
  - (h) the number of shares subscribed without stating the nominal value;
  - (j) the special conditions, if any, limiting the transfer of shares;
  - (k) where there are several classes of shares, the information under ((g), (h) and (i)) for each class and the particular rights attaching to the shares of each class;
  - (l) whether the shares are registered or bearer, and any provisions relating to the conversion of such shares unless the procedure is laid down by law;
  - (m) the nominal value of the shares or, where there is no nominal value, the number of shares issued for a consideration other than in cash, together with the nature of the consideration and the name of the person providing this consideration;
- (2) The articles of association shall, when registered, bind the company and the members of it.

#### *Comments*

The EMCA uses the term “articles of association” to refer to the document which makes up the “constitution” that every registered company must have and follow. In some jurisdictions such as Ireland the term “constitution” in relation to a private company limited by shares is used to refer to this document. In other jurisdictions such as the UK, the term “constitution” has a broader meaning referring not just to the articles of association but also to certain other shareholders’ resolutions.

The EMCA requires the same minimum information as is required by Article 3 of Directive 2012/30/EU. Hence, the requirements in Section 4(1)(a)-(m) are mandatory. Section 4(1)(a)-(m) refers to later provisions stated in the various chapters of the EMCA, such as to Section 6 on name, Section 7 on share capital, and Section 8 on shares with nominal value or no-par value shares. In addition, the articles of association may contain further provisions regarding matters set out in other chapters of EMCA (cf. Chapter 5).

Article 2(b) of Directive 2012/30/EU requires companies to state their objects in the statutes or the Instrument of Incorporation and these objects determine the company's capacity. A statement of the company's object clause may have legal consequences in three ways. Firstly, the directors only have the authority to act within the stated object (see directors' authorities and right to representation in Chapter 8 on management). Secondly, the object is a limitation regarding the rules on representation. Finally, in order to protect minorities, the directors have a duty to act within the stated objects. Where they do not do so, they may be liable to the minority (see Chapter 11 on minority protection). The requirement to disclose the object must be understood in line with this provision. The objects of the company determine the kind of business in which the company can engage. Thus it is a permanent limitation of the company's business. It may be changed however according to the rules of changing the articles of association.

It is commonly acknowledged in Member States, that shareholders can make *shareholder agreements* which contain supplementary provisions to the articles of association, for example on the transfer of shares and shareholder voting. Shareholder agreements bind the shareholders but not the company. Unlike articles of association, shareholder agreements are not generally disclosed to the public (unless market rules so require of listed companies). The EMCA does not contain any regulation on shareholder agreements but assumes that shareholder agreements are recognized in the Member States' national laws.

According to Article 3(a) of Directive 2012/30/EU, information concerning the company's registered office must be made public. The Directive does not require that the information appear in the articles of association or in the Instrument of Incorporation as it can also be made public in a "*separate document published in accordance with the procedure laid down in the laws of each Member State*". Thus, the address should be stated in the executive order of the national authorities. The EMCA does not prescribe the contents of the executive orders because of the existence of these different systems. Thus, for example, the Danish authorities have moved the demand for location and address to the executive order in order to make it simpler to change the address of an office without requiring a change to the articles of association.

Re 2) The shareholders have a right to expect that the company will operate within the framework set by the articles of association. The articles are thus binding. A similar provision exists in the UK and Ireland. There, a company's constitution forms a statutory contract between the company and its members, and between each of the members in their capacity as members to the same extent as if there were covenants on the part of the company and each member to observe those provisions (Sec. 31 Irish Companies Act 2014 and Sec. 33 UK Companies Act 2006).

Chapter 11 of the EMCA provides that the articles of association can only be altered by a super majority decision at a general meeting of shareholders.

The purpose of Sections 3 and 4 is to ensure that potential shareholders receive all information needed to invest in the company. Further information may be made available subsequently pursuant to the requirements of the Prospectus Directive and national rules on prospectuses in securities law.

#### *Section 2.05*

### **Time of Formation**

The company shall be deemed formed when the Instrument of Incorporation has been signed by all its subscribers or upon such other date as is set out pursuant to Section 3(2)(1) in the Instrument of Incorporation.

#### *Comments*

Section 5 prescribes the time the company is formed. The company will be formed either upon the signature by the subscribers of the Instrument of Incorporation or upon such later date as is set out in the Instrument of Incorporation.

The freedom provided for in Section 5 to choose the date upon which formation becomes effective is consistent with the national law in a number of Member States (see comments to Chapter 1, Section 4). As noted in Section 3(2)(1), the Instrument of Incorporation may decide that the company is formed either before or after the Instrument of Incorporation has been signed. It is important to note that formation in this context does not denote the time the company is incorporated and becomes a separate legal entity able to exercise all the functions of an incorporated company as this does not occur until the company is registered (see Chapter 1, Section 4). Instead it refers to the time when an operational entity is established and business may be conducted in its name. From this time, the company's management may undertake certain activities without incurring personal liability in order to prepare for the incorporation and subsequent functioning of the company (see Chapter 3, Section 2(4)). This is the time the contract between the subscribers is formed and the obligations arising thereunder come into existence. In addition, the time of formation determines the time when the company's income from business transactions is considered as company income and thus it has an effect on the commencement of the accounting period.

Certain limitations may apply to the chosen date arising from national tax law and accounting provisions when capital is paid up by way of cash contributions, etc. (see for example Danish Companies Act Section 40(3)-(6)).

Section 2 of Chapter 3 provides for the regulation of operations prior to registration when the company is in the process of being registered.

#### *Section 2.06*

##### **Name**

- (1) Companies shall be under an obligation to, and shall have an exclusive right to, use the term "private" or "public limited company" or any abbreviations derived therefrom.
- (2) The names of companies must differ from each other. The registration of a name is without prejudice to any claim which another person may have with respect to the improper use of a name in a manner contrary to national law.
- (3) The name of a company must not be likely to mislead the public as to the nature of its business activities.

#### *Comments*

Re 1) Article 2(a) of Directive 2012/30/EU requires public companies to disclose information about their legal organisational form and name. However, EU law does not provide for rules authorizing abbreviations of the two company types or prohibiting names which may be confused with existing registered companies. Section 6 deals with names belonging to both private and public companies.

Pre-clearance by the Registrar is not required in the majority of Member States. However, registration may be refused if the name is similar to an existing name or if it is potentially misleading according to the files at the Registrar. In considering the company's name, the Registrar is not required to consult information from trademark registers etc. Consequently, most Member States advise applicants to conduct their own checks on their choice of name for the company in order to avoid a refusal on the grounds that the name has been used before. It is not intended that registration be conclusive evidence that a name is unique.

Chapter 3 of the EMCA sets out the registration rules for companies and describes the role of the Registrar.

Re 2) The company name must not include surnames, names of firms, specific names of real property, trademarks, logos, etc., that do not belong to the company or anything which may be confused therewith. National law on trademarks and national marketing etc include more detailed provisions on names. The rules in Section 6(2) and (3) should be understood as a part of these regulations.

Re 3) The name must not include any specification of undertakings which have no connection with the objects of the company. If the name describes a specific activity, it must not be maintained in that form if the nature of the activities changes significantly.

Article 12 of Directive 2009/101/EC contains provisions relating to the nullity of companies. Among the cases where the nullity of a company may be ordered under the Directive is where the Instrument of Incorporation and the articles of association do not state the name of the company. If a company name turns out to be misleading or otherwise illegal, the consequence should not be nullity of the company but rather a court decision on the legality of the name. See further in Chapter 3.

*Section 2.07*  
**Share Capital**

- (1) Public companies and private companies shall have a share capital. The share capital in public companies shall be at least €25,000 or the equivalent in any other currency. Private companies may decide on the amount of their minimum share capital.
- (2) The minimum capital of the company must be fully subscribed. If the minimum capital has not been fully subscribed, the formation of the company and the obligations of the subscribers shall lapse.
- (3) Subscriptions for shares shall be listed in the Instrument of Incorporation. If shares have been subscribed subject to reservations, the subscription shall be void.
- (4) No subscriber may be allotted shares of a smaller amount than that subscribed for by that subscriber in the Instrument of Incorporation.

*Comments*

Re 1) There has been much debate about the necessity to have a minimum capital. Article 6(1) of Directive 2012/30/EU requires that a minimum share capital of €25,000 be subscribed for public companies. Under Directive 2009/101/EC, two alternative time periods are set for having this minimum capital - the time the company is incorporated or the time the company is authorized to commence business. There is no similar requirement for private companies. Private companies may for example choose a share capital of €1.

The requirements of the EMCA regarding share capital for public companies are consistent with Directive 2012/30/EU both with respect to minimum capital and with respect to the requirements to provide for evidence that capital is paid up. Payment for shares of a company is governed by Sections 10 and 11.

With respect to share capital in private companies, not all Member States have adopted the minimum capital requirement stated in Directive 2012/30/EU. While, the majority of Member States apply minimum capital requirements to private companies, France, Ireland, the Netherlands, Portugal and the UK do not. In several Member States such as Denmark and Sweden, the minimum capital in private companies has been reduced in recent years. In Spain, for instance, a minimum capital of only €3,000 is required. In Germany the minimum capital requirement for the GmbH is as a regular matter €25,000 (§ 5 I GmbH). But if the form and name of an “*Unternehmergeellschaft*” (UG) is chosen which is also a private limited liability company, there is only a capital requirement of €1 (§ 5a I GmbH). However, for the UG there are strict rules to build up reserves up to €25,000 (§ 5a III, V GmbH). Also, the Greek “private company” introduced in 2012 as an alternative to the Greek “EPE” (GmbH) can have a zero capital. In Poland, the minimum share capital in private companies has been reduced to approximately €1200 but a new draft of the applicable law provides for 1 zloty minimum coupled with a solvency test and other instruments to protect the company and its creditors. In the Netherlands, since the revision of the law on private companies in 2012, creditors (and other stakeholders of the company) are protected by a distribution test while the minimal capital and the system of capital maintenance have been abolished. In Luxembourg, a simplified private limited company (*société à responsabilité limitée simplifiée* or sarl-s) has been introduced in 2016 and can have a capital of €1. Like in Germany, it needs to build up reserves up to €12,000 which is the minimum capital for private companies.

Article 19 of the SPE proposal also stated a capital requirement for the SPE of at least €1.

In reality minimum capital requirements are arbitrary and do not take into account the riskiness of the business. They may also send inappropriate signals to the marketplace. The fact that money was available on a particular date does not mean that it remained with the company beyond that date. It is thus arguable whether a minimum capital rule offers creditors any real form of protection. If too high a figure is determined, it may deter persons from incorporating, impede capital rising and lead to forum shopping. On the other hand it might be considered that the requirement to raise a specified amount of finance may focus the minds of the subscribers on the business risks associated with their venture and in many cases put them to the effort of convincing a third party as to the viability of the project. On balance, the Group recommends that both private and public companies should have a share capital but that the requisite minimum level, according to Directive 2012/30/EU, applies only to public companies.

Re 2) In terms of the time period, the EMCA applies the minimum capital requirement at the time the company is incorporated, i.e. registered in the meaning of the EMCA (see EMCA Chapter 3, Section 1).

In some Member States, there is a limit to the number of shareholder for private companies. In Ireland the current limit is 149 (Section 17(4) Irish Companies Act 2014), in France (Article L. 223-3 Commercial Code) and Luxembourg (Article 181 of the Luxembourg Companies Act) it is 100. Companies with shareholders above this limit can only be public companies. In the majority of Member States, however, there is no limit and that is the option adopted by the EMCA, see above Section 3.

Although only public companies may offer shares to the public, companies are free to choose either a private or a public company. Thus, the EMCA does not prescribe a maximum number of shareholders in either public or private companies.

Re 4) Subscriptions for shares are considered to be offers to subscribe for shares. In order to avoid misleading creditors and future investors, subscribers are not allowed to subscribe for a large amount of capital and subsequently withdraw their subscriptions before allotment.

#### *Section 2.08*

### **Nominal Value or No-par Value**

- (1) The shares of a company may have a nominal value or a no-par value as provided in the Instrument of Incorporation.
- (2) If the shares have a nominal value, all shares of that class in the company shall have the same nominal value. Accountable par may differ between shares.
- (3) If the shares in the company have a nominal value, the amount to be credited to the share capital for each share at incorporation shall be at least equal to the nominal value.

#### *Comments*

Article 3 (b) of Directive 2012/30/EU provides that the statutes, the Instrument of Incorporation or a separate document published in accordance with the procedure laid down in the laws of each Member State in accordance with Article 3 of Directive 2009/101/EC must state the nominal value of the shares subscribed, and, at least once a year, the number thereof. The “nominal value”, in relation to a share, refers to a monetary amount, expressed as an amount, multiple, fraction or percentage of a currency. However, Article 3 (h) confirms that there is no requirement to issue shares with a nominal or “par” value and companies may issue shares with non-par value.

The majority of Member States allow companies the same choice. This is for example the case in Denmark (*stykkekapitalandele*), Germany (*Stückaktien*) and Sweden (*kvotaktier*). According to the Swedish Companies Act 1:6 only “*kvotaktier*” are allowed. If the share capital is divided into several shares, each share represents a certain proportion (quotient) of the share capital; the portion constitutes the share’s quotient value. In other words, the quotient value can be calculated by dividing the registered share capital by the numbers of shares issued by the company. Other countries such as Greece, Ireland, the Netherlands, Spain and the UK require shares to have a fixed nominal value.

The EMCA allows companies to choose between nominal value and no-par value.

The argument for allowing no-par value share varies. First, the Finnish justification of the adoption of no-par value shares is that the nominal price does not reflect the issue price or the market price and thus it is of dubious value. Second, it is argued that no-par value shares give companies more flexibility, gives shareholders a better understanding of the shares' actual value, and allows for an easier transfer for non-Euro Member States from the national currency to the Euro. Third, it is argued that it is easier to carry out an increase in share capital because in a no-par value system, paper share certificates need not be changed. Finally, the preparatory works to the Finnish Companies Act point out that systems using nominal values are problematic with respect to IAS/IFRS-standards.

Apart from Finland, the European systems that purport to allow no-par values are however not to be considered as *real no-par value* systems. This is because these countries have kept a prohibition on selling shares below par. This is the case for example in the Swedish Companies Act where Section 2:15 states: "the payment for a share may not be less than the shareholder's quotation value." The prohibition on selling shares below par stems from Article 8 of Directive 2012/30/EU which provides that shares in a public company "may not be issued at a price lower than their nominal value, or where there is no nominal value, their accountable par". The term "accountable par" refers to the value obtained by dividing nominal capital by the number of shares outstanding.

The Swedish and the UK authorities have considered that Directive 2012/30/EU hinders a complete transition to a real non-par value system in which there would not be any ban on issuing shares below the nominal value or any legal provisions regarding the book value.

The Finnish authorities, in turn, have taken a different position which is in keeping with US developments (starting in California (Cal. Corp. Code 409) leading to the U.S. Model Business Corporation Act (MBCA §6.21)) where the whole concept of par value has been abolished. According to the Finnish Companies Act (Section 3:5), a company can choose to continue stating the nominal value/book value. In such a case, the prohibition on selling shares below par is kept. The new draft aimed at amending the Polish Commercial Companies Code is similar to the Finnish Companies Act allowing the companies to choose "real" non-par value shares or continue to retain the traditional nominal value system. The Finnish Companies Act also permits and actually prefers a system of shares without any reference to either nominal or fractional value. This assumes that there is no prohibition on selling shares below par. The Finnish Companies Act allows the subscription price of share issues to be entered into the unrestricted equity- capital fund. The EMCA Group considers that the Finnish system is in compliance with Article 8 of Directive 2012/30/EU although this is a moot point. More than 90 % of Finnish companies now choose a non-par value system.

The EMCA Group agrees that the real non-par value system should be allowed or at least be optional. Accordingly, Section 8(3) only prohibits selling shares below par where companies choose a system with a nominal value (see Section 12 below). One possibility raised within the Group is the requirement for the name of the company to reflect the fact that a real non-par system applies.

The rules in relation to share issuance etc. are covered in Chapter 6.

PART 2  
PAYMENT FOR SHARES

*Section 2.09*  
**Consideration for Shares**

Shareholders shall pay the agreed consideration in cash or provide the agreed consideration in kind in accordance with the Instrument of Incorporation.

*Comments*

Directive 2012/30/EU regulates the form of consideration to be paid upon the issue of shares. The EMCA allows for payment in cash or in kind. The following sections regulate the quality of the consideration and the level of consideration which must be provided. Sections 9-11 are in line with Directive 2012/30/EU.

*Section 2.10*  
**Payment in Cash**

- (1) In public companies, at least 25 per cent of the nominal value of the company's capital or, in the absence of a nominal value their accountable par and any premium, shall be paid up before registration.
- (2) In public companies, unless otherwise provided in the articles of association or the terms of allotment, payment of the remaining capital can be demanded by the company at any time.
- (3) In public companies, upon transfer of a share, which is not fully paid up, the transferee and the transferor shall be jointly and severally liable for the payment.
- (4) The share subscription – in public as well as private companies - shall be binding on the subscriber when the Instrument of Incorporation has been signed. The subscribers shall not be released from the obligation to pay up their contribution. After registration of the company, a subscriber may not claim on the basis of the invalidity of the share subscription, that the terms of the Instruments Incorporation of the company have not been fulfilled.

*Comments*

As paragraphs 1-3 concern the situation where the entire capital has not been paid up, they only apply to public companies. Paragraph 4 deals with both private and public companies.

Re1) Although Directive 2012/30/EU requires a minimum capital for public companies, the full amount need not be paid up immediately. Article 9(1) provides that only 25 per cent of the nominal value or accountable par of the shares issued must be paid up at the time the company is incorporated or is authorized to commence business. In the majority of Member States the whole of any premium due must also be paid. On contributions in kind, see Section 11(2).

Re 3) In compliance with Article 14 of Directive 2012/30/EU, Section 10(3) states that the shareholders may not be released from the obligation to pay up their contributions. This applies to the amount of capital that has to be paid at the time the company is incorporated and to the remaining capital. This requirement seeks to protect other shareholders and the company's creditors. The EU Directives do not set out the consequences of late payment.

Section 10(3) applies to the transfer of shares that are not fully paid up and states that both the transferee and the transferor shall be held liable for paying capital contributions. There is no requirement that the company must give its consent to the transfer or other conditions. Such requirements can, however, be specified in the articles of association. See Chapter 5 on transferability of shares.

Directive 2012/30/EU includes no provisions as to when the remaining capital must be paid. The provision in Section 10(3) of the EMCA is similar to provisions in the company statutes in Denmark, France, Germany, Ireland, Spain and the UK. The problem does not exist in Member States such as Finland and Sweden as they require that the capital must be fully paid before registration.

A company is entitled to set out provisions for late payment in the articles of association or in the terms of allotment. Alternatively, the company could decide to rely solely on general principles of contract law.

Re 4) Section 10(4) refers to original subscribers. The problem mainly arises where there is a period between the time of subscription and the time of registration of the company. As long as companies can be registered online (see Chapter 3, Sections 1 and 8), this problem should be eliminated.

In contract law, the principles of invalidity involve a consideration of the relationship between the contracting parties. With respect to company law, there is a need to take into account the special interests of creditors. The consequence of this is that the rules of invalidity in contract law cannot be applied directly to company law.

### *Section 2.11* **Contributions in Kind**

(1) Any contribution of assets other than cash - a “non-cash contribution” - shall have a value that can be expressed as a monetary equivalent and shall not consist of an obligation to do work or perform services.

(2) A public company shall not allot shares as fully or partly paid up if the consideration for the allotment is, or includes, an undertaking which does not need to be performed until at least five years from the date of the allotment. If the undertaking should have been performed within five years but is not, payment in cash becomes due immediately.

(3) In private companies, where all or part of the share capital is paid up by way of contributions in kind, the entire share capital shall be paid up.

(4) Where shares in a public company have been paid for in kind, a statement shall be attached to the registration from an independent expert appointed or approved by an administrative or judicial authority commenting on whether the assets had a financial value to the company at least equal to the nominal value of the shares and any premium due.

(5) Section 11(3) will not apply to transferable securities and money-market instruments in the circumstances set out in Article 11 of Directive 2012/30/EU. The obligation to draw up an expert statement shall not apply to considerations of:

(a) Assets, which are individually measured and presented in annual or consolidated financial statements for the preceding financial year prepared in accordance with the provisions of the EMCA or the international accounting standards (e.g. Regulation 1606/2002/EC on the application of international accounting standards, the accounting rules laid down by legislation for financial firms, or the rules laid down in the 4th Company Law Directive (78/660/EEC) or in the 7<sup>th</sup> Company Law Directive (83/349/EEC)) and fitted with an audit report;

(b) Transferable securities or money market instruments, valued at the weighted average market price at which they have been traded on one or more regulated markets in the 4 weeks preceding the signing of the articles of association. A valuation report shall be prepared if the company’s management board considers that this average price is affected by exceptional circumstances or otherwise cannot be assumed to reflect the current value of the securities.

(6) The company’s management board is responsible for ensuring that deposits made in accordance with Section 11(5) do not damage the company, its shareholders or its creditors, and it shall prepare a declaration containing

(a) a description of the asset and its value,

(b) information about the procedure used for the assessment,

(c) a statement that the specified values are at least equivalent to the value of and, where appropriate, the premium on the shares to be issued as consideration, and

(d) a statement that no new circumstances arise which are relevant to the original assessment.

(7) The company shall publish the declaration provided for in Section 11(6) at the Register, at the latest in connection with the registration or notification of the registration of the company.

*Comments*

This Section regulates contributions in kind in order to ensure that the value placed on a non-cash asset is not inflated. In such a case, a real risk would exist that the Instruments of Incorporation would mislead creditors and future shareholders as to the capital value of the company.

Almost all Member States have provisions on contributions in kind to ensure that capital is paid up effectively. However, in Ireland and the UK, there are no statutory constraints for private companies, but directors are still bound by their duties when allotting shares for a non-cash consideration and transactions can be challenged on the ground that the consideration was illusory. Regarding formation, Directive 2012/30/EU seeks to facilitate capital related measures and eliminate specific formal requirements.

The EMCA contains rules on contribution in kind similar to the rules of Directive 2012/30/EU.

The provisions in Section 11, following Directive 2012/30/EU, are only mandatory for public companies. Some Member States have chosen to implement similar provisions for private companies. This is the case for example in Denmark, Finland, France (where even stricter rules apply), Germany, Italy, the Netherlands and Sweden. On the contrary this does not apply in Ireland and the UK. In the UK, where shares are allotted for a non-cash consideration in a private company, the directors are subject to the constraints imposed by their general duties (which would require them to obtain an appropriate value for the company) and the ability of the court to review allotments for an illusory consideration.

Generally, the EMCA Group considers that the provisions on contribution in kind in the EMCA shall apply – in accordance with the rules in the majority of Member States – to both private and public companies. If it follows from the articles of association that contributions may be made in kind, the Group assumes that there is a need to ensure that the consideration is not overvalued.

Re 1) Section 11(1) is consistent with Article 7 of Directive 2012/30/EU which provides that the subscribed capital may be formed only of assets capable of economic assessment. Not all Member States apply minimum capital requirements for private companies and if no capital is contributed at the time of formation, Section 11 clearly does not apply. Therefore, the provision in Section 11(1) only applies if there is a *contribution in kind* in a private company.

Contributions in kind may consist of any kind of assets. A question arises regarding whether claims against subscribers or shareholders may be included regardless of whether the claims are secured by a charge. The EMCA recommends that claims should be included provided that they have the value provided for in Section 11(1), for example if a claim is secured by mortgage.

Re 2) Section 11(2) is consistent with Article 9(2) of Directive 2012/30/EU which provides that where shares are issued for a non-cash consideration at the time the company is incorporated or is authorized to commence business, the consideration must be transferred in full within five years of that time. A similar provision is set out in §36a of the German AktG and in Section 587(1) and (4) of the UK Companies Act 2006. Article 9(2) indicates the difficulties which can stem from postponing payment of contributions in kind. For this reason, the Danish Companies Act 2009 requires that contributions in kind must be fully paid and this rule applies both to private and public companies. Similar provisions can be found in the Czech Republic and in the German AktG.

Section 11(2) applies only to public companies.

Re 3) With respect to private companies, the EMCA Group has considered whether contributions in kind must be fully paid up. The majority of the Group considered that Section 11(3) should also apply to private companies. This is justified on the basis that there is a greater potential for abuse in private companies and also because it prevents a lot of problems which may subsequently arise such as a change in value of the contributions in kind or the extinction of the object of the contribution. A minority of the Group considered that Section 11(3) should not apply to private companies, because it would constitute an obstacle to contributions in kind.

Re 4, 5, 6 and 7) These Subsections are consistent with Article 10 and 11 of Directive 2012/30/EU. Subsection 7 sets out the manner of publication provided for in Article 3 of Directive 2009/101/EC.

Article 10(4) of Directive 2012/30/EU permits Member States to exempt the requirement to have an experts' valuation report if not less than 90 per cent of the shares in the company are subscribed against non-cash contributions from one or several other companies and certain other requirements are met. The majority of Member States do not use this exemption and the EMCA Group assessed that there are no strong reasons to utilize the exemption in the EMCA.

The Group considers it unnecessary to define the term "independent expert" in Section 11(4). The type of expert considered most appropriate varies amongst the different Member States and the EMCA should not thus be prescriptive. In the majority of Member States, the expert will be an approved external auditor (for example, in Denmark, France, Finland, Germany and Sweden) or a public notary. In Greece, for example, an expert Committee is appointed by the Ministry (see Greek Companies Act Article 9). The EMCA leaves to the Member States to determine which expert is considered appropriate. There can also be exceptions in the Member States to the appointment of an expert for certain types of companies and for contributions in kind below a certain level.

### *Section 2.12* **Subscription Price**

- (1) Shares with a nominal value shall not be allotted for a discount.
- (2) If a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premium on those shares shall be transferred to free reserves.

#### *Comments*

The prohibition on issuing shares at a discount has been enforced since the 19<sup>th</sup> century. The prohibition is part of the capital maintenance rules designed to protect creditors. It is set out in Article 8 of Directive 2012/30/EU which provides that shares may not be issued at amounts below their nominal value. Where a Member State allows the issuing of shares without nominal value ("no-par value") such shares may be issued at a price lower than their "accountable value", see Section 8(3) above.

The issuance of shares at a discount is prohibited but of course this presents no bar to subscription at a premium. As shares generally trade at prices above their nominal value, the protection afforded by this prohibition is often limited. Nevertheless, the prohibition is thought to be of some value in Member States with the nominal value system and it is thus retained in the EMCA.

Article 8 of Directive 2012/30/EU allows Member States to derogate from the prohibition to allow those who undertake to place shares in the exercise of their profession to pay a discounted price for the shares for which they subscribe in the course of this transaction. The Group has decided not to provide for such derogation in the EMCA.

### *Section 2.13* **Substantial Acquisitions after Registration**

- (1) If a public company acquires, otherwise than on the basis of a term of the Instrument of Incorporation, assets from a signatory of the Instrument of Incorporation within two years of the registration of the company, and the consideration paid by the company is no less than one tenth of the share capital at the time of acquisition, and if the acquisition does not fall within the normal course of the company's business nor occur in the public trading of securities, the acquisition shall be submitted to the general meeting for approval.
- (2) The general meeting shall be presented with a report regarding the acquired asset and the consideration paid, as well as the statement of an approved auditor or similar independent expert on the report and on whether the value of the acquired asset is at least equal to the consideration paid for it. The decision of the general meeting shall be notified for registration within six months of the meeting. The report and statement referred to above shall be attached to the registration notification.

*Comments*

Article 13 of Directive 2012/30/EU contains inter alia a rule on hidden contributions in the form of substantial acquisitions after registration. A number of Member States such as the Czech Republic, France, Finland, Greece, Italy, Luxembourg, Poland, Slovakia and Sweden have provisions on such hidden contribution in kind, requiring shareholder approval for transactions between the company and shareholders where the transactions exceed a specific amount within a set period of time. Germany has even stricter rules on hidden contributions in kind for the public company (AG) as well as for the private company (GmbH).

Section 13 is consistent with Article 13 of Directive 2012/30/EU. Article 13 provides that if, before the expiry of a time limit laid down by national law of at least two years from the time the company is incorporated or is authorized to commence business, the company acquires any asset belonging to a subscriber for a consideration of not less than one-tenth of the subscribed capital, the acquisition shall be examined and details of it published in the manner provided for in the Directive and it shall be submitted for the approval of the general meeting. Furthermore, the Member States may also require these provisions to be applied when the assets belong to a shareholder or to any other person. It follows from Section 13(1) that Section 13 does not apply where the acquisition takes place on a regulated market or as part of the company's day-to-day business.

The rules in Article 13 of Directive 2012/30/EU apply only to public companies, and the EMCA Group considered whether they should also apply to private companies. In some Member States such as Italy, this is the case but other Member States including Austria, Denmark, Finland, Germany, Greece, Sweden and the UK apply these rules only to public companies. In Ireland and the UK, common law rules on "substantial property transactions" would also apply to such transactions.

The Group considered that the rule in Section 13 should only apply to public companies on the basis that a fixed two-year rule would be too inflexible and might easily be circumvented. Therefore, Section 13 should not apply to private companies. In private companies the problem on substantial acquisitions after registration is partly addressed by Chapter 9 on director's duties and Chapter 10 on director's liability.



## **CHAPTER 3**

### **REGISTRATION AND THE ROLE OF THE REGISTRAR**

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## General Comments

### 1. EU law

Directive 2009/101/EC (amending the 1<sup>st</sup> Company Law Directive) includes provisions on the registration of companies. It requires that basic company documents should be disclosed by way of filing with a company registry and by the publication in the national gazette either of the full or partial text of the document or by reference to the document deposited in the company registry, and that such documents should be available for inspection. In addition, Directive 2009/101/EC specifies the minimum information that companies must include in their letters and order forms. The Directive also includes provisions for the electronic filing of documents. The provisions stated in the Directive are included in this Chapter. The comments to the provisions indicate when a Directive provision has been adopted by the EMCA.

Most of the provisions of the Directive relate to both the formation of companies and the subsequent conduct of the affairs of the company. These matters are in general covered in this Chapter.

The Instrument of Incorporation cannot be changed after registration. However, the articles of association may be changed and any change should be registered.

Directive 2012/17/EU seeks to increase legal certainty and to improve the performance of public administration by promoting cooperation between business registers in Europe, setting out procedures for cross-border mergers, providing for seat transfers and updating the registration of foreign branches where cooperation mechanisms are lacking or limited. Moreover, the amendments aim to facilitate cross-border access to official business information by setting up an electronic network of registers and determining a common minimum set of up-to-date information to be made available to third parties by electronic means in every Member State.

### 2. National law

Article 11 of Directive 2009/101/EC states that “in all Member States whose laws do not provide for preventive administrative or judicial control, at the time of formation of a company, the instrument of constitution, the company statutes and any amendments to those documents shall be drawn up and certified in due legal form.” The preventive control is exercised by a Registrar or the court. In the majority of Member States there is also a requirement to involve a notary (see further below).

The agency or person responsible for registration differs among Member States. In some Member States such as Belgium, France, and Germany, a judicial body is responsible whereas in others such as Cyprus, Czech Republic, Denmark, Finland, Ireland, Malta, the Netherlands, Spain, Sweden and the UK, responsibility lies with an administrative entity. In Spain the Registrar is a highly legal qualified person.

In Bulgaria, Denmark, Finland, Ireland, Sweden and the UK there is no requirement to have a notary. In many other Member States however, such as the Czech Republic, Germany, Italy, Luxembourg and Spain there is a requirement to involve a notary to advise the subscribers, to clarify the content of the articles of association and other documentation and to verify legal compliance. This provides legal certainty and may make the task of the Registrar easier. On the other hand, it may also result in additional costs due to the potential overlap between the role of the notary and the Registrar or the court. Such an overlap may arise for example with respect to the consideration of the company’s name. Article 11 mentions a “preventive administrative or judicial control” but it does not contain any more specific provisions on the contents of this control.

In Greece, the incorporation document is drawn up by a notary and the registration is made in a Registry maintained by the local chambers of commerce. In the Czech Republic and Poland, registration courts exercise the function of the Registrar but within their authority they only inquire whether all the formal requirements have been met. It is a notary, who is entrusted with the power to draw up the deed and to verify its legal compliance. In Poland, certain documents such as the articles of association must be executed in a “notarial form.” The registration court performs the content checking only in cases where a notary is not involved. In France and Portugal, the notary is mandatory only in the case of companies formed with contributions in kind. The UK allows the Registrar to accept a statement by those forming the company that they have complied with the registration requirements (which minimizes the need for checking) while making it a criminal offence to knowingly or recklessly make misleading or false or deceptive statements to the Registrar. The latter is a general provision applicable to all statements made to the Registrar.

The EMCA Group recommends that where notaries or other independent experts are used, there should not be a duplication of functions. For example if there is a requirement in national law that a notary confirms a property valuation, the same requirement should not be imposed on the Registrar. In connection with online registration, notaries could be permitted to make online submission (see Section 8).

### **3. Considerations**

To a certain extent, the EMCA follows the provisions in Directive 2009/101/EC and the amendments while taking into account the experience of the various Member States. Thus, a departure from the Directive is made in Section 13 (see the comments to this below).

It should be noted that Article 11 of Directive 2009/101/EC is not applicable. Article 3 allows electronic filing of all documents at the Register. The EMCA Section 8 goes further and contains a provision on mandatory electronic registration. Even if electronic registration has the consequence that the Registrar does not normally check the filings, Section 1(4) allows the Registrar to check that the requirements for a registration have been met.

The EMCA Section 7 is also consistent with Directive 2012/17/EU as regards the interconnection of central, commercial and companies registers.

*Section 3.01*  
**Registration of Formation**

- (1) The directors are responsible for lodging the following with the Registrar:
  - (a) the required forms,
  - (b) confirmation that the contributions payable in cash or in kind have been made,
  - (c) a declaration by the directors that they have formed the view that the company has sufficient financial resources to meet obligations that are likely to arise until the end of the first financial year.
- (2) The documents referred to in paragraph 1 shall be submitted electronically.
- (3) The documents referred to in paragraph 1 shall be less than 6 months old at the time of lodgment.
- (4) If the requirements in paragraphs 1-3 are complied with, the Registrar shall register the company and furnish a confirmation of registration.

*Comments*

The duration of the incorporation process varies to a great extent in the different Member States from a few days up to a month. A long process of incorporation may cause problems for example with respect to liability for contracts entered into during the pre-registration period. It is therefore important to shorten the incorporation process and to make it less costly.

An electronic formation procedure would constitute a solution to these problems. According to Directive 2009/14/EC, Member States have to ensure that all the documents can be filed electronically. However, Member States can go further and require the companies to file all information electronically. The EMCA has chosen the latter option, see Sections 1(2) and 8.

Re 1) Section 1(1) applies the obligations imposed on Member States pursuant to Article 6 of Directive 2009/101/EC. According to Article 6, Member States may decide which persons are responsible for taking care of the publication formalities. Hence, Section 1(1) identifies the persons responsible for registering the documents.

The required forms include a variety of information which should be filed with the Registrar. The list of forms and the contents of each vary substantially between Member States. In many cases, however, the information may be the same but the location in which the information may be found differs. In some cases, for example, the information is included in the notarized deed or the appended documents and in others it is in the application form itself. It may also be listed in an executive order, as is the case in Denmark.

The confirmation referred to in Section 1(1)(b) should be sufficient to satisfy the Registrar that the appropriate contributions have been made. It may take the form, for example, of a declaration by all directors, a declaration by a public notary or a formal confirmation from a financial institution. In terms of the time period, the EMCA applies the minimum capital requirement (see Chapter 2, Section 7) at the time the company is incorporated, i.e. registered within the meaning of the EMCA. The reason for this is that few Member States require specific authorization to be granted from a third party to commence business after registration. These exceptions are Belgium, Ireland, Luxembourg, Slovakia and the UK where authorization is required from the Registrar, but only where a public company is formed. Applying the requirement at the time of incorporation is thus more logical. See the provisions on payment in Chapter 2, Section 10.

Section 1(1)(c) goes further than Directive 2009/101/EC. It is inspired by Belgian law. It is part of a general provision which requires directors to ensure the company is solvent.

Because of the capital requirement in connection with formation, it is important to ensure that the management has considered the need for capital to support the future activities of the company. The EMCA does not demand a certain ratio of capital to activity, but instead it seeks to ensure that management continuously assesses the need for capital (see further below in Chapter 9 on directors' duties). While compliance by management with this obligation may become particularly important if a liability suit is filed in connection with bankruptcy, it can also become important for shareholders.

Re 2) Article 3(2) of Directive (2009/101/EC) states that companies must have the option of submitting documents by electronic means. Member States may even require that it is mandatory to file all or certain types of documents by electronic means. The EMCA (see Section 1(2)) incorporates a duty to use electronic means noting that the introduction of such a duty obliges Member States to provide the necessary means to fulfill this duty. The EMCA also includes mandatory provisions on online submissions (see Section 8).

Section 1(2) is consistent with Section 8, dealing with online registration.

Re 4) The function of the Registrar in determining whether to register a company is purely administrative (see further below in Section 11).

The registration is conclusive evidence that the requirements of EMCA as to registration have been complied with and that the company is duly registered under the Act as of the date stated on the Certificate of Incorporation. Once the company is registered, the registration cannot be cancelled by the Registrar (see below in Section 13).

Directive (2009/101/EC) Article 3 requires that, in each Member State a file shall be opened in a central register, commercial register or companies register, for each of the companies, both public and private, registered therein. The Directive does not stipulate whether a register must be carried out by a public authority and Member States have thus chosen different procedures.

As an overall term for public authority the EMCA refers to “Registrar” (see Chapter 1, Section 2(12)). The European Commission refers to the term “business register” (see the Commission’s Green Paper on “The interconnection of business registers” COM (2009) 614 final and Directive 2012/17/EC as regards the interconnection of central, commercial and companies registers).

### *Section 3.02*

#### **Operations before Registration**

(1) Anyone who has undertaken an obligation on behalf of the company after the date on which the Instrument of Incorporation is signed, but before the date of registration, or who has joint responsibility in this respect, shall be jointly and severally liable for that obligation.

(2) The company shall add the words “in the process of registration” to its name during the period referred to in paragraph (1).

(3) Upon registration, the company acquires the rights and obligations stipulated in the Instrument of Incorporation or conferred on the company after the signing of the Instrument of Incorporation.

(4) The management board may act for the company without personal liability in matters relating to the incorporation of the company, as well as take measures for the collection of the payment for shares.

(5) Where a party enters into a contract subject to a condition precedent that the company be registered, that party may, unless it has been otherwise agreed, withdraw from the contract if the registration application has not been submitted within the time limit or if registration is refused. If a party contracting with the company does not know that the company has not been registered, it may withdraw from any contract purportedly entered into by the company until the registration of the company.

### *Comments*

Re 1) Chapter 1, Section 4(1) provides that a company acquires legal personality upon registration. Before registration, the company as such cannot acquire rights or enter into obligations, nor can it appear as a party in court or in dealings with other authorities. This does not mean, however, that for example an individual enterprise which is converted to a company cannot start or continue its business activity.

Even though the company only acquires legal personality upon registration, it is often necessary that a company conducts business before registration (see also EMCA Chapter 1, comments to Section 4). Article 8 of Directive 2009/101/EC states that “*if, before a company being formed has acquired legal personality, action has been carried out in its name and the company does not assume the obligations arising from such action the persons who acted shall, without limit, be jointly and severally liable therefore, unless otherwise agreed.*” This is in line with the US Uniform Commercial Code (UCC 2.04) which deals with liability for pre-incorporated contracts.

Section 2(1) provides that, in such situations, the person acting on behalf of the company will be liable for any obligations incurred.

Re 2) The provision in Section 2(2) is similar to Section 41(1) of the Danish Companies Act.

Re 3) The provision in Article 8 of Directive 2009/101/EC must be understood as meaning that the Directive has two possible solutions as to transfer of liability. One is that the assumption of liability requires approval from the company upon incorporation and the other is that the assumption of liability is transferred automatically if the contracting party is aware that the deal is made with a company in the process of registration. Some Member States such as the Nordic countries have chosen automatic transfer of liability, whereas other Member States including Belgium, France and Holland have chosen subsequent approval.

Section 2 contains a system of automatic transfer of liability, which means that at the time of registration, liability is automatically transferred to the company. Thus, the person acting on behalf of the company is no longer liable for the obligations he or she incurred. This is in line with the Danish, Finnish, and Swedish Companies Acts and is justified on the basis that the subscribers to the Instrument of Incorporation are aware of this automatic transfer and by signing agree to be bound by it when the company is registered.

Sections 2(1) and (2) do not deal with all the situations in which promoters, subscribers or the management of the company may become liable. For example, in Austria and Germany, subscribers and directors will be liable for incomplete statements and in Slovakia, subscribers and directors will be liable for failing to execute a list of acts to be approved by the company. In common law jurisdictions, liability will be determined by applying general duties of care in tort and fiduciary duties to the company. This is also the case for Denmark, Finland and Sweden. This approach widens the net of potential liability to comprise other parties such as advisers or valuers.

Article 4 of Directive 2012/30/EU determines that if the laws of a Member State provide that a company may not commence business without authorization, they shall also make provision for responsibility for liabilities incurred by, or on behalf of, the company during the period before such authorization is granted or refused. This shall not apply to liabilities under contracts concluded by the company conditionally upon its being granted authorization to commence business. As the EMCA anticipates a company commencing business following incorporation without further authorization; Article 4 does not apply.

Re 5) A contracting party who was unaware that the company was not yet registered may withdraw from the contract until the company has been registered. The purpose of Section 2(3) is to protect contracting parties acting in good faith. The provision in Section 2(4) is similar to Section 41(3) of the Danish Companies Act and Section 2:27 of the Swedish Companies Act.

In almost all Member States, it is recognized that a company can start its business prior to registration. Even though the company cannot acquire rights or assume obligations prior to registration, it may acquire a right conditional on the subsequent registration taking place. According to the national laws of Member States, the holder of an interest in an asset must undertake an act of perfection in order to protect his or her interest. The EMCA does not contain provisions on acts of perfection. Assets that have been acquired prior to registration are secured against creditors, provided that there is compliance with the national rules on safeguard procedures. However, in Ireland and the UK, a company has no existence prior to incorporation by registration and any acts done by a person in advance are done solely in a personal capacity.

Operations prior to registration may cause a number of problems leading to litigation in many Member States. The EMCA Group recommends that these problems should be avoided as far as possible by shortening or eliminating the time period of the registration procedure. Therefore, the Group recommends that Member States implement a mandatory electronic registration system (cf. the EMCA Section 8 below) and also shorten the period between the signing the instrument of incorporation and the registration (see Section 5 and comments hereto).

### *Section 3.03*

#### **Changes to Information Already Registered**

Any amendment to the articles of association of a limited liability company or changes to any other information registered with the Registrar shall be registered directly in the Registrar's IT system or submitted to the Registrar for registration.

#### *Comments*

Section 3 implements Article 2 and 3 of Directive 2009/101/EC. This provision is to ensure that the registered and published information remains up-to-date so that it is possible for stakeholders to rely, make decisions, and act on the basis thereof.

### *Section 3.04*

#### **Other Registrable Information**

(1) All members of the management board of a limited liability company as well as the company's auditor, if applicable, shall be registered in the Registrar's IT system.

(2) If an auditor resigns or is removed before the end of term, the registration of that information or the application for registration shall be accompanied by an adequate account by the management board of the reason for such termination of office.

#### *Comments*

Re 1) Section 4(1) implements the requirement stated in Directive 2009/101/EC for publicity regarding the management of a limited liability company.

Re 2) Section 4(1) originates in Article 38(2) of the 8<sup>th</sup> Company Law Directive (84/253/EEC) on statutory audits of annual accounts and consolidated accounts (now Directive 2006/43/EC). According to Article 38, the company as well as the auditor must inform the appropriate authority if an auditor resigns or is removed before the end of term. An adequate account of the reason for such termination of office must be provided by the central governing body. What is implied in "adequate account" depends on the specific situation. The central governing body must further ensure that registration regarding the change of auditor is performed (see further on auditors below in Chapter 12). The trend in Europe is towards exempting small companies from the auditing requirement (see further on auditors below in Chapter 12).

### *Section 3.05*

#### **Time of Registration**

All information to be registered under the EMCA shall be recorded in the Registrars IT system no later than four weeks after the date of the operative resolution, unless otherwise provided by the EMCA.

#### *Comments*

It is important that the registrable information is published as quickly as possible. Thus, there should only be a short time-limit for registration of the registrable information, pursuant to the Sections 1, 2, 3 and 4 above.

Directive 2009/101/EC contains no time-limits for the registration of registrable information. However, the EMCA has chosen a short time-limit of four weeks as stated in this Section. The time-limit is the same concerning both formation and subsequent decisions about registrable matters. An example of a subsequent decision about a registrable matter is a decision of the general meeting regarding changes to the management. If such a change is not registered quickly, there is a risk that former management members can enter into a contract of behalf of the company (cf. the rules on representation).

Not all decisions need to be registered within a short time-limit. For this reason, the EMCA contains longer time-limits regarding decisions about capital increases and decisions about divisions and mergers (cf. Chapters 6 and 13).

#### *Section 3.06*

### **The Register of Companies**

(1) The Registrar shall keep a register of companies registered under the EMCA. All registrations and publications under the EMCA shall be made in the Registrar's IT system.

(2) All information published in the IT system is deemed to have been communicated to third parties save in the case of transactions made on or before the 16th day after the date of publication where it is established that the third party could not have known about the published information.

(3) Information that is required to be registered and published cannot be enforced against third parties until it has been published in the IT system, save in cases where it is established that the third party knew about the information. Third parties are not prevented from relying on information that has not yet been published.

#### *Comments*

Section 5 implements Article 3 of Directive 2009/101/EC.

Re 2) As the information is registered in the IT system, third parties can no longer be in good faith as to the published information (cf. comments to EMCA Chapter 1, Section 4 and EMCA Chapter 3, Section 2 on agreements on behalf of the company). If a transaction is made on or before the 16th day after the date of publication, it will not be deemed to have been communicated if it is established that the third party could not have known about the published information. The burden of proof that the third party could not have known about the published information rests with the third party.

Re 3) Information, which is not duly published cannot be invoked to the detriment of the third party unless it is established that the third party was acting in bad faith (cf. Article 3 (5) of Directive 2009/101/EC).

#### *Section 3.07*

### **Interconnection of Companies Registers**

(1) Through the European system of interconnection of registers, the following particulars should be available across borders:

- (a) the name and legal form of the company;
- (b) the registered office of the company and the Member State where it is registered;
- (c) the registration number of the company;
- (d) the opening and termination of liquidation and insolvency proceedings of the company and the cancelling of a company from the national register; and
- (e) the completion of a cross-border merger or division

(2) The technical requirements for the establishment of a European system of interconnection of registers should be established by legislation or executive orders in the individual Member States. The Member States can choose to make additional information available.

*Comments*

Increasingly, Companies Act beyond national borders by establishing branches and subsidiaries and by engaging in cross-border mergers and divisions. Consequently, there is an increasing demand for access to information on companies in a cross-border context. Directive 2012/17/EC contains rules on the interconnection of national company registers by establishing a system of interconnection of registers, through which central information about the companies in the individual Member States is made available across borders.

This requires that both the individual Member States as well as the EU set up the technical requirements for the establishment of a European system of interconnection of registers. The Directive describes the technical requirements further. These requirements will be different in the various Member States depending on the structure of the registration authorities in the Member States. Therefore, it should be left to the Member States to determine exactly how they wish to apply the technical requirements of the Directive. This is stipulated in Section 7(2).

Section 7(1) stipulates the minimum requirements for the information, which is to be made available. Section 7(1) sums up the requirements enumerated in the Directive's Article 1 concerning the amendments to Directive 89/666/EEC on branches, the Directive's Article 2 concerning the amendments to Directive 2005/56/EC on cross-border mergers, and the Directive's Article 3 concerning amendments to Directive 2009/101/EC on coordination of safeguards.

Directive 2012/17/EC does not refer to cross-border divisions. This is because no directives have been enacted on this subject. However, EMCA Chapter 13 contains rules on cross-border divisions, and information on this is consequently included in the list of mandatory information (see Section 7(1)(e)). As already mentioned, the list of mandatory information in Section 7(1) only contains minimum requirements. Section 7(2) of the EMCA therefore authorizes the Member States to require additional information.

*Section 3.08*

**Electronic Registration**

- (1) A newly formed company shall be registered electronically. A registration that is performed electronically shall be carried out according to the law.
- (2) Access to electronic registration requires an authorization from the Registrar.
- (3) The Registrar may prescribe rules governing electronic registration including:
  - (a) the information which the applicant can, or must, register;
  - (b) the form of the documents to be filed, the requirements of the electronic systems to be used, and the use of electronic signatures;
  - (c) the disclosure of information to the public;
  - (d) fees payable for the performance of any of the Registrar's functions and the provision by the Registrar of any services in connection with any of the Registrar's functions; and
  - (e) conditions for the use of, and registration in, the Registrar's IT system.

*Comments*

Directive 2009/101/EC requires that electronic registration be possible.

Online registration is currently feasible in the majority of Member States, other than Finland, Ireland and Luxembourg. In some Member States, such as Germany, Hungary and Italy, electronic registration is mandatory. There has been a very significant increase since 2014 in Member States which allow online registration. Some Member States allow cross-border online registration (e.g. Estonia, Portugal). The 2014 proposal of directive creating the *Societas Unius Personae* (SUP) was especially designed to facilitate cross-border online registration.

In some Member States electronic registration means only that documents for registration can be filed electronically. The system mentioned in Section 8 of the EMCA goes further as it allows certain qualified users to register in the company's register and thus constitutes real electronic registration. This of course saves a lot of time, but it also requires safeguards against misuse. Such safeguards are stated in Section 8(3). National law may specify or expand the requirements in supplementary regulations to the national Companies Acts.

Section 8 of the EMCA includes a mandatory electronic registration system although the EMCA Group is aware that not all countries currently have IT-systems which would make such a mandatory rule possible. Those Member States may apply a default rule until sufficient IT-systems have been employed. Section 8 is inspired by the Companies Act in Denmark where allows electronic registration which has worked without problems for several years.

Section 8 states that national law determines which persons are permitted to make electronic submissions. This can be restricted to professionals such as lawyers, auditors or notaries but also subscribers and others may be allowed to register. However, the national law should not give freedom to register and change documents without some guarantees being put in place. The guarantee in the Danish system is that those who are able to register must have a license and must fulfil the demands prescribed by the Registrar. Thus, an executive order includes the guarantees chosen by the Danish Registrar. The executive order also includes sanctions for misusing the right to register online. Non-compliance with the duties regarding electronic registration can entail the denial of access to electronic registration and in certain circumstances may lead to civil or criminal liability.

It should be noted that any applicant registering information directly or filing an application for registration in the IT system of the Registrar warrants that the registration or application is lawful, including that the applicant is duly authorized, and that the documentation required for the registration or application is valid (cf. Section 11(2)).

Electronic registration means that the Registrar does not have an opportunity to immediately verify the registration or application. This, however, does not preclude the Registrar from verifying the lawfulness of the registration or application at a later time or on a random basis.

#### *Section 3.09*

#### **The Language to Be Used**

- (1) The Registrar may prescribe rules stipulating the language to be used in the documentation submitted in connection with registrations or applications for registration by limited liability companies.
- (2) The Registrar may prescribe rules stipulating that voluntary registration and publication of company information may also be made in any other official language of the European Union in addition to the statutory publication in one of the languages permitted in paragraph 1.
- (3) If there is any inconsistency between the documents and information that are subject to compulsory registration and publication under paragraph (1) and any translations of such documents and information that have been voluntarily published under paragraph (2), the company cannot rely on the translations as against third parties. However, third parties may rely on the text that has been voluntarily published as against the company, unless it is established that the third party had knowledge of the registrable version published in the IT system of the Registrar. Paragraph (1) does not apply to non-mandatory documents.

#### *Comments*

Section 9(2) and (3) implements Article 4 of Directive 2009/101/EC.

Re 1) It is a matter of national law as to whether languages other than the national language may be used. In connection with the establishment of the interconnection of companies registers (see Directive 2012/17/EC above) the Commission publishes the registered information in all the official languages of the Union (cf. the inserted Article 3(a) of Directive 2009/101/EC). To ease the implementation of the interconnection of companies registers, it would therefore be appropriate to require documentation submitted in connection with registrations and applications to be in, at least, the official languages of the Union.

Re 2) Section 9(2) allows Member States to voluntarily publish registrable information also in one or more of the official languages of the Union. The application must, however, always satisfy the rules stipulating the language to be used, which are set in accordance with Section 9(1).

By allowing Member States to publish registrable information in the official languages of the European Union voluntarily, this can contribute to the promotion of cross-border cooperation by removing the linguistic barriers regarding information searches for companies.

#### *Section 3.10*

### **The Duty to Disclose the Company's Identity**

(1) The company's letters, order forms and other official documents, whether they are in paper form or in any other medium, shall state the following particulars:

- (a) the registration number under which the company is filed in the register; and
- (b) the location of the company's registered office and whether the company form is public or private;

(2) Where, in the documents referred to in the first paragraph, mention is made of the capital of the company, the reference shall be to the capital subscribed and paid up.

(3) If the company has a website, it shall contain at least the particulars mentioned in the first paragraph.

#### *Comments*

Section 10 implements Article 5 of Directive 2009/101/EC.

During the process of formation, the company must make clear that it is not yet registered and add the words "in the process of registration" to its name (cf. Section 2 above).

It should be made clear if the company has entered into liquidation, compulsory dissolution, examinership or bankruptcy.

#### *Section 3.11*

### **The Role of the Registrar**

(1) Information shall not be registered if it does not comply with the provisions made pursuant to the EMCA, or the company's articles of association. The subject matter of any resolution shall not be registered if the resolution has not been passed in accordance with the provisions made pursuant to the EMCA, or the company's articles of association.

(2) Any applicant registering information directly or filing an application for registration in the IT system of the Registrar warrants that the registration or application is lawful, including that the applicant is duly authorized, and that the documentation required for the registration or application is valid.

#### *Comments*

Section 11 does not implement EU legislation.

Re 1) Section 11(1) specifies that the Registrar may request proof that the registered information complies with the law or with the company's articles of association. The Registrar has no general duty to determine whether the registered information or application is lawful. For remedy of defects see Section 12 below.

Re 2) The applicant or the person authorized by the applicant has a special duty to make sure that the information stated in the application is correct, and that the application is in accordance with the subject matter of any decision. The duty involves the applicant or the person authorized by the applicant ensuring that any decision is made in accordance with the relevant legislation, the articles of association and other agreements which in the given circumstances should be considered. The Registrar may carry out spot checks to ensure that electronic registration is lawfully made.

#### *Section 3.12*

#### **Remedying of Defects**

(1) If the Registrar believes that there is an error or defect in any information that has been filed for registration, and the error or defect can be rectified by a resolution of the general meeting or the central governing body of the limited liability company, the Registrar shall set a deadline for the matter to be remedied. If the defect is not remedied within the time stipulated, registration shall not be made.

(2) If registration is refused under paragraph (1), the applicant shall be notified in writing to such effect, including the reason for non-registration.

(3) If the Registrar becomes aware that the legality of any registration, whether pending or completed, is questionable, the Registrar shall discontinue registration under paragraph (1) until the matter has been clarified. The applicant shall be notified in writing that registration cannot take place, including the reason for non-registration. The Registrar shall also publish a statement on its IT system explaining the reason for the decision.

(4) For matters falling within paragraph (3), the Registrar may also register any resignations of the members of the board.

#### *Comments*

Section 12 does not implement EU legislation.

Normally the Registrar does not check electronic registrations, but if the Registrar is made aware that there are errors or defects in any information that has been filed for registration, Section 12 contains rules on the applicant's ability to remedy the errors.

Re 4) Conflicts regarding ownership within the company may occur which could cause disputes about who is able to manage the company and to be registered as the board. In such cases, Section 12(4) makes it possible for the Registrar to register a resignation of members of the board in order to avoid insecurity concerning the right to represent the company.

#### *Section 3.13*

#### **Subsequent Cancellation of Registration**

(1) If anyone asserts that the registration of a resolution passed by the general meeting or the management of a company is detrimental to them, the question of deregistration shall be determined by the courts.

(2) Such legal proceedings shall be commenced against the company within six months of the date of publication of the registration in the Registrar's IT system. The court shall send a transcript of the judgement to the Registrar for publication of the outcome of the case on the Registrar's IT system.

#### *Comments*

Article 12 of Directive 2009/101/EC contains provisions on the nullity of the company. Article 12 makes it clear that the Registrar does not have the competence to decide whether a company can be declared void after registration. Only a court decision can do this (cf. Article 13(a) of the Directive). This principle is stated in Section 13(1).

Section 13(2) sets a deadline for instituting proceedings concerning nullity. Article 12(b) of Directive 2009/101/EC contains an exhaustive enumeration of the circumstances which can cause nullity. Where a person believes that a registration has taken place contrary to the law or wishes to have the registration cancelled, they must apply to the courts who will deal with such claims.

The registration of any given matter such as a decision by the general meeting to change the articles of association is not a guarantee that the matter is lawful. Legal proceedings regarding lawfulness can be taken by the shareholders according to the rules in Chapter 11. Such a legal proceeding does not, however, affect the issue regarding the validity of the company. The same should apply to part of the grounds, which according to Article 12(b) of the Directive *can* cause nullity of the company. The EMCA Group considered the grounds provided in Article 12(b) and it is of the opinion that most of the grounds should not give rise to the company's nullity but only lead to the remedying of the defects. This applies to defects regarding the Instrument of Incorporation or entries in the articles of association regarding name, the size of the subscribed capital and other procedural defects in connection with the formation. It also applies to the provision in Article 12(b)(vi) concerning the number of subscribers. (This provision is not necessary, as Chapter 2, Section 1.02 states that only one subscriber is necessary.)

Consequently, the EMCA contains no special provisions on situations where a company should be declared null and void. As a result thereof, the EMCA does not contain provisions on the effects of the nullity. However, it does not prevent a situation where a company post registration can be declared null by a court decision. Article 13 of the Directive 2009/101/EC contains rules in such a case and makes it clear *inter alia* that the nullity shall entail the winding-up of the company as may dissolution. Likewise nullity itself will not affect the validity of any commitments entered into by or with the company, without prejudice to the consequences of the company being wound up.

## **CHAPTER 4**

### **FORMATION BY TRANSFORMATION AND RE- REGISTRATION**

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## General Comments

### 1. EU law

Article 15 of Directive 2012/30/EU on capital requirements of public limited liability companies (replacing the former 2<sup>nd</sup> Company Law Directive 77/91/EEC) states that “*pending coordination of national laws at a subsequent date, Member States shall adopt the measures necessary to require provision of at least the same safeguards as are laid down in Articles 2 to 14 in the event of the conversion of another type of company into a public limited liability company*”.

Directive 2012/30/EU solely deals with re-registrations from other entities to a public company. The Directive does not regulate re-registrations from public companies to private companies, nor re-registrations from public companies to other entities.

### 2. National law

Chapter 4 applies to a number of different situations.

First, the Chapter deals with the question of whether different kinds of legal entities including partnerships, co-operatives, mutual insurance associations and other forms of private associations as well as public entities may be transformed into private or public companies. The situation differs in the various Member States. In many Member States, transformation of partnerships and co-operatives is possible (Denmark, France, Finland, Germany, Greece, Luxembourg, Poland and Spain). In other Member States, certain entities such as partnerships (e.g. Austria and the Netherlands) and agricultural entities (e.g. Belgium) cannot be converted. In the majority of Member States, transformation of certain kinds of associations or legal entities, are governed outside national Companies Acts. This applies, for example, to transformation of financial institutions/associations which are governed by other legislation. In addition, foundations by nature cannot be transformed to public or private companies (they do not have an owner). In all Member States, companies can be formed either by incorporation or by transformation of other entities other than public or private companies. See further below in Section 1.

Second, the Chapter deals with re-registration of companies. Re-registration means an alteration of status when a private company decides to re-register as a public company and when a public company decides to re-register as a private company.

### 3. Considerations

The EMCA Group has decided that the EMCA should not include any limitations as to whether legal entities can be transformed into a private or public company. Such limitations should be found in national legislation governing these entities.

National law is different regarding which entities can be transformed into a public or private company. Therefore, the EMCA cannot choose the same rule for all Member States.

More Member States have rules on re-registration from public or private companies to other company forms, such as partnerships, cooperatives etc. The EMCA does not deal with these situations because of the disparity in treatment in national laws.

*Section 4.01*

**Formation by Transformation**

(1) Unless otherwise provided by national law or the entity's articles of association, any legal entity may be transformed into a public or private company taking in account the relevant provisions of the EMCA on formation.

(2) The transformation should be considered as an in kind payment of the share capital and as such must fulfil the requirements of Section 24 of the EMCA.

*Comments*

Re 2) Section 1(2) only applies to situations where a contribution in kind takes place. This is consistent with Article 15 of Directive 2012/30/EU on capital requirements of public limited liability companies which determines that “*pending coordination of national laws at a subsequent date, Member States shall adopt the measures necessary to require provision of at least the same safeguards as are laid down in Articles 2 to 14 in the event of the conversion of another type of company into a public limited liability company.*” This means that the safeguards in EMCA Chapter 2 on valuation, information and demand for a prospectus apply.

*Section 4.02*

**General Provision**

A private company can be re-registered to a public limited company and vice versa. Re-registration of a company will not alter the legal personality of the company.

*Comments*

Section 2 confirms that the re-registration of a company will not alter the company's legal personality. Thus, following re-registration and notwithstanding the issue of a new certificate of incorporation to reflect the altered circumstances, the entity continues in existence without any loss of legal continuity and with its rights and obligations entirely unaffected.

*Section 4.03*

**Private Company Becoming a Public Company**

(1) The shareholders may, with the same majority required to amend the articles of association, resolve to re-register a private company into a public company.

(2) Re-registration of a private company into a public company will be deemed to be implemented when the company's articles of association have been amended to comply with the requirements for public companies and when the re-registration has been registered in the Registrar's IT system.

(3) The rules on minimum capital, contributions in kind, acquisitions after registration and other applicable provisions in the EMCA Chapter 2 also apply.

*Comments*

Re-registration from a private company to a public company must involve fulfilment of the requirements set out in Article 15 of the Directive 2012/30/EU, see above. Thus, all the safeguards in EMCA Chapter 2 apply, including Section 11 on contribution in kind and Section 13 on acquisitions after registration. Further, the requirements for minimum share capital must also be fulfilled. To re-register a private company as a public company, all the requirements in the EMCA concerning public companies must be complied with and any necessary changes to the articles of association must be made. The re-registration may be implemented without the consent of creditors.

*Section 4.04*

**Public Company Becoming a Private Company**

- (1) The general meeting may, with the same majority required to amend the articles of association, resolve to re-register a public limited company into a private company. The re-registration may be implemented without the consent of creditors.
- (2) Re-registration of a public company into a private company will be deemed implemented when the company's articles of association have been amended to comply with the requirements for private companies and when the re-registration has been registered in the Registrar's IT system.

*Comments*

The re-registration of a public company to a private company entails the company after the re-registration being subject to the requirements of the EMCA regarding private companies. In some ways, these requirements are more flexible than the requirements regarding public companies, for example, with respect to the requirement for a minimum capital. The company must make all necessary changes to the articles consequential on the change in the company's status.



## CHAPTER 5 SHARES

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## General Comments<sup>43</sup>

### 1. EU law

The EU company law Directives do not contain many rules that limit the discretion of national regulators in respect of shares –particularly so in the case of private companies but also for public companies.

#### *1.1. Nominal value and accountable par*

It is sometimes argued that the 2<sup>nd</sup> Company Law Directive forces Member States only to allow for their public companies either nominal value shares or par value shares. This would mean that true no par value shares would therefore not be allowed. It seems that there was a view in the UK during the developmental stages of the Companies Act 2006 that true no-par value shares could not be introduced because of the Directive. This interpretation of the directive is almost certainly wrong. Nowhere does the Directive contain an explicit rule concerning nominal or par value. The argument that there is a requirement to choose between nominal value and par value is usually derived from the provision in Article 8 of the Directive: “Shares may not be issued at a price lower than their nominal value, or, where there is no nominal value, their accountable par.” The concept of accountable par was introduced into the Directive of 1976 because since 1913 Belgium had allowed shares with what Belgian legislation described as a “fractional value”. Whatever the original intention of the Belgian legislator, this type of shares has long since evolved into a true no par value share system in all but name and with some procedural complications. Since the 2<sup>nd</sup> Company Law Directive is based on the Belgian system, it seems fair to argue that the Directive does allow true no par value shares. This has in any case been the interpretation of the Finnish legislator, who introduced such shares, also for public companies, in the new 2006 Finnish Companies Act.

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<sup>43</sup> The working group on Chapter 5 was chaired by Professor Hans de Wulf (University of Gent, Belgium).

It may be useful to briefly illustrate the Belgian system with an example. Suppose a company has a legal capital of 1000 divided into 100 shares without nominal value. The par value/accountable par/“fractional value” of these shares is “1/100th” of capital, in this case: of a legal capital of 1000 which can also be expressed as 10. In a true no par value system, this “10” can change over time even while the 1/100th stays the same, or additional shares can be issued and each share will be deemed, as a rule, to represent 1/nth of the legal capital, “n” being the total number of shares that has been issued. The Belgian system is a true no par value system, but procedurally more complicated than systems that were true no par value systems from the 1<sup>st</sup> Article. Suppose our model company wants to perform a capital increase because it needs new funds as a result of losses, and the company has found an investor willing to provide those funds. Assume that the net asset value of the existing 100 shares is lower than legal capital (because of the losses), say it is 800, i.e. 8/share. Assume the new investor is prepared to buy 100 additional shares at a price of 8 per share. Under Belgian law what will happen is that the company increases its share capital through a decision of the general meeting to 1800, represented by 200 shares (100 old ones, 100 newly issued). For a legal second, the company will have two groups of shares (not considered classes in the legal sense by Belgian law): one group representing the original legal capital and with a fractional value of 10 and the group of newly issued shares with a fractional value of 8. Immediately after approving the principle of the capital increase, the general meeting will take a second decision, unifying both groups of shares. This will result in a legal capital of 1800 divided by 200 shares with an accountable par/par value/ fractional value of 9 each. Since each share represents an equal fraction of legal capital, they will normally have the same rights (Belgian law provides that in public companies, voting rights are mandatorily proportionate to fractional value; for profit rights this is merely the default rule). All that needs to happen for this transaction to be lawful under Belgian law is that (a) the general meeting, not the board using authorized capital, must take the decision (b) as indicated, the general meeting must explicitly decide to unify the two categories of shares (c) the board must present a report to the general meeting in advance of the general meeting deciding on the capital increase in which it explains the financial implications of the transaction for present and future shareholders. The only - unimportant- differences between the Belgian approach and an approach in which par value/ accountable par plays no role at all are that, first, under such a true no par value system, there is probably no need for a general meeting decision unifying the two categories of shares – but note that under Belgian law, too, these categories are not seen as classes and their unification therefore does not need to happen under the rules for unification of or changes to class rights- and second, that under a true no par value system, the rights attached to shares are not even theoretically linked to the par value/accountable par of the share but are, as a rule equal for every share (whereas in Belgium this equality theoretically takes the form of proportionality between rights and fractional value/accountable par, with the rule being mandatory for voting rights).

It is important to note that since the Directive allows the Belgian system, and the Belgian system is a true no par value system in all but name, true no par value systems cannot be deemed incompatible with the 2<sup>nd</sup> Company Law Directive. EMCA proposes to adopt such a system.

### ***1.2. Equality***

The principle of equality is expressed in Article 46 of the 2<sup>nd</sup> Company Law Directive for public companies, and in Article 4 of the 2007/36/EC Shareholder Rights Directive for listed companies. Article 46 states: “*For the purposes of the implementation of this Directive, the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position.*” This is essentially an anti-discrimination provision. It does not mean that shareholders should all have the same rights. On the contrary, the default rule in corporate law is that rights are proportionate to investment, leading to albeit proportionate inequalities. More importantly and to the point, the rule of equality in the directives does not preclude disproportionate shareholder rights (preferential dividends, multiple voting rights, non-voting stock). It is nothing more than a ban on discriminatory treatment of shareholders by the company (and hence company organs like the board). The European Court of Justice has ruled that EU company law does not contain a general principle of equal treatment of (minority) shareholders, only discrete (but important) illustrations limited to specific situations such as, in the 2<sup>nd</sup> Company Law Directive, capital increases and capital reductions.<sup>44</sup>

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<sup>44</sup> ECJ, 15 October 2009, case C-101/08, Audiolux and others v. GBL and others, Bertelsmann AG and others.

### *1.3. Voting rights*

There is no EU legislation regarding classes of shares. Under Internal Market Commissioner McCreevy (2004-2010), the Commission considered the issue of one share/one vote and for a while considered making this rule mandatory for listed companies. In 2007 several studies of the issue, commissioned by the EU Commission were published<sup>45</sup> and based on these and the feedback from stakeholders, the Commission decided to drop its plan for legislation in the area. Even for listed companies, no convincing rationale could be found for an across the board enforcement of a one share one vote rule. EMCA therefore favors allowing multiple voting rights.

### *1.4. Transferability of shares*

The 2<sup>nd</sup> Company Law Directive mentions restrictions to transferability. Article 3 of the Directive contains a provision stating that either the instrument of incorporation or the articles of association must include information concerning any restrictions to transferability. Article 3 also states that the instrument of incorporation or the articles of association should decide the form of the shares. However, there is only a duty to provide information on the restrictions in question and not substantive restrictions. The question of restrictions is thus regulated by national law.

Directive 2004/25/EC on Takeover Bids contains rules on squeeze-out and sell-out. Article 15 and 16 contain rules on the rights of squeeze-out and sell-out for offerors and offerees, respectively. The rules in Article 15 apply where the offeror holds securities representing not less than 90 % of the capital carrying voting rights and 90 % of the voting rights in the offeree company. According to the Directive, the rules apply only to companies whose shares are traded on a regulated market.

### *1.5. Information on shareholders*

Regarding registration and publication of information on shareholders, the 2007/36/EC Shareholder Rights Directive contains provisions on the company's register of shareholders, see Article 13. The Article requires inter alia a list disclosing to the company the identity of each client and the number of shares voted on his behalf (power of attorney). The provision deals with the shareholders' exercise of voting rights at the company's general meeting (see the EMCA Chapter 11 on general meeting.)

Regarding shareholder identification there are two main approaches. First, there is a need to provide investors with information on ownership of the company. This is needed especially in listed companies in order to clarify the ownership structure for all involved so that creeping acquisitions of control are prevented and investors know what type of power structure they are buying into. Article 10 of the Takeover Directive is crucial in this respect as is the disclosure requirements of the Transparency Directive 2004/109/EC. Article 12 of the latter contains provisions which force the shareholders owning major holdings, i.e. 5, 10, 15, 20, 25, 30, 50 and 75 % of the voting rights to notify the company of the acquisition or disposal of shares (cf. Article 9 and the following). The Transparency Directive applies to companies traded on a regulated market. Therefore, the Directive is usually implemented in the Member States' securities laws.

The second approach is the company law approach. The question is whether the company and the shareholder need mechanisms to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues, and further to enhance the shareholders' possibilities to safeguard their interests in relation to the company. There are currently no rules on this at EU level but the amendments to the Shareholder Rights Directive adopted in 2017 will introduce rules on "shareholder engagement" which seek to foster a long term approach by shareholders to their relationship with companies. As part of this approach, the Directive also will introduce in Member States law additional measures to allow companies to identify their shareholders, so that effective communication between company and shareholders would be enabled.

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<sup>45</sup> See [http://ec.europa.eu/internal\\_market/company/shareholders/indexb\\_en.htm](http://ec.europa.eu/internal_market/company/shareholders/indexb_en.htm)

## 2. National law

Shares may have different form and contents. Shares may be registered shares (name shares) or bearer shares. Further, the shares may either be transferable or non-transferable. Shares may be dematerialized or non-dematerialized. If shares are dematerialized, they are issued through a special register and therefore they are not paper-based. Shares, which are not dematerialized, may be issued using a share certificate (ie paper-based) or without issuing certificates. In some Member States, for example Denmark, it is possible to issue share certificates in respect of registered shares as well as bearer shares conditioned so that they are not dematerialized.

In the majority of Member States, shares in private companies are uncertificated (ie not paper-based), with the managing directors/board of directors generally assuming responsibility for maintaining a share/shareholders' register. In Denmark, Finland, Germany, Greece, Lithuania and Sweden, it is possible for company shares to be certificated (though in practice this is rarely done) whilst certification of registered shares is the norm in private companies in the UK and those Member States with Anglo Saxon legal roots. Bearer shares issued by private companies in the EU are uncommon and are possible only in a small number of jurisdictions. For example, bearer shares are not allowed – in private as well as public companies - in Sweden, the Netherlands and Belgium.

The majority of Member States allow domestic public companies to issue either registered or bearer shares. However, they vary as to the certification requirements. While there are Member States providing for obligatory or voluntary certification, other Member States, such as France (since 1981) – or in case of a traded company – Sweden and the UK, oblige traded companies to have dematerialized shares.

A large number of Member States permit shares in a private company to be transferred only by way of a notarial deed or in written form with signatures certified by a public notary, whilst the remaining Member States do not require such a level of formality and allow shares to be transferred pursuant to simple agreements or written declarations. It is often the case that the company must, as a minimum, be notified so that the relevant share/shareholders' register can be updated (e.g. France, Germany, Greece, Lithuania, Luxembourg, the Netherlands, Poland, Slovenia, and Slovakia). Many Member States allow the articles to set out the exact mechanisms of transfer, and in some cases, to adopt a more relaxed (e.g. Czech Republic) or stricter (e.g. Austria, Belgium, and Italy) approach than provided by law.

The transfer requirements regarding shares in public companies are more varied and can differ substantially from Member State to Member State. Probably the greatest similarity in approach lies with bearer shares, when they are not dematerialized, where physical delivery of the certificate will generally be sufficient to transfer title. In Germany, where certification is obligatory, the individual unregistered shares will normally be represented by a global share certificate which is held by a depository and in which case the individual share will be transferred by way of the assignment of a delivery claim against the depository. The transfer of registered shares can be effected in most Member States through endorsing the certificate (e.g. Austria, Czech Republic, Germany, the Netherlands, Poland, Slovakia and Slovenia) whilst other Member States (e.g. Greece) allows transfers to be effected by way of a simple transfer document which, in contrast to the general position for private companies, does not need to be notarized. Dematerialized shares may be transferred by written agreement and, in almost all Member States the transferor or transferee must ensure that the share register is updated.

The company laws in all Member States include provisions which demand the company to keep a share register. There are substantial differences regarding the contents of and the access to the register (shareholder identification). This is both related to the question of whether companies are allowed to issue name shares/bearer shares and who has access to the register. As mentioned above, the company may choose to issue either registered shares or bearer shares. If the company issues bearer shares, the identity of the shareholder does not appear from the register.

Most Member States' Companies Acts include a provision which states that shares in principle are freely transferable for public companies while the transfer of shares in private companies require approval by the board or by the shareholders in some Member States. To some extent, all Member States also allow restrictions on the transferability of shares. However, there are substantial differences regarding which restrictions are allowed. Thus, on the one hand the Danish Companies Act (Section 48), the Dutch Companies Act (Section 2:195, for private companies) and the UK Companies Act allow all restrictions, whereas for example Finland and Sweden only allow limitations which are explicitly provided in the law (in Sweden post-sale purchase right, right of first refusal and consent clause). In Greece (Article 3 of the Companies Act) all restrictions are allowed, provided that the transfer does not become totally impossible. In Belgium the rules (see Article 510 Companies Act for public companies) vary depending on the kind of restriction and some have to be compatible with the interests of the company, others are restricted in time and still others are unregulated and therefore permitted).

Generally, it is recognized in the company law Directives that there can be varying voting rights attached to the different kinds of shares, including non-voting shares. However, there is no actual EU regulation on either non-voting shares or possible limitations to the issuance of non-voting shares. Issuing non-voting shares as well as creating larger voting differences than 1/10 is allowed in accordance with the rules of most Member States. The EMCA Group is of the opinion that the EMCA should allow non-voting rights as well as voting differences of any kind.

The shareholders' exercise of voting rights at the company's general meeting will be dealt with in Chapter 11 on general meeting.

The articles of association may include provisions on redemption. It is voluntary for companies to include provisions on redemption and in order to redeem shares, the articles of association must include provisions specifying the terms of redemption. There is difference between redeemable shares and rights of squeeze-out. As noted earlier provisions on squeeze-out/sell-out give major shareholders a right to squeeze out minority shareholders and the minority shareholders a right to sell out their shares. Such provisions are, according to their nature, mandatory and should therefore be included in the EMCA. Rights on squeeze-out and sell-out are found below in EMCA Chapter 11 and there is also a reference to them in Chapter 15 on groups since they are part of the regime on groups.

### 3. Considerations

The EMCA grants the companies the freedom to choose the capital structure and share structure they want. Companies should be free to choose their financing structure and should be allowed to issue a whole range of financial instruments to finance themselves. The EMCA Group is of the opinion that there should be no *numerus clausus* for issuing new types of financial instrument, nor a system of state (sponsored) oversight of financial instruments. In other words, no permission should be needed to create new instruments; this should be left to the market and freedom of contract. New types of debt instruments in particular can be created as long as the new instrument does not contravene mandatory rules in existing (civil) law.

The present Chapter only deals with shares, that is bundles of membership rights issued (as a rule) in exchange for a contribution. These rights almost always entitle the holder to a share of the profits of the company and often, but not necessarily always, give governance rights to the holder especially voting rights at the general meeting of shareholders. The Chapter does not deal with bonds or other debt instruments or convertible and mezzanine financial instruments. It also does not deal with what constitutes valid consideration for shares, nor does it contain rules on the minimum amounts to be paid up upon issuance of shares. This is dealt with in the Chapter on formation.

The main questions facing someone regulating shares are

- To what extent should companies be free to determine the rights attached to the shares and especially whether multiple voting rights are allowed? Should the rights be proportionate to the percentage of legal capital a share represents? This latter question only makes sense in an environment where at least limited liability companies have legal capital and where shares have a par value, which is still an important concept in Europe. What, in this context, is the exact meaning of the concept of "class" of shares and how should one deal with changes to class rights? What indeed exactly is a change to class rights?

- Should shares have a par value or are true no par value shares along the Finnish and US (Delaware) model allowed?
- What forms can shares take? Is it a good idea to still allow bearer shares or should all shares be registered in someone's name? Should one allow paper share certificates or even make them mandatory? What about book-entry shares (“dematerialized”, “electronic” shares)?
- Are there reasons to limit the possibility of articles of association or perhaps also shareholder agreements to limit the free transferability of shares? Should there be mandatory statutory limitations to the free transfer of shares in private companies/companies that legally are considered “close(d) companies”?
- Should certain countries allow either the company or the shareholder (in certain company types) to redeem shares in the sense that the shares will be annulled and their value will be paid out? Is it wise policy to provide for redeemable shares and under what circumstances?

In addition there are of course many practically important but less fundamental questions, such as how to deal with cases where several persons claim to have – or legally have – voting rights based on one and the same share e.g. spouses or cases of beneficial ownership; what the value of the share register is in ownership disputes (does the register create presumptions about civil law ownership, or only about who can claim to be a shareholder and therefore exercise the rights attached to the share ?); and how someone can prove that he or she is a shareholder/ can exercise the rights attached to shares in order to attend the annual or other general meetings.

When dealing with these issues, two guiding principles have animated the work of the EMCA Group:

- Contractual freedom, that is freedom to deal with issues in the articles of the company, should be the starting point and the default position, and should only be limited when there are clear indications that the interests of stakeholders (from shareholders, managers and workers to the State and public interest because of for example environmental implications) need to be protected; this is especially true regarding the rights, including voting rights, attached to shares and their transferability
- As a rule, Companies Acts should not deal with civil law in the sense of (primarily) contract and property law concerning transactions in which the company is involved; specifically, this means EMCA does not deal with the contractual aspects of share transfers but does, on the other hand, determine the conditions under which a share transfer can be relied upon against the company and clarifies that the share register is not an instrument to prove ownership of shares, but simply creates a presumption that someone registered as shareholder in that register is presumed to be the shareholder and can therefore exercise the rights attached to the shares
- In addition to these guiding principles, it should be borne in mind that EMCA as a model Companies Act does not purport to deal with securities regulation/capital markets law, nor with all kinds of regulatory rules that can be seen as flanking measures of corporate law and that are often intended to combat abuses in the area of tax or social security or economic crime. Often these rules regulate economic activities, whereas the focus of Companies Acts is to be organisational law, which is an additional reason (in addition to maintaining legibility of Companies Acts) for not incorporating these rules into Companies Acts. Hence EMCA does not contain rules mimicking rules on shareholding transparency as set forth in the Transparency Directive, rules on transparency with a view to combating money laundering or rules on the organization of the (national) central securities depository that is the central node in the system of transfer of book-entry (“electronic”, “dematerialized”) shares. We do acknowledge that some Member States take a different approach. For example, in Denmark the rules in Directive 2005/60/EC on money laundering have been partially implemented in the Companies Acts (Article 55 on notification of major share holdings). But the EMCA Group thinks it is better to deal with such issues outside the Companies Act and in any case it is, as indicated, not the purpose of a model act to deal with these issues. In the same vein, as a rule EMCA does not contain rules specific to listed companies, for instance rules on shareholder engagement similar to what is being proposed in the aforementioned amendments to the Shareholders' Rights Directive.

*Shareholder identification*

As noted above, there is currently a European and world-wide debate about shareholder identification and particularly about identifying the ultimate owner/beneficiary of shares. This has to be seen against the background of an increased desire to combat tax evasion, corruption, money- laundering and financial fraud. In June 2013 the G8 leaders agreed on a set of principles on beneficial ownership transparency. These were followed by FATF –Financial Action Task Force, the international anti-money-laundering standards body- “Guidance on Transparency and beneficial ownership (October 2014) and the “High level Principles on beneficial Ownership” adopted by the G20 in November 2014. More concrete and specific action was undertaken by the UK with its March 27 2015 ”Small Business, Enterprise and Employment Act 2015” which organizes a public register listing the beneficial owners also of private companies (as well as requiring that company directors are natural persons). Denmark has announced plans for similar legislation and the 4th EU Anti Money Laundering Directive of 2015, adopted the obligation for all EU Member States to organize a register where all corporate entities will have to file information about beneficial ownership (see Article 30 of directive (EU) 2015/849 of 20 May 2015). For the same reasons, there has been worldwide pressure on the use of bearer shares (at least in physical form), and some Member States have either, like Belgium, completely outlawed the use of bearer shares, or limited their use to public companies (where free transferability of shares, which, outside a system of book-entry shares, is easier with bearer than with registered shares). EMCA does not deal with administrative, regulatory rules that impact companies but are not part of organisational law and therefore contains no rules on ownership transparency. The EMCA Group considered advocating a ban on bearer shares along the Belgian model, but in the end refrained from doing so because in several countries a deep attachment to bearer shares exists, based notably on the protection of privacy, at least for certain company types. It remains to be seen whether this will survive the international regulatory tide. For the time being, the Group thinks a balance can be struck between the desire for more transparency while still allowing bearer shares by a system of mandatory disclosure of large (more than 3 or 5 %) shareholdings, as it has been organized for listed companies by the EU Transparency Directive. Such a system could be expanded to non- listed, including private companies.

*Section 5.01*  
**Definition of Share**

In this Act, “Share” means an equity participation entitling the holder to be a member of the company.

*Comments*

EMCA tries to adopt a definition of “share” which is as neutral as possible without being completely devoid of meaning.

The definition is neutral in that it does not define which rights a share must at a minimum entail for its holder. For instance, since in certain countries companies must always be for profit whereas in other jurisdictions companies may be non-profit entities, the definition does not refer to an entitlement to part of the profits generated by the company (i.e., in the first place, declared dividends) as an essential feature of any share. Some shares may be non-profit-sharing, others may have no voting rights. The Dutch law on closed companies provides that shares in such a company (“B.V.”) must at least either entitle the holder to a vote, or to a part of the profits. The aim of the reference to “membership” in the EMCA-definition is similar: it is impossible (and useless) to create shares to which no rights at all are attached. But the definition leaves it to national legal systems to determine what the minimum content of membership rights should be.

Entitlement to membership of the company is the first essential feature of any share. The second is that the share represents equity, the claims of which on the company’s assets are subordinated to those of debtholders. Both in finance and accounting and in a legal context, an essential distinction is made between equity and debt instruments. Of course there are many securities that have features of both debt and equity, or that can be converted from debt into equity, or of which it is difficult to determine whether they should be regarded as debt or equity (“mezzanine finance”). The distinction between debt and equity is fundamental nevertheless. Essentially, holders of equity do not have the right to claim any assets or pay-out of the company for which they can take the unilateral initiative. Normally, the shareholders have no right to receive back their contribution as long as the company exists without complying with the procedure of reducing the share capital or the procedure of liquidation. Certain types of preference shares with fixed claims and “redeemable shares” are the most important exceptions to these rules, hence debates about whether such shares should be regarded as debt for accounting or certain regulatory purposes. In any case, any claim to the company’s assets that a shareholder might have, is subordinated to that of debt-holders.

Securities that receive a pay-out or at least claim that is not conditional on the company making an accounting profit are, as a rule, debt instruments. This is also the case regarding so-called profit sharing debt instruments, see EMCA Chapter 6, Section 16. An important legal consequence of the distinction between debt instruments and shares is that the issuing of shares should be decided by the general meeting of the company while issuing debt instruments as a rule is decided by the board of the company.

Under certain circumstances, at least in certain legal systems, it is possible to create new shares without any additional contribution being made to the company, or even without an increase in its equity. That is why the EMCA does not define a share as a security issued in exchange for a contribution to the company’s equity. Nevertheless, this conforms to the usual definition of share and the most common way of creating shares. All shares in any case “represent” equity –and this would be the case even in a legal system without legal capital–in that (a) they do not represent debt and (b) they almost always entail a contingent claim on a part of any positive liquidation surplus that may exist when the company has been liquidated.

Section 1 only defines “share” and does not deal with other securities that companies may issue. The EMCA Group is of the opinion that companies should be allowed to issue all types of equity and debt instruments that are not outlawed by the laws applicable to the company. In other words, there is no “*numerus clausus*” concerning securities. This Chapter only deals with shares and therefore does not contain any rules on other types of securities, hence also no definitions. EMCA Chapter 6, which deals with financing techniques, does contain some rules on debt securities (but not on straight loans that do not take the form of debt securities).

The definition in Section 1 applies the English term "shares", which is also applied in the UK Companies Act 2006 as a term for shares in both public and private companies. In a number of Member States, there are different terms for shares in private and public companies, respectively. Thus, for example, the German Companies Act uses the term "*Anteil*" for shares in private companies and "*Aktie*" for shares in public companies. The same is the case in Denmark, which uses the term "*anpart*" for shares in private companies, and the term "*Aktie*" for shares in public companies. In France, shares in private companies are called "*Parts sociales*" while shares in public companies are called "*Actions*". In Greece shares in public companies (SAs) are called "*μετοχές*", whereas shares in private companies, namely limited liability companies (Sarl) and the more recent "private companies" (IKE), are named "*εταιρικά μερίδια*". Such terminological distinctions have little relevance and are mainly explained by the fact that when public companies in their modern form were created, in most countries, in the 19<sup>th</sup> century, the free transferability of their shares was a novelty. In addition, these shares were then novel forms of securities (in the sense of the German "*Wertpapier*", French "*valeur mobilière*") which incorporated the rights of the holder/beneficiary/owner to an extent that was not true to the holders of shares of closed companies, where the personal bond between shareholders was deemed more important and where the transfer of the rights entailed in shares was to a larger extent governed by civil law than in public companies, where the shares themselves fully incorporate the rights and duties associated with them.

Belgian and Dutch companies have a practice of creating "*aandelencertificaten*", literally translated "share certificates" but perhaps better called "share depositary receipts" (SDRs-, although they are not to be confused with the SDRs issued to allow non-American issuers to get exposure to investors on American stock exchanges without listing their actual shares there). They are securities created on a contractual basis when a shareholder swaps his shares for the SDRs issued by the foundation or other entity that will henceforth hold a stake in the company that issued the original shares. Institutional investors do not like these SDRs in listed companies, but they are quite often used in both private and public companies, including in listed companies, and can be very useful for example to deal with family succession issues. They are used, among other things, to split up the voting rights attached to shares and the financial rights. The issuer (typically a foundation) of the SDR is a shareholder in a company, and therefore its board determines how to vote the shares it owns. Dividends are also paid to the issuer, but the issuer has a contractual obligation to immediately pay them through to the receipt holders (former shareholders). The issuer is fiscally transparent (payments to it by the company are tax neutral as a result of Belgian and Dutch legislation).

The EMCA Group has considered whether the EMCA should have a provision on SDRs, but it decided not to deal with SDRs as the use of SDRs would require that other national laws such as tax laws would possibly need to be changed. This should not be interpreted as a limitation of the practice of SDRs, which the Group feels should be allowed.

Some Member States also have special kinds of non-debt instruments called, in Belgium, "*winstbewijs*" / "*Part bénéficiaire*". The same instrument exist also in Luxembourg company law, while France (where they were known as "*Parts de fondateurs*") prohibited their issuance in 1966 because of previous abuses. These are "shares" which someone receives in exchange for a contribution that is not booked as capital. Hence the rules on capital formation do not apply when these "shares" are issued (e.g. no independent expert valuation of contribution) and the rights attached to these "shares" are, within the limits set by the Companies Act, determined by the articles, and not in relation to the share of the capital they represent (since they do not represent any fraction of the capital). The EMCA Group does not see the need for such shares especially since EMCA has opted for no-par value shares whose rights are determined in the articles anyway.

*Section 5.02*

**Types of Shares: Bearer and Registered**

- (1) A company may issue the following types of shares:
  - (a) Registered shares: shares that are registered in the company's share register in the name of the shareholder.
  - (b) Bearer shares: Shares not registered in a shareholder's name in the company's share register.
- (2) The articles of incorporation indicate which type of shares, registered or bearer, the company may issue. A company may simultaneously issue or have shares of two different types.
- (3) As long as a share has not been fully paid up, it must take the form of a registered share and will be treated as such.

*Comments*

Re 1) This Section deals with types of shares – registered or bearer – not with the form of shares, which is dealt with in Section 3. Both registered and bearer shares can be issued as paper certificates or as dematerialized shares, meaning they are book-entry securities whose existence is only apparent from a securities account.

This combination will seem odd to lawyers from certain countries, where registered shares cannot, by definition, exist in any material form such as a paper certificate, and where dematerialized shares in the sense of book-entry shares are not a form but a type of share, next to bearer shares and registered shares. Belgium is a good example. Until a few years ago, Belgian public companies could issue two types of shares. The first was registered shares, whose owner is registered in the share register, that are transferred by changing the share register and that cannot be issued in paper form. The second form was bearer shares which had to take the form of paper certificates and circulated through transfer of the paper and which incorporated all the rights of the shareholder. Bearer shares could be “immobilized” by a system also used by many non-Belgian listed firms who used Euroclear as an intermediary. Under this system, one global paper certificate was created upon issuance of the shares, but the shares were actually held in dematerialized form in securities accounts. They could, however, be printed on demand. The law was then changed and bearer shares were abolished in order to combat money laundering and tax evasion. Simultaneously, true dematerialized shares were created, i.e. shares that have from the start been created in a securities account, without any paper global certificate, and that are transferred from one securities account to another. The idea that bearer shares do not exist in paper form, and especially the idea that registered shares can take the form of paper certificates, is not only strange but also confusing to a Belgian lawyer, since in case of registered shares it makes it possible to transfer the paper certificate without transferring the share, namely in case the share register is not adapted. Nevertheless, in view of the practice in several of the leading jurisdictions in Europe, the EMCA Group favors the system presented here.

Registered shares are “nominative” shares: they are registered in the name of someone (a natural or legal person) in the share register. When they are transferred, the share register will have to be adapted and as a consequence the share transfer can be relied upon against the company and third parties. (See Section 11 where it will be made clear that, under EMCA, the share register does not determine who is the owner of a share, nor is the transfer brought about by the registration: the registration's purpose and effect is to make the transfer reliable against the company and third parties; and transfer of ownership is governed by the regular rules of civil law, not by company law). If paper certificates representing the registered share are issued, these certificates will mention the name of the shareholder. The certificates do not incorporate the share, that is, the rights and duties of the shareholder. Therefore, the transfer of the paper certificate is not as such a transfer of the share: the share is transferred in accordance with the rules of civil law (contract, donations, property law, etc.) and can be relied upon when the share register has been changed accordingly.

Bearer shares are not registered in anyone's name. They are not mentioned in the share register. See Section 14 for the rules on their transfer. If they take the form of paper certificates, the paper incorporates the rights that the share entails. The regular rules of civil law in the Member State determine how ownership is transferred, but the transfer can only be relied upon if the paper has been transferred and conversely, there is a rebuttable presumption in favor of the holder of the paper that he/she/it is the owner of the share. If a bearer share is dematerialized, there are no paper securities, just book entries. The transfer of ownership takes place in accordance with the regular rules of civil law. The transfer can only be relied upon if the transfer has been performed through the securities clearing system, i.e. when the securities account of the acquirer has been credited with the book-entry shares.

EMCA allows bearer shares because the EMCA Group thought it premature to outlaw them: they are still part and parcel of the legal systems of many Member States. However, as indicated in the Introduction to this Chapter, there is a general trend towards more transparency about who a company's shareholders are, also in unlisted companies. For the enforcement of various regulations, it is important to know the identity of the ultimate owners of company shares. This is relevant for example in the fight against money laundering, tax evasion or simply the enforcement of criminal law against organizations that try to hide the criminal nature of the controllers of certain companies. The EMCA Group would therefore in fact welcome the complete abolition of bearer shares, following the examples of Belgium, Sweden and certain other Member States. However for the reasons indicated in the Introduction to this Chapter, the EMCA Group deemed it too soon to actually propose this in the text of the EMCA. Some within the EMCA Group suggested the outlawing of bearer shares for private companies, since in private companies shares are not meant to be publicly traded and bearer shares would be mainly useful to allow efficient public trading on a stock exchange. The EMCA Group has not chosen this route because listed shares will be dematerialized anyway, whether they are bearer or registered shares, and it is especially in private companies that the anonymity that comes with bearer shares is valued. The EMCA Group considered that if one wants to do away with this anonymity, one should abolish bearer shares altogether, not just for private companies.

Re 2) According to Dutch, French and German law it is possible to use a combination of bearer and registered shares. The EMCA Group considers that this should also be possible under the EMCA. However, the articles must clearly indicate what types of shares the company may issue: it is not possible for a company to issue e.g. bearer shares if this possibility has not been provided for in its articles.

Re 3) When shares have not been fully paid up, it is important that the company is able to easily identify the debtor of this obligation. With bearer shares, which are by definition not registered in anyone's name, this is often impossible and always difficult. Therefore, shares that have not been fully paid up must, mandatorily, take the form of registered shares. They will therefore be subject to the legal rules on registered shares. This rule overrules the requirement that only such shares as have been indicated in the articles of incorporation can be issued by a company: if shares have been issued as bearer shares but have not been fully paid up, they will nevertheless have to be treated as registered shares, even if the articles do not provide for this type of share.

### *Section 5.03*

#### **Form of Shares: Paper or Dematerialized**

(1) Both bearer shares and registered shares may take the form of paper share certificates or be dematerialized. Registered shares may also take the form of a registration in the name of a shareholder in a share register.

(2) "Dematerialized shares" are defined as shares that are created and held in an electronic securities account with a financial institution.

*Comments*

Traditionally, shares took the form of paper certificates, at least in the case of bearer shares. In the case of registered shares, in certain countries it is common to issue paper certificates as well, but in most countries, if any such certificates are issued, they do not incorporate the rights entailed in the registered share. The certificate in such cases only has a function similar to a bank statement indicating someone has a certain amount of money in a bank account: transfer of the paper certificate does not entail transfer of the registered share, by seizing the certificate one does not legally seize the shares etc. The registered share itself is therefore immaterial. Theoretically, it could be dematerialized in the sense of EMCA as well: in addition to the names in the share register, it would be possible to create shares in a securities account. These shares could then be transferred from one account to another, with the transfer only becoming reliable against third parties when the share register is amended accordingly.

Dematerialized shares are shares that have been created in securities accounts and that are held in and transferred through such accounts. In other words, they are book entry securities. For listed companies, it would be impractical to have their shares transferred in any other way. For most non-listed companies, and certainly for the vast majority of closed companies, using dematerialized shares is too complex and too costly because of the fees intermediaries such as banks charge.

In most jurisdictions that allow true dematerialized shares, there is one central clearing organization, or a limited number of such organizations that have been recognized by regulators to perform this function. The ultimate shareholder usually has a securities account with a bank or broker, which in turn has a securities account with the central clearing house. Sometimes, foreign clearinghouses hold accounts with the central clearing house in the country where the company issued its shares. More complex chains with multiple intermediaries are possible.

The EMCA defines dematerialized shares and allows them both in public and private companies. It does not try to deal with the rules on clearing houses and intermediaries, the rules on chains of intermediaries, their rights against each other or the rights of the ultimate beneficial owner, the ultimate shareholder. EMCA Chapter 11 on General Meetings does contain, however, rules on how to participate in a general meeting as a holder of dematerialized shares. The ultimate shareholder will by definition not have paper share certificates, meaning he or she will only be able to exercise his or her rights as a shareholder through the cooperation of intermediaries, who could, for instance, issue a statement concerning the number of shares held by the ultimate owner in a certain company at a certain date. This written statement could then be the basis for the shareholder to vote a certain number of shares at the general meeting.

*Section 5.04*

**Change of Form of Shares**

- (1) A shareholder always has the right, which cannot be excluded in the articles, to exchange their bearer shares for registered shares. The shareholder should direct their request to do so in written form to the board of directors, who will amend the share registry accordingly.
- (2) A shareholder holding registered shares cannot demand of the company that they be exchanged against bearer shares, unless the articles expressly provide for this. In that case, the costs involved in converting the shares into bearer shares will be borne by the shareholder demanding the conversion, unless the articles provide otherwise.
- (3) The company may decide, in its articles of incorporation or by a resolution of the general meeting, that the shares should be dematerialized. The decision of the general meeting should be taken with the same majority as needed for amending the articles of association.
- (4) A company resolution to exchange dematerialized against non-dematerialized shares shall be valid only where parties holding security interest in the shares have given their written consent to the resolution.

*Comments*

Re 1) A shareholder may always exchange their bearer shares for registered shares. This is a transaction which increases transparency about ownership, offers comfort to the shareholder who can now rest assured that the shares are considered theirs and no-one else's. The swap does not impose meaningful costs on the company. For all these reasons, a right to such an exchange may be recognized.

Re 2/ The exchange of registered shares for bearer shares can only take place if permitted by the articles of association. This kind of swap decreases transparency, can contribute to an increase in ownership disputes and potentially imposes considerable costs on the company, since bearer shares will usually be in paper form and will therefore have to be printed. The costs should be borne by the shareholder.

Re 3 and 4 The company may wish to change dematerialized shares for non-dematerialized shares, for example if the company delists from a stock exchange. The decision should be taken by the general meeting with the same majority as needed for amending the articles of association, see Chapter 11, Section 29.

A special problem arises if the shares are pledged as security. In that case, those holding the security interest in the shares should be asked for permission. Paragraph 4 is inspired by the Swedish Companies Act Chapter 3 Section 7.

*Section 5.05*

**No-par Value or Nominal Value of Shares**

(1) A company must indicate in its articles of incorporation whether it operates with shares with a nominal value ("nominal value shares") or shares with no par value ("no par value shares"). No other types of share may be issued. A company may not operate with the two possible types of share simultaneously.

(2) In case of nominal value shares, the nominal value will be indicated in the articles of incorporation and in the share register. A company may issue shares with a different nominal value. Nominal value shares may not be issued at a subscription price lower than their nominal value. That part of the subscription price that corresponds to nominal value must be booked as stated capital in the accounts of the company. The remainder will be booked as a restricted or unrestricted reserve, in accordance with the issuing conditions, the articles of association and applicable accounting rules. If it cannot be determined on the basis of issuing conditions, articles of association or applicable accounting rules whether the aforementioned reserve is restricted or unrestricted, it will be treated as unrestricted.

(3) In case of no par value shares, the shares have no accountable par. The subscribers of the company for shares issued upon incorporation and the company body that, within its competences, decides to issue new shares after than the moment of incorporation, will determine the price for which the shares are issued and which part of the subscription price will be booked as stated capital in the accounts of the company. In case no express decision is taken by the subscribers or the competent company body, the whole amount of the subscription price will be booked as stated capital. In case only part of the subscription price is booked as stated capital, the remainder will be booked either as a restricted or as an unrestricted reserve, in accordance with accounting rules, the articles of association or the issuing conditions. In case it cannot be determined on the basis of the aforementioned criteria whether the remainder of the subscription price is restricted or unrestricted, it will be treated as unrestricted.

*Comments*

This Section is inspired by the Finnish true no par value system described earlier, introduced into the Finnish Companies Act of 2006. A "camouflaged" version of the same system has been in operation in Belgium, for public companies only, since 1913. As explained in Chapter 2, under such a system, the historical value of the contributions for which shares were issued plays no role, the rights attached to shares are determined without reference to the percentage of legal capital a share represents and shares may be issued without a contribution taking place at the same time and without legal capital being affected. The sections of EMCA dealing with rights attached to shares clarify that when a company opts into the no par value system, the default rule will be that each share has an equal claim to profits and has one vote, but with the possibility for the articles to deviate from these rules (thus creating classes of shares).

Under a no par value system, contributions will be booked either as legal capital, restricted reserves or unrestricted reserves, without the EMCA containing any rules from which it could be derived how the contribution should be distributed over those three categories. In other words, the issue is left to the discretion of the board and general meeting deciding on a capital increase. “Restricted reserves” are not available for distribution to shareholders. “Unrestricted reserves” are available for distribution to shareholders by decision of the general meeting. Some reserves cannot even be incorporated into capital because this would mean they become “distributable” in an indirect way, namely through a capital reduction.

The Section does not outlaw the use of the traditional system of nominal value shares. It reiterates the rule that when nominal value is used, such shares may not be issued for a price lower than their stated nominal value. The sections of EMCA dealing with rights attached to shares will clarify that as a rule, profit and voting rights will be proportionate to the nominal value of the shares, but with a possibility to deviate in the articles of association.

Some additional explanation concerning the difference between a nominal value and a no par value system is in order.

*Nominal value, accountable par (“fractional value”) and true no par value shares.*

Traditionally – and this is still the case in many European countries - companies had to issue shares with a nominal value and upon issuance of such shares, the subscription price could not be lower than this nominal value (so-called issues below par (value) were not allowed). Nominal value is expressed as a number, e.g. 10. This means the subscriber to such a share must pay a contribution of at least 10. Of course, such a share may subsequently be sold for a price higher or lower than the nominal value: nominal value has nothing to do with market value. Nominal value should also be distinguished from book value. Book value is obtained simply by dividing the net assets (“own funds” which are essentially equity in the broad sense of the word, i.e. legal capital plus retained earnings/reserves) of the company by the number of shares. If a company has important reserves, the book value of its shares will be higher than their nominal value. When a company has incurred losses, the book value will be lower than the nominal value. Nominal value can be obtained by dividing legal capital by the number of shares. In other words, in a nominal value system, the total number of shares issued by a company times their nominal value yields the company’s stated legal capital.

The number expressing nominal value is also called the share’s “par value”. Under traditional, “true” nominal value systems, this number is fixed and cannot change over time: when capital is increased, new shares are issued and they will have the same nominal value and therefore par value as the old shares (see below). The rule common to all nominal value systems that shares cannot be issued for a price lower than their par value is self-evident and an essential part and consequence of double-entry bookkeeping: nominal value times number of shares yields stated capital, meaning that if shares were issued for a contribution lower than their nominal value, the value of the assets contributed for legal capital at the moment of the creation of this legal capital and the corresponding shares would be lower than the amount of legal capital expressed in the accounts, meaning these accounts would be highly misleading. In this (very limited) sense, outlawing below par creation of shares protects corporate creditors: assets should have been contributed with a value at least equivalent to the nominal value of the shares. Sometimes (especially in the 19<sup>th</sup> century), the concept of nominal value is (was) also defended as a rule of investor protection: the nominal value expressed the contribution a shareholder had to pay in in order to obtain a newly issued share, so that the shareholder could not be “surprised” by extra calls for additional contributions: by paying in the nominal value, the shareholder had performed their contractual duties.

Under a traditional system where nominal value is in principle fixed, technical issues arise when the company wants to issue new shares and is supposed to give them the same nominal value as the “old”, already existing shares, but the book value of these existing shares is substantially higher or lower than their nominal value.

In case the book value of the existing shares is clearly lower than their nominal value, it is likely that nobody would be prepared to buy new shares for the same nominal value as the old shares. Three solutions are possible:

- a) the nominal value of the existing shares is first revised downwards through a change to the articles of association that takes the form of a capital decrease, in order to reflect their lower book value; the new shares are issued at the new nominal value for a price that is equal to this new nominal value;
- b) the company chooses, if the law permits this, the complicated route of henceforth using two classes of shares with different nominal values, having different rights attached to them, proportional to their different nominal values;
- c) the new shares are issued at the same price as the nominal value of the existing shares, but the buyers of the new shares are compensated for the fact that they overpaid by preferential rights (profit rights, voting rights etc) compared to the “old” shares and in that sense, again two classes of shares are created.

In case, conversely, the book value of the shares is substantially higher than their nominal value and the company wants to, or is legally required to, issue the new shares with the same nominal value as the old ones, a share premium can be asked, i. e. part of the subscription price, exceeding the nominal value, will be booked as premium instead of as legal capital, therefore not being linked to the nominal value and as a matter of principle not affecting the rights attached to the shares, which are, as a rule proportional to the nominal value of the shares.

When the euro was introduced, nominal values had to be converted into euros as well. This led to nominal values that were not whole numbers, for example 10.82. This was very impractical and fortunately the 2<sup>nd</sup> Company law Directive also allowed “shares without nominal value”, which are called share with an accountable par in other places of the Directive. Since the 1930’s Belgium and Luxembourg had allowed such shares, and now several countries, including for example Germany, allow their companies to issue such shares (“*Stückaktien*” in German). But the difference between nominal value shares and shares without a nominal value in this sense, is largely formal. The accountable par is just another way of expressing nominal value, namely not as a whole number, but as a still fixed fraction of legal capital. Each share represents a part of legal capital, e.g. 1/10,000<sup>th</sup>. The value is not expressed through a number. But if a company has 10,000 shares without nominal value and its legal capital is one million, one might as well say that its shares have a nominal value of 100. If one adds the rule that this value is fixed, i.e. that future shares will also have to be issued for a contribution equal to 100, then the difference with a nominal value system is purely formal. Historical par values play a role.

This was not how shares without a nominal value were perceived in Belgium –together with Luxembourg (who usually follows Belgium), the only EU country that allowed such shares prior to the introduction of the euro and the reason why the 2<sup>nd</sup> Directive refers to shares without a nominal value. In Belgium, such shares are called “shares with a fractional value” and they are equivalent to the true no par value shares that have existed in the U.S. for a long time and that were introduced in 2006 in Finland. It might be worthwhile to illustrate the traditional Belgium system with the example of a capital increase with issuance of new shares in a situation where the book value of the existing shares is clearly below their “fractional value”. Suppose a company with a legal capital of 10 million that has issued 1 million shares, each representing 1 millionth of legal capital and thus having an accountable par (par value) of 10. As a result of losses, the book value of these shares is only 8 per share, so in total 8 million. Suppose the company needs a capital injection in order to survive. It decides to issue 1 million additional shares. If it demands an issue price of 10 per share, the new shareholder overpays and will only be prepared to do this if he or she gets preferential rights. What a Belgian company will typically do –and which it is allowed to do, whereas a German company could not do this in the same way- is issue one million shares for a price of (a maximum) 8 euro per share. After this capital increase, the company will have legal capital of 18 million, divided by 2 million shares. For a legal second, the newly issued shares will have an accountable par (par value) of 8, whereas the old shares have par value of 10. However, immediately after voting the capital increase, the same general meeting will vote to unify these categories of shares, determining that each represents one 2millionth part of legal capital of 18 million, with each share consequently having the same accountable par of 9 and the same rights attached to them, since they represent an equal part of legal capital (they have the same “fractional value”). From an economic perspective, this is the same as having no par value shares as understood in Delaware, but with a procedure that is more cumbersome: the general meeting needs to “unify” two classes of shares (not applying the specific rules that apply to this under other circumstances) that existed for a legal second. Directors have to draw up a report explaining the implications of the transaction to the general meeting.

In Finland, a “naked” or “pure” no par value system was introduced in the 2006 Companies Act. Under such a system, contributions will of course still be booked as equity, but they can be booked as capital, as a distributable or as a non-distributable equity reserve, whereby the latter need not have the accounting status or economic function of a share premium. It is up to the company body deciding on the share issue to determine how the contribution will be booked and this does not affect shareholder rights/the rights attached to the shares. The board will have to take its responsibility in proposing an issue price and suggesting (when, as usual, the general meeting needs to approve the issue of the new shares) which rights should be attached to the shares, in exchange for which price/contribution. Also, there is no link between the price shares were issued for at one stage and the rights that will be attached to future shares. In other words, the whole idea, never respected in practice but nevertheless lurking behind the nominal value system in its most traditional form, that shareholders subscribing to new shares in year a + 5 should not receive shareholder rights (voting power, dividend rights etc) that are larger than those received by shareholders who subscribed to shares in year a if both groups pay the same price for their shares, does not apply. Historical values of shares and the percentage of legal capital they are deemed to represent play no role. The whole issue is left to the fiduciary duties of directors, who will propose a certain ratio of rights/subscription price to the general meeting approving the issue.

Under such a system, it is also easy to issue additional shares without a capital increase and, conversely, capital can be increased without new shares being issued (even if new contributions are made and we are not simply dealing with an incorporation of reserves). As indicated, the rights attached to shares are not determined in relation to the percentage of capital a share represents nor to the value of the contribution for which they were issued; the rights are determined in the articles of association (within the limits allowed by the EMCA) without reference to any accounting figure.

Assuming vigorous enforcement of the duty of the board to inform existing shareholders and investors considering a purchase of newly issued shares about the financial and governance (power) implications of the proposed price/rights ratio for shares that the company intends to issue, the no par value system offers greater simplicity and flexibility without harming any stakeholder’s interests. The EMCA Group is therefore in favor of such a system.

*Section 5.06*

**Voting Rights Attached to Shares**

- (1) Unless otherwise provided in the articles of association, each non-par value share shall carry one vote. Unless the articles provide otherwise, each nominal value share shall carry voting rights proportionate to its nominal value. In case of shares with different nominal values issued by the same company, the shares with the smallest nominal value shall carry one vote. The articles of association may provide for shares with multiple voting rights and/or for non-voting shares.
- (2) Non-voting shares shall carry all shareholder rights except voting rights. However, non-voting shares may vote, with one vote per share, on resolutions proposed to the general meeting concerning any amendment to the rights attached to these shares, including the abolition of the class of non-voting shares. A company must issue at least one share with voting power.
- (3) The percentage to which a share has been paid up has no influence on the exercise of the voting rights attached to the share, unless the articles of association provide otherwise. In particular, the articles may make the exercise of the voting right conditional on the full payment of the shares, or may make the exercise of the voting right proportional to the percentage of the nominal value that has been paid in.
- (4) However, in any case the voting right(s) attached to a share are suspended when a share has not been fully paid up even though it should have been paid up as a result of the provisions of this Act, a lawful demand made of the shareholder by the competent company body or an agreement between shareholders.
- (5) Priority shares, i.e. shares that entitle the holder or category of holders to decide certain matters within the competence of the general meeting on their own, irrespective of the number of votes attached to the shares or the category of shares, and shares that give the shareholder a right of veto against certain or all decisions of the general meeting, are allowed.

*Comments*

If given the choice, most companies would probably issue no par value shares with each share having equal rights, namely one vote and a claim to a percentage of the profits that is obtained by dividing the profits by the number of shares. This is the simplest, most workable option. EMCA offers this possibility, and also allows for a deviation from this rule. Deviations must be explicitly provided for in the articles of association.

Deviations could consist in the creation of non-voting shares, shares with multiple votes, or priority shares.

*Priority shares* in this context refers to shares that have special decision-making powers, either veto powers or powers to decide things without the cooperation of other shareholders. For instance, certain shares could be awarded the right to appoint a certain number of directors, irrespective of the other votes cast at the general meeting. Or they could offer the holders of such shares a right to block the appointment of directors, or certain major transactions. Such shares, which in continental Europe were probably most often used in the Netherlands, can create an oligarchy among the shareholders. They are therefore controversial. In Belgium, “priority shares” are not allowed because they are deemed to undermine the power of the general meeting and the fear is that they could lead to concentration of power without an equivalent investment. In the Polish Companies Act Article 354 and also – without a special provision – in Denmark, priority shares are allowed. The same is true in France (*actions de préférence*, Article L.228-11 of the Commercial Code). Priority shares are also allowed in the US. Normally, a priority right concerning vetoing appointments of new directors would be contained in a shareholder agreement, but the EMCA Group cannot find plausible arguments against allowing a provision of such a kind in the articles of association. In listed companies, priority shares are especially controversial and institutional shareholders have exerted pressure on companies to do away with them. The EMCA is not intended to replace specific rules in corporate law, securities regulation and listing rules that deal specifically with issues for listed companies. In closed companies, the EMCA Group does not see any objection against this type of arrangement, because shareholders are supposed to be able to fend for themselves when deciding whether to accept such shares.

*Non-voting shares* can be issued to attract equity without affecting the balance of power within the company. Often, the lack of voting power will be compensated with preferred dividends/profit rights, but the EMCA does not mandate such compensatory mechanisms. It does mandate however the rule, from which the articles of association should not be allowed to deviate, that non-voting stock is a separate class and that these shares can vote, with one vote per share, if the general meeting wants to change the rights attached to these shares for example to lower a preferential dividend that had initially been accorded to such shares.

Something mid-way between a voting and non-voting share may also be created: shares that can vote on certain issues (e.g. capital increases) but not on others (e.g. directors' appointments and dismissals).

According to previous Finnish Companies Acts and the present Belgian Companies Act, non-voting shares were only possible if they were preference shares. The restriction has been abandoned in the recent Finnish Companies Act. The EMCA Group considers that there is no reason to limit non-voting rights to shares with preferential profit rights.

The question of *multiple voting rights* is controversial in Europe. As mentioned in the introduction, the EU Commission in 2007 considered introducing a mandatory one share one vote rule, but then concluded this would not be efficient or at least was not necessary. Member States have different approaches. In Belgium, Germany, Greece, Poland and Spain, multiple voting rights are prohibited. Italy, which used to ban multiple votes, allowed them in 2014 in non-listed companies. Luxembourg also allowed them, although not explicitly, in 2016. In the UK and Ireland, they are permitted but very rare. In some Member States that allow multiple voting rights, there is a maximum multiplier: in Sweden there is still a 1:10 limit and in Italy 1:3. The former Danish Companies Act had the same limitation but in the recent legislation there is no such limitation; the same applies to the Netherlands. Similar to the Danish Companies Act, the former Finnish Companies Act contained a limitation of 1:20 and shares without voting rights were only possible if they were preference shares. According to the recent Finnish Companies Act, these restrictions have been cancelled and the company has the freedom to decide the voting rights of the shares.

The EMCA allows shares with multiple voting rights and without a mandatory multiplier. This seems the best option in view of the fact that EMCA allows non par value shares. This implies shares can be issued for any price deemed acceptable by the shareholders who decide to issue them (or the board, acting with due care and loyalty, to whom issuing power has been delegated) and investors who are asked to buy them. This means companies could charge different subscription prices to different investors whose shares have the same rights. This is economically equivalent to issuing multiple voting rights. An additional reason for not introducing a multiplier is that non-voting stock can be created.

From the outset, it should be stressed that a case can be made that limits to multiple voting rights in listed companies are desirable. Firstly, the introduction of multiple voting stock for the first time after a company has been listed should be outlawed, as this may completely disturb the corporate power structure and would defeat the legitimate expectations of investors who are outvoted when the multiple voting structure is being introduced. Secondly, in listed companies it is probably wise to introduce a maximum multiplier (e.g. of five). This dampens the one effect that is the main drawback of multiple voting stock, namely a disconnect between power and economic interests, meaning a shareholder with multiple votes does not fully bear the financial consequences of the decisions they help impose on the company, while they can often build a controlling stake that allows them to extract private benefits of control. Maximum multipliers have been introduced in most countries that in the past allowed multiple voting stock without, or with very high, multipliers. Also, while the potential effects of multiple voting stock on take-overs are complex, shareholders with control based on multiple voting stock should probably not be encouraged or allowed to cash in on their private benefits of control when they sell their shares. Therefore, the EMCA group is favorably disposed, for listed companies, to the French system (predating the recent changes through the 2013 *Loi Florange* which made it the default rule) where the articles of association may provide for double voting rights for loyal shareholders, that is shareholders who have held their shares for an uninterrupted period of two years (Article L. 225-123 of the Commercial Code). These “loyalty shares” have a maximum multiplier of two, thus preventing a too large disconnect between financial contribution and risk on the one hand and power on the other, while still offering a meaningful way to subscribers, families, employees and other long-term investors to leverage their long-term investment. This may contribute to the goal of fostering long term strategic vision at companies, a goal pursued by parts of the proposed reforms to the EU Shareholders’ Rights Directive. At the same time, the rule that double voting power is lost when the shares are transferred, prevents the shareholder from cashing in on their loyalty and the heightened control rights that attend it.

But EMCA does not deal with rules specific to listed companies. In unlisted companies, the EMCA Group sees no reason to fear abuses and therefore does not limit the use of multiple voting stock and therefore leaves the matter to the Articles.

The EMCA does not contain specific provisions on loyalty shares because this would have been superfluous in view of the fact that the EMCA offers great flexibility concerning voting rights. Companies could introduce loyalty shares under the EMCA if they wanted to. As mentioned, the best known system of loyalty shares is the French one. The French law on public companies (*Sociétés anonymes*) allows loyalty shares and, since 2014, they are the default rule for listed companies unless a majority at the extraordinary general meeting votes against. They provide for a double voting right after a certain period, which cannot be less than two years. Loyalty shares may also provide for increased dividends (see Section 8). This is also permitted in France in public companies but there is a limitation on the amount of the supplementary dividend. In simplified public companies (*Sociétés par actions simplifiées* or SAS), loyalty shares which provide for increase votes and dividends, are also valid and their regime is organized by the articles of association.

Loyalty shares are legal in some other Member States such as Denmark, but they are hardly ever used – perhaps because of a lack of knowledge or familiarity. The Finnish and the Swedish companies’ acts do not mention explicitly whether loyalty shares are allowed, however the Finnish and the Dutch Companies Acts are very flexible and liberal so loyalty shares could be used if stated in the articles of association. Yet, as in Denmark, they are hardly ever used. Italy allowed them in 2014 for listed companies, following the French model. In Member States such as Belgium, Germany, Greece, Luxembourg, Poland (after 2001) and Spain, loyalty shares are prohibited.

The drawback to loyalty shares is that they complicate the assignment of control, because the transferee cannot be subrogated to the extra voting rights, which are only received after a given time period. The Directive on Takeover Bids (2004/25/EC) excludes loyalty shares from the Directive and thus from the optional breakthrough rule in Article 11 because Article 11 (3) only covers shares with “multiple voting rights”, where the rights depend on their class, i.e. they are determined in the articles of associations. The consequence of this is that loyalty shares keep their voting rights contrary to shares with multiple voting rights, which only has one vote on general meeting where defensive measures are taken. This can help to make these shares attractive.

According to the French system loyalty shares could be introduced with 2/3 majority (except in listed companies where they are the default rule since 2014), since it is open to all shareholders to keep their shares and have the benefits.

Loyalty shares could also mean that the shareholders should have more dividends according to the duration of possession. If the company decides to introduce loyalty shares, the question arises whether the shareholder should have more dividends according to the time they possess the shares. In French law this is limited, but the EMCA Group considers that the use of higher dividends could be an effective means to foster loyalty and therefore there should be no legal limitation.

A legislator who, contrary to EMCA, would deem it useful to introduce a provision on loyalty shares, could take inspiration from the following draft:

- A voting right equivalent to twice that attributed to other shares may be attributed to fully paid shares which can be proved to have been registered in the name of the same shareholder for at least two years, depending on the proportion of the share capital they represent, by the memorandum and articles of association or a special shareholders' meeting. Furthermore, in the event of an increase in capital by incorporation of reserve funds, profits or issue premiums, a double voting right may be conferred from the date of issue on registered shares allocated to a shareholder free of charge in proportion to any former shares for which he has the benefit of that right.
- Any share converted into a bearer share or changing hands shall lose the right to a double vote attributed pursuant to paragraph 1. Nevertheless, a transfer on succession, or on the partition of property jointly owned by spouses, or a gift *inter vivos* to a spouse or a relative entitled to succeed to the donor's estate shall not cause the right to be lost, nor interrupt the period of time referred to in the said Section. The merger or division of a company shall have no effect on double voting rights capable of being exercised within the beneficiary company or companies, where the memorandum and articles of association of the latter created it.

At present, the laws of many Member States offer less flexibility than EMCA concerning voting rights, in that they prohibit multiple voting rights, or mandate shares with equal rights all over, including voting rights, or mandate proportionality between the par value of the share and the (voting) rights attached to it. The EMCA Group sees no reason to be less flexible than Delaware or the Netherlands after its introduction in 2012 of its "Flex-BV (flexible closed company)". However, when a company has chosen to issue nominal value shares, consistency requires that the default rule is that rights attached to those shares are proportionate to the nominal value of those shares. As explained in the comments to Section 6, the idea behind nominal value is that it offers an easily recognizable measurement of shareholders' duties (to pay an amount at least equal to nominal value for the share) and rights. This may be an obsolete idea, or an idea that has never been convincing, but those companies that still opt for nominal value shares without being forced to, should bear the consequences and accept the consistency of the system they opted into. In this respect, the law of some countries or US states that allow or even mandate nominal value shares without assuming, as at least a default rule, any relationship between this nominal value and the rights attached to the share, are to be criticized for depriving the concept of nominal value of any value it may have possessed. For this reason, Section 6.1 of EMCA creates proportionality between nominal value and voting rights attached to the shares. If all shares issued by a company have the same nominal value, each will have one vote. If shares with different nominal values (e.g. 10 and 30) have been issued –something most companies would want to avoid because of the complexity this brings with it - then the share with the smallest nominal value will have one vote and the shares with a larger nominal value will have multiple votes, whereby parts of multiples are neglected (e.g. the shares with a nominal value of 30 would have 3 votes; if the company issued shares with a nominal value of 25, having 2.5 times the nominal value of the shares with a value of 10, the shares with a par (nominal) value of 25 would have 2 votes per share, not 2.5.).

As the text of Section 6 makes clear, all these rules are default rules only, from which the articles of association may deviate.

Section 6 contains one rule which we think should be mandatory, in order to avoid majority shareholders from excluding it to their own benefit through provisions in the articles of association; It is the rule in the second paragraph of Section 6.3, which provides that the voting rights of a shareholder who should have paid in their full contribution for the shares but has not, are suspended. This is an efficient sanction of a breach of contractual duty committed by the shareholder, obviating the need for the company to go to court in order to at least put significant pressure on the shareholder to pay up.

*Section 5.07*

**Profit Rights Attached to a Share**

- (1) “Profit rights” mean the right to receive parts of any profit distributions including the distribution of dividends and of the liquidation surplus decided by a competent company body.
- (2) In case of nominal value shares, shares have profit rights proportional to their nominal value, unless the articles of association provide otherwise.
- (3) In case of no par value shares, each share is entitled to an equal part of any profit distribution, unless the articles provide otherwise.

*Comments*

Most companies are for-profit, meaning the intention is to distribute the profits, sooner or later, among shareholders. Of course, a decision by the board or the general meeting, depending on the relevant legal system, is necessary before a shareholder can claim its share of profits in the form of a dividend.

The same philosophy as was used to determine the voting rights attached to shares is used for profits: the right to profits is proportionate to par value in case of nominal value shares, and is the same for each share (i.e. equals total profit distribution/number of shares) in case of no par value shares, but the articles are free to deviate from these default rules.

Companies will often retain part of their profits or more exceptionally all of their profits. Shareholders are then entitled to their part of the profits when the company is wound up/dissolved. Even though the text of the articles do not express this, when there is a (positive) liquidation surplus, shareholders should be entitled to share in this on the same basis as they shared in dividends. This is on the basis that a liquidation surplus represents retained earnings.

*Section 5.08*

**Classes of Shares**

If a company has issued shares with non-identical rights attached to them, shares with identical rights each form a class of shares. Only differences in the rights attached to shares, not differences in the rights accorded to one or more shareholders personally can give rise to the formation of a class of shares.

*Comments*

Shareholders buying shares when they are issued or on the secondary market attach at least some importance to the rights (governance and financial) attached to these shares when determining what price they are prepared to pay for the shares. Especially when not all shares that a company has issued have the same voting and profit rights, this will normally be reflected in price differences for the shares.

Shareholders will therefore want some protection against changes to the rights attached to their shares, which is the topic of the next Section.

There are different definitions of the concept of “class of shares” in different Member States and indeed considerable uncertainty within Member States as to what exactly constitutes a “class of shares”. For instance, in some Member States, shares having different rights do not necessarily constitute different classes of shares: when one company takes the unusual step of issuing shares with different nominal values, but the rights are proportionate to these different values and therefore different themselves, these shares would not constitute separate classes. Likewise shares with the same rights attached are considered to belong to different classes in some Member States, namely again in the scenario where the shares have different nominal values/accountable par values, and despite this have the same rights attached to them.

However, in other Member States, probably in a majority, a class is simply defined as any group of shares with the same rights attached, so that groups of shares with different rights attached constitute different classes, irrespective of whether these rights are proportionate to the share of legal capital represented by such shares. The EMCA has adopted this simple approach, which is also more in line than other definitions with a true no par value system as proposed by the EMCA.

To our knowledge, no European country attaches importance to different nominal or accountable par values as such for defining a class of shares and this approach was not considered by the EMCA Group.

By contrast, there is uncertainty in certain countries whether situations where special rights are granted to a shareholder, without those being attached to the shares themselves, should give rise to the rules on classes of shares. One might consider for example a situation where the articles of association provide that anyone holding 10 % of the shares may propose two candidates for board membership and that the general meeting must appoint at least one of its directors from among the candidates proposed by such a 10 %- shareholder. Here the privilege of a binding nomination of directors attaches to the fact of holding a certain number of shares, not to the shares themselves. According to the EMCA, there is therefore no separate class of shares. Therefore, this “special right” of 10 % + shareholders could be taken away by a simple amendment to the articles, without a vote per class of shares (since there are no classes).

Individual contractual rights of shareholders towards the company or rights unilaterally granted to individual shareholders are simply that: individual rights, which therefore cannot, of course, be amended by the general meeting, but only in accordance with the general rules on the laws of obligations, which will usually entail individual consent of the affected shareholder.

#### *Section 5.09*

#### **Change to the Rights of a Class**

- (1) If a company has more than one class of shares, the rights attached to a certain class can only be changed in accordance with the rules required for changes to the articles of association, and the majorities required must be met within each class that is affected.
- (2) The board of directors must draw up a written report that is made available to shareholders in accordance with Section [see Chapter 11] at the same time as the agenda of the meeting, in which it explains the potential consequences of the proposed changes to class rights. Any financial data in this report must have been checked by an external auditor, who will draw up a report that is made available at the same time and in the same manner as the directors’ report, in which the auditor particularly gives his or her opinion on whether the financial data given in the directors’ report are fair and not misleading.
- (3) The introduction of a new class of shares in a company where there previously were no different classes of shares is not deemed to be a change of class rights.
- (4) The introduction of a new class of shares in a company where there previously already are different classes of shares is a change of class rights.
- (5) The abolition of a class of shares is considered to be a change of class rights.
- (6) Provisions may be included in the articles of association on the conditions and procedures under which shares can be converted from one class to another. The conversion shall be notified for registration without delay. The conversion shall take effect upon registration.

(7) If the company issues a disproportionate number of shares of one class compared to the number of shares issued at the same time for the other classes, this is deemed to be a change of class rights for all classes.

#### *Comments*

Shareholders need to be protected against changes to the specific rights attaching to their shares by simple majority. On the other hand, it should be possible for companies to change most class rights without unanimity among shareholders, which may be impossible to attain in companies with more than a handful of shareholders. Therefore the EMCA endorses the midway solution reached by most European legal systems, of requiring the majority required for amendments of the articles within each affected class.

The difficult question in practice is what exactly constitutes a change to class rights. When a preferential dividend of a class of shares is lowered, this clearly is a change to the rights of that class. But in all jurisdictions there is at least some uncertainty about situations where the company does not directly change the rights attached to the shares of a specific class, but nevertheless takes an action which negatively affects the rights of a specific class. This may arise for example where the creation of a new class de facto affects the amount of the preferential dividend (expressed as a percentage of total profits) that a class may expect to receive, or the issuance of additional shares in one class but not in another thereby dilutes the interests of the members of the former class. Section 9 seeks to provide a clear answer to most hypotheses that are controversial in several jurisdictions. Specific attention may be drawn to section 5.09(5) which proposes to treat the complete abolition of a class as a normal change of class rights. This seems logical since economically a change consisting in a serious reduction of the rights of a certain class and the complete abolition of the class need not differ very much. Nevertheless, it seems clear that some legal systems will prefer to impose a requirement of unanimous shareholder consent in such cases.

#### *Section 5.10*

#### **Multiple Claimants on Shares**

The articles of association or, if the articles are silent on this matter, the board of directors calling a general meeting, may provide that if a share is owned by several persons at the same time, the voting rights attached to the share will be suspended until one person has been indicated by the co-owners who will be entitled, as the only person, to exercise the voting right attached to the share at the general meeting. If the co-owners cannot agree to appoint a proxy, any co-owner can ask the court to appoint a proxy. This person may be one of the owners or a third party.

#### *Comments*

In some Member States, the issue of multiple claimants on shares seems non-existent whereas in others, it is very common and leads to many disputes. For instance in France and Belgium, cases about who is entitled to vote in cases of “usufruct” on shares are unfortunately quite common. The case of co-ownership (*indivision*) is also dealt with in the French Commercial Code. Similar issues may arise in certain jurisdictions when married people jointly own shares and both members of the couple could exercise the voting rights attached to the shares separately according to civil law rules on marital property law. The EMCA Group felt it would have been difficult to harmonize the rules on such issues, because of divergences between national civil law rules. The EMCA Group certainly did not intend to design a rule that would catch situations where several people have concurrent and competing claims arising out of contract on one and the same share, let alone situations of “empty voting”, which can for example result from share lending and in which the person voting has interests that potentially diverge from the legal ownership of the share or the person it will revert to after the share lending deal has expired.

The EMCA does not even deal with all cases of simultaneous real rights in a share such as a result from usufruct and also for example from pledges on shares.

Section 10 only deals with co-ownership in the narrow sense. In such a case, the civil law issues seem relatively straightforward and the EMCA Group considered that any legal system could live with the rule proposed here. The purpose of the rule is, of course, to prevent a situation where one and the same share could be voted twice or more during the vote on one issue, once by every co-owner.

Nothing would of course prevent a national legislator from extending the solution proposed by the EMCA for co-ownership to other cases of competing real rights on one and the same share.

A word of explanation on usufruct: In civil law countries, the property right in a share can be divided into several rights. The main distinction is between usufruct (*usufruit*), also called life interest (see Article 10 of the Transparency Directive), and bare ownership (*nu propriété*). The beneficiary of the usufruct may use the object of the usufruct and receives the “fruits” (products) of this object, but they cannot transfer property, which remains with the “bare owner”. As with any asset, the ownership of shares can be divided between a life interest and a bare ownership. Because the articles in the Code Napoleon on usufruct do not deal with shares and immaterial goods were unimportant at the time the Code Napoleon was drafted (1804), they do not resolve the issue, controversial ever since, of the distribution of voting and financial rights between the usufructuary and the “bare owner”. The separation between usufruct and bare ownership is widely used in several countries including France and Belgium in order to allow the owner of a company to transfer the property of the shares at a lower tax cost, while retaining the economic benefit (usufruct), or doing the reverse (granting the usufruct but keeping control). Nothing in the EMCA prevents such a separation between usufruct and bare ownership. In common law jurisdictions, share trusts can be used to reach similar effects. But as indicated, the EMCA Group did not think it was possible or a good idea to propose one uniform rule to deal with these issues.

#### *Section 5.11*

### **Share Register for Registered Shares**

- (1) This Section only applies to registered shares.
- (2) A company that has issued registered shares must have a share register. The share register must be held in paper or electronic forms that remain accessible over time. The share register must be held at the company’s registered office. Several copies may be created and held in places other than the company’s registered office, but only where the company has an establishment or at the office of a financial institution. In case of discrepancies between several copies of the register, the content of the register kept at the company’s registered office is the only legally binding one.
- (3) The share register should state the total number of shares issued by the company.
- (4) Each transfer of shares must be registered in the share register by the parties involved. The registration must mention the names of transferor and transferee, their addresses or, in case of legal persons, their registered offices, the number of shares transferred, the date of the transfer and the date of the registration. The share register must also mention whether the shares have been fully paid up and, if not, what the amount is that remains to be paid up and who the debtor is of this obligation.
- (5) Each shareholder must receive an extract from the share register setting out at least the full name and registered office of the company and the number of shares for which that shareholder is registered in the share register. If there is a change in the number of shares held by a shareholder, they must receive a new certificate attesting to this new number. The extract can be used to prove shareholdership. However, in case of discrepancies between an extract and the share register, the register prevails. The extract does not incorporate the rights and duties attached to a share. Transfer of the extract does not bring about a transfer of the shares, and a transfer of shares remains valid even when the extract(s) have not been transferred.
- (6) Unless proof to the contrary exists, the person mentioned as shareholder in the share register is considered to be the owner of the shares mentioned under their name and is entitled to exercise the rights attached to the shares and bound to perform the duties attached to them.

#### *Comments*

This Section only applies to companies that have issued registered shares and to the transfer of such shares. Bearer shares by definition are not registered. The transfer of dematerialized shares could in theory be registered, but the EMCA Group sees no need for that in view of the fact that “registration” takes place in securities accounts and that transparency is safeguarded by transparency rules. It is only for registered shares that one needs a register to prove the quality of shareholder.

If companies issue registered shares, they must have a share register. The share register's essential function is to make transfers of shares reliable against the company and in principle also other third parties.

As expressed in paragraph 6, the person listed (registered) in the register as shareholder will be deemed to be the shareholder. This person will be the only one allowed to exercise the rights attached to the shares. Hence Chapter 11 of EMCA, on the general meeting, indicates that only the person registered in the share register as being the shareholder can take part in the general meeting and exercise the voting rights.

However, the share register is not conclusive proof of ownership. It only indicates who the shareholder is, that is the person entitled to exercise the rights attached to the shares (of course, in case of power of attorney, others can exercise those rights on account of the shareholder). The question of ownership is dealt with in accordance with contract law and the law on real rights, not by corporate law. (See also the comments under Section 13 on transfer of shares.) If a person alleges to be the rightful owner of shares, but is not registered as such in the share register, they can try to have the share register forcibly amended through court action under the applicable national rules. But as long as the register has not been amended, the person listed in the share register will be treated as shareholder. Courts could of course treat someone as shareholder before the register has actually been amended, but after they have been satisfied that someone else other than the person registered is the real owner and therefore real shareholder. All this follows from the wording in Section 5.11(6), which says that the basic rule applies "unless proof to the contrary exists".

Share registers may be held in paper or electronic form. "Electronic form" simply means that the information is stored on a computer or possibly a website (server). The electronic share register kept by the company itself is not to be confused with the securities accounts held at a central securities depository that is a sort of central share register for all dematerialized shares of all companies using this central depository. As already indicated, the EMCA does not deal with this central depository, which is essentially also a clearing and settlement organization.

The "extract" or certificate not entailing any rights attached to the shares of the register has the same function as a bank statement: just like a bank statement, an indication that one has 50.000 euro in the bank cannot be used to pay 50.000 euro because the statement does not constitute money. The extract is not a share but simply a document that the shareholder can use for administrative reasons, to keep track of how many shares they have in a company and to show to other persons, including the company, how many they have. But the entries in the register have precedence over the extract (in case of discrepancies) and transfer of the extract does not entail transfer of any shareholder's rights.

The "duties" of shareholders mentioned in the Section are mainly the duty to fully pay up the shares.

#### *Section 5.12*

#### **Access to the Share Register**

- (1) The register of shareholders must be kept available for inspection by public authorities. The articles of association must specify the place where the register of shareholders is to be kept if it is not kept at the company's registered office. The register of shareholders must be kept within the EU/EEA.
- (2) The register of shareholders must be kept available for inspection by shareholders and company organs and the articles of association may provide that the register must also be kept available for inspection by the public.

*Comments*

It has been debated in several Member States if the share register should be available for inspection by the company's shareholders. Thus, for example, the Danish tradition in public companies is that shareholders do not have the right to access the register unless the articles of association provides for it, cf. Section 16(2). The share register in private companies in Denmark and the Netherlands is available for inspection by a shareholder. The restriction for public companies has been debated in Denmark and the other Nordic countries are more open. This is especially the case in Sweden where the register is completely open to shareholders and everyone else. In other Member States there are different rules. For example in Belgium the share register is open to everybody but in Germany it is restricted to the shareholders because of data protection and privacy concerns (AktG § 67). The UK position is that the register of members of all companies, public and private, is open to inspection - subject to a power introduced in the Companies Act 2006, for the company to go to court for permission to refuse access. As information on members is also held by the Registrar of Companies, in practice people tend to go there to seek information on the membership rather than to the company's register.

The EMCA Group has considered different arguments for and against granting unrestricted access. Arguments for granting unrestricted access include the need for shareholders to know each other, the possibility of raising class actions, facilitating takeover bids, and improving transparency/democracy. An argument against granting unrestricted access may be based on privacy concerns. The EMCA Group considers that the share register should be open to all shareholders in public as well as private companies.

On the other hand, the EMCA Group sees no need to force companies to open up their share register to everyone including non-shareholders. Whether the public has access is an issue which may be left to the articles of association, the default rule being that there is no access for the public in general.

The EMCA Group has opted for a compromise solution whereby, as is already the case in several Member States, public authorities including tax authorities have access to the share register. Such a solution will probably be imposed on all EU companies pursuant to the 4<sup>th</sup> Anti-Money Laundering Directive, which obliges Member States to organize a central register of beneficial ownership for all companies.

*Section 5.13*

**Transfer of Shares**

- (1) Shares are freely transferable, unless otherwise provided by the articles of association in accordance with Section 14.
- (2) A transfer of paper bearer shares cannot be relied upon against the company as long as the transferee does not hold the printed share certificates embodying the transferred shares.
- (3) A transfer of dematerialized bearer shares cannot be relied upon against the company as long as the securities account of the transferee has not been credited.
- (4) A transfer of registered shares cannot be relied upon against the company as long as it has not been registered in the share register, unless the company through its board of directors has acknowledged the transfer of the shares.

*Comments*

Section 13 deals with two problems. First, whether shares are freely transferable and second, which requirements should be fulfilled in the case of transfer in order for the parties to be able to rely upon the transaction against the company.

Concerning the first issue, that of free transferability: Regarding private companies, many Member States have transfer restrictions based on the understanding that private companies will often be formed by a small group of shareholders, who wish to jointly pursue a business aim and that the ability of a shareholder to transfer his or her interest to an outside third party could be prejudicial to the corporate success. In a number of Member States, therefore, transfers of shares in a private company may require board approval or even shareholder approval. This is for example the case in Belgium (mandatory), France (mandatory for sale to non-shareholders), Germany and Italy (if stipulated in the articles), Luxembourg, the Netherlands and Poland (if stipulated in the articles). Other Member States provide for a statutory pre-emption right, particularly in favor of other shareholders. This is the case in Estonia, Hungary and Lithuania.

Transfers of share in public companies are substantially less restricted, reflecting the fact that shareholders in public companies often participate purely as investors especially if the shares are traded on a stock exchange.

The EMCA Group does not see a reason to deal with the issue of transferability through mandatory rules. It should certainly be possible to limit the free transferability of shares and that is what this Section allows, referring to Section 14. But it should be left to the articles of association to deal with the issue of transferability, with free transferability as the default rule in any type of company.

The reference in this Section to the articles of association is not a ban on shareholders' agreements outside the articles. Shareholders' agreements are acknowledged in all Member States. The general approach regarding shareholders' agreements in Member States is that they are binding for the shareholders involved but not for the company or parties acquiring the shares in good faith, without knowledge of restrictions in the private shareholders' agreement. The EMCA does not include specific provisions on shareholder agreements but certainly would not want to prohibit them.

Public companies are also allowed to include limitations of transferability in the articles of association. However, if a public company is publicly traded, securities regulation demands that the shares are freely transferable.

On the issue of which *formal requirements* should be fulfilled in the case of transfer, a large number of Member States permit shares in a private company to be transferred only by way of notarial deed or in written form with signatures certified by a notary public, whilst the remainder do not generally require such a level of formality and allow shares to be transferred pursuant to simple (including oral) agreements or written declarations. It is often the case that the company must, as a minimum, be notified so that the relevant share (or shareholders') register can be updated. This is the case in France, Germany, Greece, Lithuania, Luxembourg, the Netherlands, Poland, Slovakia and Slovenia. Many jurisdictions allow the articles to set out the exact mechanism of transfer and, in some cases to adopt either a more relaxed (as in the Czech Republic) or stricter (as in Austria, Belgium, Hungary and Italy) approach than that provided by statute.

The transfer requirements regarding shares in public companies are more varied and can differ substantially from Member State to Member State. Probably the greatest similarity in approach lies with bearer shares where physical delivery of a certificate will generally be sufficient to transfer title. In Germany, where certification is obligatory, the individual unregistered shares will normally be represented by a global share certificate which is held by a depository and in which case the individual share will be transferred by way of assignment of a delivery claim against the depository.

The transfer of registered shares which are certified can be effected in most jurisdictions through endorsing the certificate. This is the case for example in Austria, Czech Republic, Germany, Poland, Slovakia, Slovenia whereas other jurisdictions allow transfers to be effected by way of a simple transfer document which, in contrast to the general position for public companies, does not need to be notarized.

Dematerialized shares may be transferred by written agreement and, in almost all jurisdictions, the transferor or transferee must ensure that the share register is updated. A number of Member States require the register to be updated before a transferee may exercise their rights as shareholder (for example in Germany, the Netherlands (private company) and Sweden) or in order to give effect to the transfer (for example in Lithuania and Luxembourg). Certain Member States such as France, Greece, Ireland and the UK require furthermore the payment of transfer or stamp taxes.

The EMCA Group has opted for a simple system that at the same time creates legal certainty and is consistent with the EMCA's definitions of the different forms of shares. The first choice EMCA makes is not to require the intervention of a notary. Notaries can certainly contribute to legal certainty, but legal certainty can probably also be attained through the mechanism described in the Section at a much lower cost to parties involved.

Secondly, the EMCA, as noted above, does not deal with the civil law (contract law, property law etc.) aspects of corporate transactions. How shares can be sold is essentially a topic that is and should be dealt with under national rules on sales of moveable property. How one validly acquires ownership of a share, is a matter for civil law, mainly contract law. Companies legislation, such as the EMCA, only has to deal with identifying the circumstances in which the acquisition of a share as a result of a transfer can be relied upon against the company. It is possible that as a matter of contract law, a share transfer has been fully effected and the buyer has become the owner of the shares, but the owner cannot as yet rely upon his ownership against the company, since the necessary formalities for such reliance have not yet been met. For instance, it often occurs that national contract law provides that ownership of a share is transferred as soon as both parties involved agree on the number of shares and their price. But if it is a registered share, the transfer cannot be relied upon against the company unless it has been registered in the share register, which sometimes will only happen several days or weeks after the transfer of ownership. As long as the buyer has not been registered as the new shareholder, they will not be able to exercise their rights as a shareholder vis-à-vis the company. For example, they will not be allowed to attend or vote at a general meeting. Under EMCA the share register is not conclusive proof of ownership, but only indicates who should be regarded as shareholder in the sense of being entitled to exercise the rights attaching to the shares.

EMCA has opted for a simple system that takes into account the different forms shares may take – differences in form that are mainly relevant for the way the share can be transferred. For registered shares, the share registry naturally is proof of the transfer and registration is required to make any transfer reliable against the company. For dematerialized shares, the securities account of the acquirer will need to have been credited. Finally, in the case of bearer shares incorporated in a paper certificate, the paper certificate needs to have been transferred and therefore needs to be in the possession of the acquirer for them to rely on the transfer.

Of course, persons may prove that according to civil law, they are the rightful owner of shares, but for some reason or another, the transaction has not been made reliable for example because the board refuses access to the share register. They can then sue according to normal private law rules to have this remedied. But until they have succeeded with such an action, their ownership cannot be relied upon against the company.

#### *Section 5.14*

### **Limitations on Free Transferability of Shares**

- (1) The articles of association may limit the free transferability of shares or a certain number of shares. The limitation may entail a total ban on transfers of shares for a fixed period of time or any other kind of limitation such as a right of first refusal and a consent clause.
- (2) Unless the articles expressly provide otherwise, the limits on free transferability will only apply to transfers of full property, not to the pledging of shares or the granting of limited real rights on the shares.
- (3) Any transfer in violation of the articles of association is void.

#### *Comments*

The EMCA assumes that shares are freely transferable, in accordance with normal civil law or common law, rules on transfers of property and other real rights.

At the same time, the EMCA Group is unaware of convincing reasons for rules that would mandatorily limit the free transferability of shares.

The issue is therefore left to the articles of association, which may limit free transferability. It will be important to draft the articles carefully, in order to design a workable transfer limitation mechanism, and also to define the concept of transfer. This is a matter of contract drafting, not something to be dealt with in the EMCA. However, in order to save costs by clearly answering a question which has frequently arisen in practice in several Member States and to which national law does not always provide a clear answer, the EMCA states explicitly that unless the articles expressly say otherwise, limitations to transfers will only apply to transfers of full ownership, not to the granting of limited real rights, such as when shares are pledged as security.

One issue drafters will have to take care of is whether a limit to transferability would also apply upon the death of a shareholder. Even though the Section contains no rule on this, the EMCA Group believes that the standard interpretation of “transfer” includes a transfer to heirs upon death. When, on the other hand, “sale” is used, the limitation will only apply to sales. However, it should be clear that company law and in any case the EMCA do not interfere with the law on estates/succession law. Therefore, the question who inherits the shares of the deceased is as a rule not affected by Section 15 or the rules on limits to free transferability of shares.

For this last principle to hold perfectly, Section 14 should have provided that transfers in violation of the limits imposed by the articles cannot be relied upon against the company, so that the transferee would not be deemed to have become the new shareholder. The EMCA group considered such a solution, but in the end felt that a clear-cut solution would offer more legal certainty and would lead to real enforceability of limitations to free transferability in the articles. The EMCA therefore provides that transfers in violation of the articles are null and void (after having been declared null and void by a court).

Some Member States explicitly allow shareholders to agree on limitations to free transferability of shares in shareholder agreements and even where Companies Acts provide nothing on this, it is presumably permissible in all Member States to enter into such agreements. By providing that the articles of association may limit free transferability, the EMCA Group certainly does not want to exclude such purely contractual arrangements. But it should be clear that such arrangements will only have effects among the parties involved.

The exit rights awarded to shareholders in Chapter 11 of EMCA overrule limits to free transferability in the articles of association: if a shareholder has the right to be bought out by the company (or another shareholder), the limits provide in the articles should not apply.

#### *Section 5.15* **Redeemable Shares**

- (1) If the articles of association so provide, the company may issue redeemable shares under the conditions set forth in this Section. Redeemable shares are shares that can be redeemed against the company. Upon redemption, the redeemed shares are cancelled and the redemption price is determined and becomes payable to the shareholder.
- (2) Only shares that have been issued as redeemable shares, before they are allotted, may be redeemed. After shares have been issued, they cannot be turned into redeemable shares, notwithstanding anything to the contrary in the articles of association or any company resolution.
- (3) Redeemable shares may be redeemable at the option of the company, of the shareholder, or by both, according to the provisions in the articles of association or the terms of issuance of the redeemable shares.
- (4) Redeemable shares may only be issued if the company has issued and still has non- redeemable shares.
- (5) Redemption must take place under the conditions and in the manner set forth in the articles of association. If the articles contain no conditions, and subject to the rules on redemption price in Paragraph 7, a resolution of the general meeting with an ordinary majority may determine the conditions and manner of redemptions. The general meeting may, for a specific redemption, delegate its authority to decide on the conditions for and manner of redemption to the board of directors, unless the articles of association provide otherwise.
- (6) Shares may only be redeemed if they have been fully paid up.

(7) The decision to redeem shares has no effect before the redemption price is determined. The articles of association must determine the redemption price or contain rules to determine it. Redemption is not possible if the articles contain no rules to make the redemption price determinable.

(8) The redemption price may only be paid out of distributable profits. Chapter 7, Section 2. Chapter 7, Section 33 applies *mutatis mutandis* if the redemption price has been paid out of non-distributable profits.

(9) The redemption price must be paid within 12 months of redemption, unless the articles of association provide a shorter period.

(10) If a shareholder who is entitled to do so wants to redeem their shares, they must notify the company and the redemption will take place upon an ordinary board resolution. If a company that is entitled to do so wants to redeem shares, its board will notify the shareholders.

(11) During the winding up of a company, and from the moment winding-up has been proposed in a board resolution or requested by anyone else, redemption may not take place except when the request or proposal to wind up the company has been rejected.

(12) Unless all shareholders unanimously decide to waive this rule, a redemption offer by the company can only be made in equal measure to all holders of redeemable shares.

#### *Comments*

Several issues must be distinguished. All Member States allow share buy backs, whereby the company takes the initiative to buy back a number of its own shares from the shareholders. This is governed by the 2<sup>nd</sup> Company law Directive. In addition, a company may acquire some of its shares through a capital reduction. The corresponding shares are then annulled, which is not necessarily the case when shares are bought back as they can be held as treasury shares. The EMCA does not deal with the relationship between share buy-backs and capital reductions with immediate annulment of shares.

The above Section 15 does not deal with share buy-backs nor with capital reductions (for those two transactions, see the Chapter 6 on Financing of Companies).

Nor does Section 15 deal with exit rights that take the form of a forced buy-back by the company (appraisal rights) or by another shareholder (along a model often used in Belgium) of a shareholder who feels aggrieved by fundamental changes in the company or can invoke just grounds (for example oppression of a minority shareholder) to have his or her shares bought by the offending shareholder. See Chapter 11 of EMCA for such exit rights in case of conflict/fundamental changes in the company.

Section 15 deals with the less frequently occurring phenomenon of redeemable shares in the sense of shares that have been designated from the moment they were created as being eligible for redemption. Redemption here means that the company will pay the value of the shares to the shareholder.

It is possible to envisage a system whereby capital is reduced through a redemption. For instance, in Belgian cooperative societies (which are considered to be companies and are dealt with in the Companies Act) shareholders have a right to exit the company by offering their shares to the company, which then must pay out their value, as long as legal minimum capital is not affected. This leads to an automatic reduction of legal capital corresponding to the number of redeemed shares, without the rules and procedures on capital reduction having to be respected. Hence this part of capital that can be used for such redemptions is called “flexible capital”. The “fixed capital” is then the amount determined as such in the articles of association - which in a cooperative with limited liability must be at least equal to statutory minimum legal capital - which can only be reduced using the procedure for capital reductions.

However, this is not the system which is envisaged by the EMCA. Section 15 of EMCA relates to shares that can only be redeemed with distributable profits. The main differences with a simple system of share buy-backs are that (a) redeemable shares must have been thus designated at the moment they were issued; (b) hence, when redemption takes place, the principle of equality (equal buy-out offer to all shareholders) does not come into play; and (c) the EMCA allows the articles of association to make shares redeemable on the initiative of the shareholder, meaning the shareholder has an enforceable right towards the company to have their shares redeemed, whereas in a share buy-back, redemption only takes place on the initiative of the company, when it seems fit.

## CHAPTER 6 FINANCING OF COMPANIES

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## General Comments<sup>46</sup>

### 1. EU law

Traditional means utilized to finance companies are share capital (equity) and different kinds of debt. As regards regular debt instruments in this context, EU law contains no general provisions. Financing by share capital is addressed particularly in Directive 2012/30/EU (recasting Directive 77/91/EEC (the 2<sup>nd</sup> Company Law Directive) as amended by Directive 2006/68/EC).

The stated capital of a company may be increased by subscriptions for new shares, conversion of the company's reserves into share capital by the issue of bonus shares, or the issuance of convertible financial instruments or warrants and options. New shares may not be subscribed for at a discount. Those who undertake to place shares in the exercise of their profession, however, can pay less than the total price of shares for which they subscribe in the course of the placing transaction (Article 8(2) of the 2012/30/EU Directive). According to article 29 of the 2012/30/EU Directive any increase in capital must be decided upon or authorized by the general meeting, and both this decision and the increase in the subscribed capital must be published in the manner laid down by the laws of each Member State. Where appropriate, the increase in the subscribed capital has to be decided on within the limits of the amount fixed, by the company body empowered to do so.

A capital increase can be carried out in exchange for cash contributions as well as by contribution of assets other than cash or by conversion of debt. Conversion is the exchange of debt for equity and constitutes a transaction in which a lender agrees to convert a loan or a debt instrument into shares of equity. In the accounts, items are moved from liabilities to equity. Article 33 of the Directive provides that whenever the capital is increased by consideration in cash, the shares must be offered on a pre-emptive basis to shareholders in proportion to the capital represented by their shares. The pre-emption rights may not be restricted or withdrawn by the articles of association or instrument of incorporation unless the laws of a Member State specifically allows for this. Otherwise, a pre-emption right can be restricted only by decision of the general meeting. In general, in case of a capital increase in exchange for contribution in kind, one or more experts who are independent of the company and appointed or approved by an administrative or judicial authority will report on the consideration. Article 33 contains rules on priority.

Convertible debt instruments give the holder the option to exchange the bond for a predetermined number of shares in the issuing company. A derivative security that gives the holder the right to subscribe for new shares at a specific price within a certain time frame is “a *warrant*”. Article 29 (1) and (4) of the Directive states that the authority to issue convertible debt instruments and warrants lies with the general meeting.

The EU does not regulate the content of the resolution on the increase of share capital.

The rules in the Directive regarding capital increases in listed companies are supplemented by the rules on prospectus in the Prospectus Directive 2001/34/EC as amended by 2010/73/EU and the prospectus regulation no. 809/2004. The rules on prospectus apply to the offer of securities on a regulated market and can, according to national rules, also be applied to other public offers worth less than 2.5 million Euros. The proposed new Prospectus Regulation (2015) will introduce inter alia changes in the minimum issuance thresholds where a prospectus is required.

Directive 2012/30 only applies to public companies.

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<sup>46</sup> The working group on Chapter 6 was chaired by Professor Matti J. Sillanpää (Turku School of Economics, Finland) and included Professor Theodor Baums (Goethe University Frankfurt am Main, Germany) and Professor Paolo Giudici (Free University of Bozen-Bolzano, Italy).

## 2. National law

Directive 2012/30 contains minimum requirements regarding the information, which is to be provided in connection with a capital increase. Regarding a contribution in kind, an account must be made by one or more experts who are independent of the company and appointed or approved by an administrative or judicial authority. As noted, the Directive does not however contain any further rules concerning the contents of the resolution to increase the capital. In different ways, however, all Member States require that investors be provided with relevant information regarding the contents and the condition for the subscription of capital.

In accordance with Article 33, all Member States have rules on pre-emptive rights. The national rules follow Article 33 with some modifications. In most Member States, the rules on pre-emptive rights are the same in respect of public and in private companies. However, in some Member States, there are no pre-emptive rights in private companies. The EMCA Group considers that pre-emptive rights are not less important in private companies.

Not all Member States have provisions on convertible bonds and warrants. Such provisions are found for example in Denmark, Finland, France, Germany, Greece, Italy (covering convertible bonds only), Slovakia, Sweden, and the UK. In Finland there are only provisions on warrants but convertible bonds can be created by attaching warrants to bonds. Typically, the provisions require a resolution by the general meeting, cf. article 29 (4) of Directive 2012/30. The Directive does not determine the majority required for a decision, and the national rules vary significantly in this respect. Similarly, the Directive does not include any further rules on the contents of the resolution by the general meeting. In this matter the national rules are also very different.

As mentioned, the Prospectus Directive and the Prospectus Regulation apply to capital increases in listed companies. The Directive's prospectus rules in all Member States are implemented in the national law on securities regulation which in this way supplements the Company Law rules in the Member States.

## 3. Considerations

Traditional means utilized to finance companies are share capital (equity) and different kinds of debt. Some of the financial instruments have attributes of both categories including profit-sharing debt instruments and participative financial instruments ("hybrid instruments"). Others entitle the investor to exchange them for shares or to buy shares on fixed terms ("equity linked instruments"). Which financial solution a company prefers depends, inter alia, on how the company is run but also on considerations concerning choice of financial instrument (e.g. pricing and tax effects), risk (e.g. favorable equity ratio and bankruptcy risk) and the attitude towards inviting new shareholders to the company. In recent years, the *concept of economic efficiency* (corporate governance) has become increasingly important.

The EMCA Group generally seeks to give companies the greatest possible freedom to choose the best suited capital structures. A part of this is to grant companies permission to develop and use the most suitable types of financing. These types of capital span a wide range of financial instruments – from the usual share capital via intermediate forms like convertible bonds, warrants and profit-sharing debt instruments, to different kinds of debt.

The EMCA Group considered that the EMCA should include provisions on the types of financing that are covered by the articles of association's information on the company capital, which therefore have to be decided by the general meeting of the company. The rules should ensure that such information is provided to the investors so that the investors can assess their legal position. Further, the rules should protect the creditors of the company by ensuring that real capital is paid in. Therefore, there should be the same guarantees for example regarding contribution in kind as indicated in Chapter 2 on Formation.

The rules on different types of financing in Chapter 6 should not be interpreted in a way that excludes other types of financing. The competence to use such other types lies with the company's management.

Further, the EMCA Group has considered whether the provisions in Chapter 6 constitute an exhaustive list or not. For example, the list is considered as providing only examples in Denmark and France, whereas the Swedish Companies Act lists the instruments and Germany lists the hybrids on which the shareholder's meeting has to take a decision. The EMCA Group has decided to adopt a liberal approach which has been adopted in Member States such as Italy and is working well.

The Finnish Companies Act and the German insolvency law have provisions on subordinated loans. Such loans may be taken out without consent of the general meeting. Therefore, the EMCA Group does not consider that the EMCA should contain special provisions on such loans in this Chapter.

PART 1  
GENERAL RULES ON INCREASE OF CAPITAL

*Section 6.01*  
**Increase of Capital**

- (1) A company may increase its share capital by
  - (a) issuing new shares against a contribution of cash or payment in kind;
  - (b) issuing new share by converting reserves
  - (c) converting convertible debentures.
- (2) If the company is not using the par value system, it can issue new shares against contribution of cash or payment in kind and by issuing new shares free of charge. In this system, the company can decide whether the contribution or payment goes to share capital or to the free reserves.

*Comments*

Re 1) The main purpose of Chapter 6 is to include rules on any situation where the company's capital increases in such a way that the general meeting should decide upon it. However, Section 18 of Chapter 6 also includes a provision on profit-sharing debt instruments, which also should be decided upon by the general meeting.

Re 1 a) Shares may be issued for cash or for considerations in kind. Section 6 below deals with contribution in cash or in kind. An important question in this regard is whether debt can be used as contribution and whether debt should be considered as contribution in cash or in kind ? Section 5(3) below provides that debt contribution is considered as a cash contribution in the EMCA.

*Section 6.02*  
**Resolution by the General Meeting**

- (1) An increase of share capital shall be decided by a resolution of the general meeting with the exception of the provisions in Section 5. The resolution shall be passed by the same majority of votes as it is necessary for changing the articles of association.
- (2) The resolution on increase of share capital shall include at least the amount of increase, the method of increase of capital, and the number, the type and the nominal value, if any, of shares to be issued as a result of increase of capital. The resolution should also include all the information necessary for shareholders and investors to take an informed decision. In case of an appraisal right, the time for the exercise of such right must not be less than two weeks.

*Comments*

Re 1) Chapter 11, Section 27 of the EMCA establishes that amendments to the articles of association require a two third majority. In public companies, Member States such as Belgium, France, Greece, Luxembourg and the Nordic countries do the same. However, some Member States make higher demands on qualified majority. In France for example, in the case of private companies (SARL), an alteration of the articles of association requires a three quarters majority if the company has been formed before 2005. If the company is formed after 2005, only a two third majority is required. All Member States have a provision requiring a resolution by the general meeting in their Companies Acts.

Re 2) The resolution must contain the necessary information for shareholders to decide if they should sign for the various types of capital increase. The specific requirements for information are found in the following sections describing the ways to increase capital.

For example, the information that might be provided for a resolution to increase capital by a subscription for new shares might include:

- the minimum and maximum amount by which the share capital (or in the case of no- par value system

the number of shares) may be increased;

- when the new shares will confer on the holders a right to receive dividends and other rights in the limited liability company;
- the estimated costs of the capital increase that are to be paid by the company;
- the share class for the new shares if different classes exist or are contemplated;
- the pre-emption rights of the shareholders or others and any restrictions on the new shareholders' pre-emption rights in the event of future increases;
- the time allowed for subscription and a time limit that allows shareholders at least two weeks from the date they are notified to exercise their pre-emption rights;
- the last day of payment for the shares and, where the allotment is not left to the central governing body, the rules governing allotment in case of oversubscription of any shares not subscribed for by the exercise of a pre-emption right;
- any restrictions on the negotiability of the new shares or any obligation on the new shareholders to have their shares redeemed;
- whether the new shares are negotiable instruments;
- whether the new shares will be registered shares or bearer shares, and
- the subscription price of the shares.

*Section 6.03*  
**Subscription**

The authorization of the management to issue the new shares expires if the total amount of new capital is not subscribed within the time limit set by the resolution.

*Section 6.04*  
**Amendment to the Articles of Association**

- (1) According to the rules in this Chapter, the decision of the general meeting concerning capital increase should be stated in the company's articles of association.
- (2) If the general meeting fails to do so, or if the subscription procedure brings a result which is not in harmony with the draft modification, the articles of association shall be modified after the subscription of new shares.

*Comments*

On the basis of this Section, it follows that decisions on capital should be registered, see Section 17 below.

*Section 6.05*  
**Authorization to Increase Capital**

- (1) The articles of association or the general meeting may authorize the central governing body to increase the capital or, in the case of non-par value system, issue new shares. Section 2 applies to the general meeting resolution.
- (2) The authorization described in para. 1 may contain conditions and limits, such as the maximum amount or the time limit.
- (3) If the capital can be increased in whole or in part by a contribution of assets other than cash, this must be stipulated in the articles of association. Also, any resolution made by the general meeting to depart from the existing shareholders' pre-emption rights must be specified.

*Comments*

Section 3 implements article 29(2) and (4) and article 33(5) of Directive 2012/30, and hence, most Member States have a similar provision in their Companies Acts. According to article 29(2) of the Directive, the authorization to increase capital can also be given by a resolution of the general meeting. Section 3 deals with both private and public companies.

PART 2  
INCREASE OF CAPITAL BY ISSUING NEW SHARES

*Section 6.06*

**Types of Contributions**

- (1) In the case of an increase of capital (or in the non-par value system, an increase in the number of shares) by issuing new shares, the general meeting's resolution shall determine whether the new capital contributions are in cash or in kind.
- (2) The rules relating to considerations for shares in Chapter 2, sections 22-24, shall be applied. See also Chapter 2, Section 24(3).
- (3) In case of increase of capital, company debt owed to a creditor can be set-off against the creditor's obligation arising from his subscription to the capital.
- (4) If the subscription price is paid with other assets (contribution in kind), the assets shall have a financial value to the company at least equal to the price thus paid.

*Comments*

There is a need to decide which type of contribution is used, since the need for protection of shareholders and creditors is different. The rules should be similar to the rules in the Chapter 2 on formation in order to avoid circumvention of the rules of formation.

The case covered in subsection 3 concerns the situation where the company owes a debt to a creditor that subscribes to the share capital. Here the question arises whether the creditor must bring in their receivable as a contribution in kind and whether there has to be a valuation. In such cases of a debt-equity swap, the company is freed from an obligation at its nominal value, therefore the evaluation seems unnecessary and a set-off is permissible.

*Section 6.07*

**Pre-emptive Rights**

- (1) In the case of an increase of capital by issuing new shares for monetary contribution, the existing shareholders have pre-emptive rights to the newly issued shares.
- (2) The shareholders may exercise their pre-emptive right within a time limit fixed by the general meeting's resolution. Such time limit cannot be shorter than 14 days of the notification of shareholders on the increase of capital or the making public of the increase of capital.
- (3) The notification of shareholders or a publicly available announcement on the increase of capital shall include the same information as the general meeting's resolution and all other information that is necessary for exercising pre-emptive rights.
- (4) The general meeting can decide to derogate from the shareholders' pre-emption right. The decision of the general meeting must be passed with the same majority as when amending the articles of associations, at least two-thirds of the votes cast as well as at least two-thirds of the share capital represented at the general meeting.
- (5) (a) If, within 15 days, the existing shareholders have not exercised the pre-emption right, the management board shall announce a second, at least two-week term for the exercise of the pre-emption right with respect to the remaining shares by all of the existing shareholders. After the end of both terms, shares which have not been subscribed according to paragraphs (2) and (5) are made available at the free discretion of the Board of Directors of the company at a price not lower than the price paid by the existing shareholders.

(b) In an issue resolution, it may be determined that excess bonus share rights and subscription rights shall be sold through the company. In conjunction with a bonus issue, the sale shall relate to each shareholder's bonus share rights that do not correspond to an entire bonus share. In conjunction with new issues of shares, issues of warrants and issues of convertible instruments, the sale shall relate to each shareholder's subscription rights which do not correspond to an entire new share, warrant or convertible instrument. The sale shall be carried out by a securities institution. The proceeds from the sale of such bonus share rights and subscription rights, less the sales costs, shall be allocated between the persons who would have been entitled to receive or subscribe for the new shares, warrants or convertible instruments.

#### *Comments*

Section 8 on pre-emption rights implements article 33 of the 2<sup>nd</sup> Company Law Directive. Section 8(4) implements art 33(4) of the Directive.

Re 2) According to the Directive, the time limit should be at least 14 days. In the UK, the time limit is 21 days and in Denmark, Germany, Slovakia, Sweden, the time limit is 14 days.

Re 4) Section 4 allows for specific derogations from the pre-emption right. Even though there is a two third majority in favor of a derogation, the rule requires that the minority rights, including the principle of equality, are not violated. In that way, the derogation must either be necessary or an advantage for the company as a whole.

Re 5 (a) and b) If the shareholders do not use their pre-emptive rights, the question arises what should be done with the excess bonus share rights and subscription rights. There are two different solutions: according to French /Polish/Italian law there is a second term which provides a possibility for the other shareholders to sign for the remaining shares (alternative (a)). The alternative solution which does not involve a second round is found for example in the Swedish Companies Act, chapter 11 paragraph 9. It allows the company to sell the bonus share rights and subscription rights. The proceeds are allocated between the persons who would have been entitled to receive or subscribe for the new shares, warrants or convertible instruments. This is also the common way to deal with the situation in Denmark, Finland and Germany. Likewise, Slovak law does not expect second round of call for exercising the pre-emptive rights. In Greece the matter depends on the articles and the resolution of the general meeting.

#### *Section 6.08* **Bonus Shares**

(1) The limited liability company may issue bonus shares by transferring amounts to the share capital that have been recorded in the company's latest annual report, as adopted, as:

- (a) retained earnings; or
- (b) reserves

(2) For the issue of bonus shares, the company may also use:

- (a) any profit realized in the current financial year and not distributed, spent or tied up; or
- (b) any distributable reserves accumulated or released in the current financial year ( cf. Chapter 7, Section 2).

(3) Any resolution passed under paragraphs (1) and (2) must specify the amount of the share capital increase and the size and number of the shares. Section 6 (1), paragraphs c, f and i to k, apply with such changes as are necessary.

(4) In the case of an increase of capital by converting company reserves into share capital, the company should issue new shares to the existing shareholders in proportion of their original participation or modify the par value of the shares issued.

*Comments*

It follows from the principle of equal treatment of shareholders that bonus shares should be given to all shareholders.

PART 3  
EQUITY LINKED INSTRUMENTS

*Section 6.09*

**Convertible Bonds and Warrants**

- (1) The company may issue convertible bonds, which grant the holder, in whole or in part, a right to exchange their claim for shares in the company.
- (2) The company may issue warrants. Warrants entitle the owner to the right to subscribe for new shares in the company in exchange for a payment in cash.

*Comments*

Section 9 contains provisions regarding the types of financial instruments (including those mentioned in Section 1) whose issuance must be decided by the general meeting. The issuance of debt instruments does not require a decision by the general meeting and the authority for this purpose lies with the management of the company, according to the rules on management competence, see Chapter 8.

Convertible bonds are financial instruments which give the owner a right but not an obligation to convert bonds into shares. However, they can also be issued as so-called “mandatory convertibles” which require the owner to convert. The rules on convertible bonds and warrants seek to ensure that the owners of the convertible bonds and warrants in question receive all the relevant information regarding their rights and duties in connection with the issuance. Further, the rules ensure that a number of pivotal questions regarding the owner’s legal position in connection with future developments in the company are dealt with in the document. Member States such as Denmark, Finland, Greece, and Sweden have provisions in their Companies Acts concerning warrants.

Warrants are instruments which entitle their owners to subscribe for new shares. Of course, warrants can also give the right to purchase own shares (EMCA Chapter 7, sections 19 ff.) Hence, the issuance of warrants requires a decision by the general meeting. A company can also issue call options, which include a right to acquire shares already issued for a pre-specified price (exercise price). Such options are not regulated in the EMCA. The decision to issue options does not require a decision taken by general meeting. The decision as well as the specific setting of the conditions of the option can be taken by the company’s management.

*Section 6.10*

**Decision by the General Meeting**

When the company issues convertible bonds or any other financial instruments convertible into newly issued shares or which entitles the owner of the right to subscribe for new shares in the company, the decisions shall be taken by a resolution of the general meeting. The resolution requires the same majority as necessary for amending the articles of association.

*Comments*

Issuing convertible bonds as well as warrants gives the owner or the issuer a right to convert or the holder a right to sign up for shares of the company, respectively. This implies that the decision should be taken by the general meeting because the decision will result in a change of the articles of association. Therefore, the decision should be taken with the same majority as other changes to the articles of association.

*Section 6.11*

**Contents of Resolutions on Convertible Instruments, Warrants and Options**

The resolution of a general meeting shall determine the maximum amount of the capital increase that may be converted or subscribed on the basis of the instrument, or the number of shares. The resolution must provide shareholders with pre-emptive rights on such an instrument, determining the conditions and time limit for exercising such right. The pre-emptive rights can be excluded in accordance with Section 7.

*Comments*

In the case of an issuance of convertible bonds, the general meeting shall decide the conditional increase of capital in an amount equal to the sum of the face values of the shares to which the owners of convertible bonds are entitled. If the company has non-par value shares, the number of shares to which the holders of the bonds are entitled to is laid down in the terms of the bonds.

The resolution of the general meeting must specify whether the convertible bonds and warrants are negotiable instruments.

All the other issues can be decided by the board or by the shareholder meeting.

*Section 6.12*

**Authorization to Issue Convertible Bonds or Warrants**

(1) The general meeting may authorize the governing body to decide upon the issuing of instruments in the sense of Section 5 and according to Section 14 above (cf. Chapter 5, Section 1).

(2) The resolution described in paragraph (1) shall contain a time limit for the authorisation and determine the maximum amount of instruments to be issued by a resolution of the governing body.

*Section 6.13*

**Decision to Convert**

(1) The owner of the convertible bond or the company may request in writing to convert the bond into a share within the time limit determined by the resolution on the issuance of the convertible bond.

(2) If the price at which the convertible bond was issued was lower than the face value or the price of the share to be issued in exchange, the difference shall be paid by the bondholder or be covered by the part of equity that is distributable for dividend purposes at the time of the notification of the request to convert, according to Chapter 2 Section 23 regarding payment in cash.

*Comments*

Section 16(2) ensures that the prohibition on subscription of shares at a discount is also complied with in respect of the issuance of convertible bonds. If there is a difference between the amount which has been paid up and the nominal value of the equity holding, which is to be converted, any remainder must be paid on request. Alternatively, any remainder should be able to be withheld in the amount, which can be used as dividend. This can also apply in cases where the market value of the shares lies below their nominal value.

*Section 6.14*

**Convertible Bonds' and Warrants' Pre-emptive Rights.**

If the terms of the convertible instrument or warrants do not provide otherwise, the holders of convertible bonds and warrants have pre-emption rights in subscribing for new shares, within the time limit determined in the resolution on issuance of such convertible bonds and warrants. Section 8 applies correspondingly.

*Comments*

As a starting point convertible bonds and warrants have pre-emption rights in connection with later capital increases (or in the case of the no-par value system, increases of the number of shares), if the terms of the issuance do not provide otherwise.

PART 4  
HYBRID INSTRUMENTS

*Section 6.15*

**Performance Linked Instruments**

- (1) The company may issue debt securities that make the consideration or the repayment of the capital dependent on the economic performance of the issuer.
- (2) The decision on issuing debt securities described in paragraph (1) shall be taken by the governing body. The governing body must inform the subsequent shareholder meeting about the terms and the reasons for the issuance.

*Comments*

Some Member States such as Italy have adopted a liberal approach to the issuance of financial instruments. Accordingly, the company can issue debt securities that are linked to the performance of the economic performance of the company. This choice gives companies greater financial flexibility.

*Section 6.16*

**Participative and Non-participative Instruments**

The company can issue, even as consideration for work or services provided for by shareholders or third parties, financial instruments that include economic or administrative rights. These financial instruments may incorporate voting rights for specifically determined subjects, such as the appointment of one or more directors. The articles of association shall set the procedures and conditions for the issue, the awarded rights, the sanctions in case of lack of performance and the restrictions, if any, to the transfer of such instruments.

*Comments*

According to article 7 of Directive 2012/30/EU, an undertaking to perform work or supply services cannot form part of the assets that form the subscribed capital. Some Member States such as Italy have provisions that allow companies to issue participative financial instruments for assets or services that cannot form capital. These financial instruments are not equity, but give the right of participation, either in economic terms (e.g., the right to the benefit of economic performance) or in administrative terms (e.g., inspection rights, voting rights etc) or both. Thus, the holder becomes a party to the company contract. Consequently, the issuance of these instruments needs to be foreseen by the articles of association and their introduction requires a resolution of the shareholders' meeting. They are frequently used, for example in debt restructuring transactions where bank debt is often swapped with participative financial instruments.

Together with tracking shares and other types of equity issued by the company, participative and non-participative financial instruments can offer a wide array of financial solutions to European companies.

PART 5  
NOTIFICATION AND REGISTRATION OF CAPITAL INCREASES AND SHARE ISSUES

*Section 6.17*

**Application for Registration of a Resolution to Increase the Capital or Issue Shares**

- (1) Any resolution by the general meeting or the central governing body to increase the capital or issue shares under this part of the EMCA must be registered directly or an application for registration must be filed with the Registrar within two weeks after payment for the shares has been made or the time limit for making such payment has expired.
- (2) Any resolution by the general meeting or the central governing body to issue convertible debt instruments or warrants and to amend the articles of association must be registered or be the subject of an application for registration with the Registrar no later than two weeks after the resolution is passed.
- (3) Any registration or application for registration of a capital increase is subject to payment of the share capital that is required to be paid up under Section 23 of the EMCA or the articles of association. Where a premium has been fixed, this must be paid up in full.
- (4) When registration is complete, the share capital is considered to have been increased by the total amount of the capital increase.

*Comments*

The Companies Acts of Member States such as Denmark (Section 173), Germany (AktG Section 181) and Poland (Article 256) contain rules on registration of a resolution to increase the capital.

*Section 6.18*

**Registration of Exercise for Conversion of Convertible Bonds and Warrants**

- (1) As soon as possible after the expiry of the time limit provided for conversion of convertible debt instruments or the exercise of warrants, the central governing body must register or apply for registration of the amount of convertible debt instruments or the number of warrants that have been converted into shares with the Registrar.
- (2) The central governing body may make any amendments to the articles of association that are necessary because of the capital increase.

*Section 6.19*

**Revocation of a Resolution to Increase the Capital**

- (1) Any resolution to increase the capital will lapse if registration is refused.
- (2) A resolution will also lapse if it has not been registered or no application for registration has been filed within twelve months after the date of the resolution.
- (3) If a resolution on the capital increase has not been registered, any amounts already paid must be refunded as soon as possible without deduction for costs, and any assets other than cash must be promptly returned.

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## General Comments<sup>47</sup>

### 1. EU law

The 2<sup>nd</sup> Company Law Directive (77/91/EC) as amended by Directive 92/101/EC, 2006/68/EC and 2009/109/EC and recast by Directive 2012/30/EU contains a number of rules on the protection of the company's capital in connection with formation, as well as rules on the maintenance of the company's capital during its existence. The rules on formation are taken into account in Chapter 2 of the EMCA. This Chapter deals with the rules on capital protection which apply during the company's existence. This includes the rules regarding distribution of dividends, repurchase of own shares including financial assistance and the reduction of share capital. Regarding redemption of a company's own shares the 2<sup>nd</sup> Directive is supplemented by the Regulation on exemptions for buy-back programs and stabilization of financial instruments (2273/2003). Further, additional rules of relevance are found in the Directive 2009/109/EC concerning reporting and documentation in connection with mergers and divisions. These rules are taken into account in Chapter 13 of the EMCA.

Shareholder loans other than financial assistance are not regulated by EU Directives. Regulation of shareholder loans is left to the individual Member States. The same applies to the so-called cash pool arrangements which imply that affiliate companies work together to ensure an equalization of liquidity between the companies.

The 2<sup>nd</sup> Company Law Directive of 1976 was somewhat liberalized with the amendment directive of 2006. Amongst other things, this eased the conditions for the acquisition of own shares. In addition, to a certain extent the Directive now allows for financial assistance.

Directive 2012/30/EU includes only few amendments compared to the existing directives. The recent 2012 action plan of the EU Commission (COM(2012) 740 final) does not portend any further changes to it.

Directive 2012/30/EU concerns only public companies. Thus, Member States are free to fully or partially refrain from applying the same provisions to private companies. The EMCA Group emphasizes that Member States should carefully weigh any advantages derived from the application of the rules in the Directive to private companies against the clear disadvantages in applying the very same rules to private companies.

### 2. National law

In many respects, the provisions of Directive 2012/30/EU contain a freedom of choice. For example, it is not mandatory for the Member States to make use of the liberalized rules from the 2006 amendment (now 2012/30/EU) such as the rules regarding repurchase of own shares and financial assistance. Similarly, in several respects it is possible for the Member States to introduce more restrictive rules than required by Directive 2012/30/EU. A number of Member States have not fully made use of the liberalized rules, while, on the other hand, there are examples of Member States that have more restrictive rules than required. In some Member States, for example, there are no rules prohibiting shareholder loans, whereas in other Member States such loans are prohibited, see further below. Likewise, some Member States have fully made use of the liberalization possibilities concerning repurchase of own shares, whereas others have maintained the existing limitations or even prohibitions.

Regarding the application of the Directive 2012/30/EU rules to private companies, there are also significant differences. For example, the UK Companies Act 2006 only applies the provisions of the Directive to a limited degree to private companies whereas Denmark by contrast applies the same rules fully to private companies.

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<sup>47</sup> The working group on Chapter 7 was chaired by Professor Jan Andersson (Jönköping University, Sweden) and included Professor Hans de Wulf (University of Gent, Belgium) and Professor Professor Andres Vutt (University of Tartu, Estonia).

### 3. Considerations

The overall concept of the EMCA is to make rules that are flexible and simple. From that starting point it is easy to criticize Directive 2012/30/EU for being overly complex, even after the recent liberalization. In recent years there has also been a discussion regarding the system of capital protection which Directive 2012/30/EU illustrates.

Alternative capital protection systems are found in other countries including a number of states in the U.S. (and in the American Model Business Corporation Act § 6.40; MBCA) and in New Zealand. At European level, there have also been proposals for the implementation of an alternative capital system. For example, the Rickford Group has proposed that the board should scrutinize whether the company after a value transfer has assets that equal the liabilities. If this is not the case, the company may nonetheless undertake a value transfer if the company's board "when making or recommending distributions ... provide a certification of solvency on a going concern basis."<sup>48</sup> These proposals have had some impact at Member State level. Thus, in 2013 Netherlands changed the rules concerning distribution of profits, repurchase of shares and reduction of capital in close (private) companies (*besloten vennootschap*), and thereby introduced a *balance sheet test* (net equity must be higher than reserves which must be maintained pursuant to the law or the articles of association) and a solvency test in the legislation. It should be noted that the law reform included an abolishment of the minimum share capital. To summarize, Netherlands has introduced a regime for private companies similar to that in § 6.40 of the MBCA and abolished the old system.

The EMCA group has discussed whether the capital protection rules of Directive 2012/30/EU is appropriate or whether the EMCA should introduce an alternative capital protection system on the basis that the Directive reflects an obsolete legal paradigm. There were basically two views in the EMCA Group. One view favored an abolishment of the old capital system in favor of a new system based on § 6.40 of the MBCA or similar. Another view favored the old system and recognized that it has some advantages, but not is not flawless. Those advantages, however, make up for whatever flaws the old capital system might possess. Against this background, and although there are different views within the EMCA Group as to which solution is preferable, it is notable that it is unlikely that the EU-capital protection rules will be changed fundamentally in the near future. Article 17 of the Directive 2012/30/EU limits the dividend payments on the basis of the company's net assets as set out in the company's annual accounts. However, the Directive does not prevent the Member States from supplementing this model with a solvency based system. This opportunity is utilized in Finland. The current trend in Europe resembles the situation in the US a few decades ago with a slow move from an old system to a new system. It is the opinion of the EMCA Group, and in particular because of Directive 2012/30/EU, that the time has not yet come to radically alter the legal framework based on the old capital system. Consequently, this Chapter makes use of the liberalized rules of Directive 2012/30/EU. In situations where it is possible to derogate from the Directive, the least burdensome solutions have been chosen in most cases. This approach will also allow most of the rules in this Chapter to be applied without difficulty to private companies.

This Chapter contain rules on capital outflow in the form of distributions, dividends, gifts, repurchase of own shares, financial assistance in connection with acquisition of shares in the company and capital reduction.

Regarding own shares the EMCA Group has chosen to follow the liberalization of the 2<sup>nd</sup> Company Law Directive in 2006. Furthermore, the Group is of the opinion that also private companies should be able to repurchase own shares. Similarly, the Group has chosen to make use of the liberalized rules on financial assistance in the 2006 amendment.

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<sup>48</sup> See J. Rickford (ed.), *Reforming capital: Report of the interdisciplinary group on capital maintenance*, European Business Law Review 15 (2004), pp. 919-1027.

There are no rules, as mentioned earlier, on ordinary shareholder loans in Directive 2012/30/EU. Therefore, it is up to each Member State to decide whether shareholder loans should be forbidden or restricted. Without any restrictions, loans to shareholders, and also loans to directors and members of the management, may be open to abuse either by the management at the expense of the interest of the shareholders or by a majority shareholder in its capacity as a shareholder or member of the board or management at the expense of the interest of the minority shareholders in the company. Therefore, there is a need for provisions which protect shareholders and in particular minority shareholders.

Company's legislation in the Member States have very different approaches to rules on shareholder loans or, for that matter, loans to directors and members of the management. Most Member States allow shareholder loans. This is for instance the case in the UK. However, section 197 of the UK Companies Act 2006 and the sections that follow require approval of members for loans to directors. In some Member States, in particular the Nordic countries, loans to directors and shareholders are forbidden on the premise that such loans may cause harm to the creditors. Illustrative for this legal approach is Denmark, where shareholder loans are forbidden.

The EMCA Group has considered which model should be preferred in the EMCA. Firstly, the Group has concluded that loans to shareholders (and the provision of security for loans which the shareholder obtain from someone else), directors and member of management may cause harm to the creditors. However, the Group has also concluded that provisions in this context usually are very complex in their nature, will cause excessive transaction costs compared to the level of creditor protection which they effectively provide for and, in the end, are usually circumvented by individuals who choose to do so. For those reasons the Group has not proposed any rules concerning loans (and the provision of security) extending other rules in the EMCA providing protection for creditors. Although the Group does not propose additional rules, it should be remembered that, under certain conditions, a loan (and the provision of security) to a shareholder may constitute a disguised distribution of profit, in which case Section 1 and 2 below applies. In addition, even if a loan (and the provision of security) may be legal under the rules in this and the following sections, the governing body must still at all times be aware of transactions which infringe their duty of care or their duty of loyalty. In particular, the exceptions in Section 2(5) of this Chapter, should be interpreted and understood with this in mind.

Secondly, the EMCA Group has come to the conclusion that loans (and the provision of security) to shareholders, directors and member of management should be analyzed in the context of related party transactions, i.e. dealings whereby the company contracts with its directors or controlling shareholders, may cause prejudice to the company and its minority shareholders, as they give the related party the opportunity to appropriate value belonging to the company. As was stated by the European Commission in a communication 2012,<sup>49</sup> adequate safeguards for the protection of shareholders' interests are of great importance.

It may be argued that loans (and the provision of security) to shareholders, directors and member of management should be regulated in the wider context of related party transactions. In the absence of such a general rule, it can be argued that at least loans (and the provision of security) to shareholders, directors and member of management should be the object of regulation in the context of protection for minority shareholders, because financial transactions of this kind might be seen as the most typical transaction whereby management, members of the board or majority shareholders may abuse their position. However, again the problem is that such rules usually are very complex in their nature, will cause excessive transaction costs compared with the level of shareholder protection they effectively provide and, in the end, are usually circumvented by individuals who choose to do so. For that reason the EMCA Group does not propose any rule in this regard.

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<sup>49</sup> Action Plan: European Company Law and Corporate Governance – A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies (COM(2012) 740 final).



PART 1  
GENERAL PROVISIONS

*Section 7.01*

**Distribution**

(1) The term “distribution” in the EMCA includes any transfer of money or money’s worth without due consideration directly or indirectly to a shareholder or third party in the absence of a genuine commercial purpose, including, but not limited to, the following:

- (a) ordinary dividends, based on the latest adopted financial statements (see Section 3);
- (b) extraordinary dividends (see Section 5);
- (c) charitable gifts according to Section 6;
- (d) payments in connection with repurchase of shares (see Section 8 to 17);
- (e) payments in connection with capital reductions (see Sections 25 to 32) or redemption of shares (see Chapter 5, Section 15); or
- (f) payments in connection with the dissolution of the company (see Chapter 14).

(2) The company’s assets may only be distributed to its shareholders or third party according to the principles and rules in the EMCA and the articles of association.

*Comments*

Re 1) The definition of the term “distribution” in Subsection 1 basically clarifies that a distribution may take the form of money or money’s worth, i.e. in the form of tangible or intangible assets. The definition also clarifies that a “distribution” not only may be in the form of a distribution directly to a shareholder, but also indirectly, for instance to a legal person owned by the shareholder or a natural person such as a close relative. This latter principle has been inspired by the law in certain Member States most notably Germany and Sweden. Furthermore, it includes situations where for instance a shareholder purchases something for their own benefit and the purchase is reimbursed by the company at a later point.

Article 17 (4) of Directive 2012/30/EU states that the “expression” distribution” used in paragraphs 1 and 3 includes in particular the payment of dividends and of interest relating to shares. The EMCA Group is of the opinion that even if this definition might be satisfying for purpose of the Directive, and in particular Article 17 therein, the rules and principles in this and the following chapters require a more elaborate definition. It should also be noted that the definition in Article 17 (4) is *illustrative rather than elaborate*. The purpose of the definition in subsection (1) supra is therefore somewhat different than that in the Directive in that the intention is to provide *both an illustrative and an elaborate definition*.

The EMCA Group has, thus, firstly designed the definition with the intention to provide an illustration of the transfers of assets from a company to shareholders which are common practice in most jurisdictions, which may easily be recognized by shareholders, members of the governing board, auditors and other interested parties, and which explicitly have been regulated in the EMCA. Dividends, extraordinary dividends, payments in connection with repurchase of shares, payments in connection with capital reductions and payments in connection dissolution of the company are all familiar concepts to shareholders, stakeholders and even the public in general. In addition, in some jurisdiction gifts from a company for charitable purposes to third party are also regulated and have therefore been included in EMCA.

But the definition also has another purpose. The EMCA Group has, secondly, designed the definition in an elaborate manner, where the intention is to clarify that the rules concerning capital outflow should be applied to any disguised distribution to shareholders, for instance the sale of an asset below market value to shareholder or the purchase of an asset from a shareholder above the market value. For practical purposes, only the rules on dividends, and no other rules concerning capital outflow, should be applied *mutatis mutandis* on disguised distributions since the amount available for dividends may be distributed in any case to the shareholders. From the definition, it follows that a disguised distribution is not present if either a) the consideration from the shareholder equals the market value of the assets transferred by the company or b) if there are other commercial benefits in either short or long term for the company despite a discrepancy between the market value of the asset transferred by the company and the market value of the asset received by the company.

The EMCA Group has considered a number of different legal approaches to disguised distributions in various jurisdictions, and more specifically when various transactions between a company and its shareholders should be considered as such. A common problem in most jurisdictions is the fact that there is no clear definition in statute as to what constitutes a disguised distribution. In many cases the judiciary therefore is left with a situation where it is open to debate amongst academics and practitioners as to how a disguised distribution should be defined. This of course leads to legal uncertainty with an additional transaction cost *ex ante*, and in some cases even increased transaction costs *ex post*, a particular transaction.

Against this background the EMCA Group came to the conclusion that a legal definition of the term “distribution to shareholders” should be elaborate enough to include disguised distributions, and, in addition, should be precise enough to filter out such transactions which are commercially sound and those which are not. Firstly, the definition is based on the view that a transaction, which is concluded at market value, never can be regarded as a disguised distribution because a distribution implies a transfer of value from the company. Secondly, even if a transfer of value from the company is present in a particular transaction, for instance sale of company assets below market value to a shareholder, there might be sound commercial reasons for the company to do so. The company might for instance purchase another asset from the shareholder at a lower price, expect a future, successful business relation with the shareholder in his or her capacity as a supplier or customer or the transaction might be necessary to immediately enhance the liquidity of the company in order to avoid a potential bankruptcy.

However, the EMCA Group wants to stress that even if a particular transaction does not constitute a disguised distribution because condition a) or b) in the definition are not met and, thus, the rules concerning capital outflow do not apply to it, this does not mean that transaction for other reasons might not be invalid. A transaction, for example, might be unfairly prejudicial to minority shareholders because of the circumstances in the particular case viewed together with the terms of the transaction. In other words the transaction might be unreasonably beneficial to a majority shareholder such as a holding company at the same time as it is disadvantageous to the minority shareholders (cf. Chapter 8, Section 25).

Re 2) Section 1(2) states that the company’s assets may only be distributed to its shareholders according to the principles and rules in the EMCA and the articles of association. Basically, this means that any distribution of the company’s assets to its shareholders presupposes that the distribution is in accordance with the principles and explicit rules in the EMCA and the articles of association. Other ways of retrieving capital is not permitted.

A particular problem which the EMCA Group has addressed is the legality of disguised distributions as such regardless of the rules concerning capital outflow. One legislative approach is to make such distributions illegal even if the company has distributable reserves available for it, i.e. any distributions not following the formal and material rules in the EMCA concerning the particular distribution - here “dividend” – would make it illegal (cf. § 57 in the German AktG). Another legal approach is to make disguised distributions legal as long as all shareholders agree to them and assuming the rules in the EMCA concerning creditor protection are respected (cf. § 30 in the German GmbHG). However, even with this latter, more liberal approach, a disguised distribution may be illegal if not all shareholders agree to it on the basis that the disguised distribution is contrary to the principle of equality between shareholders or that it entails a transaction which the particular organ or person could not legally enter into on behalf of the company (because it requires either consent from all the shareholders or a decision by the shareholders meeting).

The EMCA Group is of the opinion that the better solution for practical reasons is the latter one. For public companies with one or few shareholders, but also private companies in general where the number of shareholders is typically limited, there is no practical reason to uphold a strict legal regime which would render every type of disguised distribution illegal even if the shareholders has agreed to it. Such a regime does not serve any meaningful purpose and would, furthermore, just be an incentive for unnecessary litigation and, in the end, higher transaction costs without any substantial benefit in terms of protection for creditors and, for that matter, shareholders.

As stated above, *any distribution of assets from the company to its shareholders presupposes that the distribution is in accordance with the principles and explicit rules in the EMCA and the articles of association.* However, since the EMCA Group is of the opinion that disguised distributions should be considered legal as long as all shareholders agree to them and *assuming the rules in the EMCA concerning creditor protection are respected*, this may be considered as an “exception”. But the Group wants to stress that this is not an “exception” in the strict sense of the word since the principles of the EMCA recognizes the merits of a consent by all shareholders to a particular legal act. In other words, the EMCA recognizes that if all shareholders agree to a disguised distribution such distribution is valid *conditional that the rules concerning creditor protection in the Act are respected.* See Section 2, Subsection 5.

The EMCA Group has also considered the rule in article 17(5) of Directive 2012/30/EU which allow interim dividends under certain conditions. The view of the Group is that there presently is a limited practical need for a rule on interim dividends, and for that reason no rule concerning interim dividends has been included in the EMCA. However, this view might be subject to review at a later stage if, and when, a practical demand can be identified.

#### *Section 7.02*

#### **Distribution and Creditor Protection**

- (1) Any type of distribution to shareholders or a third party according to Section 1, Subsection 1, must be legal according to Subsection (2)-(4) in this Section, unless the legality of the particular type of distribution is regulated differently in this Act.
- (2) Distribution may only be made out of distributable reserves, which are amounts stated as retained earnings in the company’s annual report for the last financial period approved by the general shareholder’s meeting, and reserves that are distributable by law or the company’s articles of association, less retained losses.
- (3) Distribution may not be made if the company after the distribution would not be able to pay its debts as they become due in the usual course of business.
- (4) The company’s central governing body is responsible for ensuring that distributions do not exceed a reasonable amount having regard to the company’s financial position and, for parent companies, the group’s financial position, and that no distribution is made to the detriment of the company or its creditors according to the duties of the governing body laid down in Chapter 9 Section 2.
- (5) Even if all shareholders agree to a distribution to one or all of them or third party in contravention of subsection (1)-(4), such agreement is invalid.

*Comments*

Re 1) From the title of Section 2, it follows that the protection of a company's creditors is a purpose which requires mandatory norms in the EMCA in the context of distributions to shareholders. In particular the wording of Section 1, Subsection 1, clarifies those mandatory norms through the reference to subsection (2)-(4). Subsection (2)-(4) may be described as general rules expressing general principles of company law as those principles are understood in the EMCA. As follows, most types of distributions to shareholders must be legal under Subsection (2) to (4) such as ordinary or extraordinary dividends as well as disguised distributions even if all shareholders agree to it. However, some distributions to shareholders are specifically regulated differently in the Act because of their character and nature. This is for instance the case with a reduction of share capital. Subsection (1) clarifies this by stating that Subsections (2)-(4) apply to most types of distribution to shareholders, but not if the particular type of distribution is regulated differently, and then expressly so, in the Act.

Admittedly, § 6.40 of the US MBCA is a superior legislative model to that in Section 2, subsection 1, of the EMCA *in technical terms* in that all types of distribution to shareholders must meet the same, simple standard test without any exceptions. And this is true regardless of which opinion one holds on the merits of the solution chosen in § 6.40 MBCA from a *material point of view*, i.e. basically a test based on insolvency in the bankruptcy and equity sense. The EMCA Group has not chosen the material rule in § 6.40 of the MBCA for reasons stated earlier and because of this, there is no other alternative than to regulate distribution to shareholders in the simplest way available, which is a general rule with exceptions to it.

Re 2) In Article 17 (1) of Directive 2012/30/EU, it is stated that except for cases of reductions of subscribed capital, no distribution to shareholders may be made when on the closing date of the last financial year the net assets as set out in the company's annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes. This rule is further strengthened by the rule in Article 17 (3), according to which the amount of a distribution to shareholders may not exceed the amount of the profits at the end of the last financial year plus any profits brought forward and sums drawn from reserves available for this purpose, less any losses brought forward and sums placed to reserve in accordance with the law or the statutes. The end result is a codification of the capital maintenance doctrine with the specification that only retained, earned profits may be used for distribution to shareholders, but with the exception that also capital reserves available for the same purpose may be used.

The EMCA Group has in Section 2.1 rewritten Article 17 (1) and 17 (3) with the intention to make it more comprehensible, but without any change as to its content. Since it is a rule common to all Member States and follows a long legal tradition, it should not cause any practical problems. In any case the rule in Section 2.1 must be read and understood against Article 17 (1) and 17 (3) of the Directive.

It should be noted that the reference to the fact that any distribution must be made on the basis of the annual accounts for the last financial period approved by the ordinary general meeting, against the background of Section 2, Subsection (2) and Article 17 (1) and 17 (3) of the Directive, is mandatory for the protection of the creditors of the company.

Section 2 does not contain any rules on "legal reserves". The EMCA Group has considered whether the companies should be obliged to place certain amounts at a legal reserve. According to the German AktG Section 233, dividends may not be paid for as long as the legal reserve and the capital reserve in aggregate do not amount to 10 per cent of the share capital. Also other Member States have provisions on legal reserves. This is for example the case in France, Greece, Italy, the Netherlands, Poland, and Portugal as well as previously so in Denmark and Sweden. A stronger argument for a legal reserve might arise in private companies where the minimum capital is only 1 Euro, see above under consideration. However, the Group considers that the provision in Section 2(2), which includes a solvency test, is sufficient to protect the creditors and does so in a more efficient manner. The proposal of Directive of 2014 on single-member private limited liability companies and creating a *Societas Unius Personae* (SUP) also adopts this approach. In addition, the EMCA Section 2(4) stresses that the company's central governing body is responsible for ensuring that distributions do not exceed a reasonable amount having regard to the company's financial position. Thus, the EMCA does not contain any rules on legal reserves.

Re 3) The merits of the capital maintenance doctrine have been questioned by many scholars. A more modern approach, and indeed already in existence in many U.S. states and other jurisdictions including some EU Member States, is to replace the doctrine altogether with a solvency test similar to the one in § 6.40 of the Model Business Corporation Act. The EMCA Group did indeed consider this as an alternative, more realistic form of restricting distribution to shareholders other than the capital maintenance doctrine. For reasons already stated, and in particular Article 17 Directive 2012/30/EU, the Group instead chose to keep the well-established solution already in existence and favored by the EU.

However, the merits of a solvency test cannot be denied. In addition, a solvency test fulfil the purpose of being a necessary barrier to a distribution of a company's assets to its shareholders (or a third party) at a time when the company cannot either meet its liabilities as they become due or will not be able to do so in the foreseeable future. For that reason, and the fact that the capital maintenance doctrine cannot hinder such distributions, the EMCA Group is of the opinion that an additional rule based on a solvency test is necessary as an additional protection for creditors. Indeed, some Member States have already included such rule in their legislation.

Section 2 (3) stipulates that a distribution may not be made if the company after the distribution would not be able to pay its debts as they become due in the usual course of business. Any distribution of ordinary dividends – whether a dividend in cash or other assets of the company - must meet ex ante the criteria of solvency of the company ex post the very same distribution. The measurement should not only be if the company is unable to continue paying its due debts immediately after the distribution, but also if the company in the foreseeable future after the distribution – in most cases a few months and seldom longer than half a year – is unable to continue paying its due debts. It should be noted that the wording of the Section does not mean that there is a requirement of logical causality between the distribution and the fact that the company is unable to continue paying its debts after it. Instead, it is a measurement of the economics consequences of that distribution, and the critical question is if a distribution is more likely to lead to a situation immediately after, or in in the foreseeable future after, the distribution where it is more likely that the company will be unable to continue paying its due debts than not. The relevant time to measure whether the distribution meets the solvency test or not is immediately before the distribution is to be decided by the shareholders meeting or, as the case might be, the general governing body of the company, or at least as close in time as practically possible to the decision.

It should be emphasized that the solvency test does not prevent a distribution in other assets than cash, even if the asset in question is of such a nature that it can be converted easily into cash, conditional that such a distribution does not directly or indirectly lead to situation immediately after or in in the foreseeable future after the distribution where it is more likely that the company will be unable to continue paying its due debts than not.

In most cases a company's board of directors, management board as well as the managing director will have financial information such as recent cash flow analysis available to themselves or prepared by others to measure ex ante whether the company as a going concern in the normal course of business will be able to pay its debts as they become due in the usual course of business immediately ex post a particular distribution and, in addition, in the foreseeable future after the distribution. In the absence of such information it is, however, necessary for the company's board of directors, management board and managing director to obtain such information and instruct officers of the company or – as the case may be in a SME – a third party to prepare such information necessary to validate if the solvency criteria will be met immediately and in the foreseeable future after the distribution.

When the circumstances indicate that the company is encountering difficulties or is in an uncertain position concerning its business, for instance in the aftermath of a financial crisis in the economy, the liquidity of the company either should be preserved for such reasons for operational use in the business for the forthcoming months or at least should not be used for any distribution to shareholders or a third party until the company's future as a going concern including its business operations becomes more clear to the company's board of directors, management board and managing director.

In determining whether the solvency requirement is met immediately and in the foreseeable future after the distribution, the company's board of directors, management board and managing director may as a rule of thumb rely on certain assumptions as to the future course of the company's business, absent direct or indirect indications to the contrary. As a rule of thumb, and absent direct or indirect indications to the contrary, the company's board of directors, management board and managing director may assume (a) that based on existing and genuinely in good faith anticipated future demand for the company's products and services, it will be able to generate funds over a longer period of time – up to the forthcoming 12 months and regardless of the distribution - sufficient to satisfy its existing and reasonably anticipated obligations as they mature with a marginal surplus and (b) that indebtedness which mature in the near-term – up to the forthcoming 12 months and regardless of the distribution - will be refinanced where, on the basis of the company's financial condition and future prospects and the general availability of credit to businesses similarly situated, it is reasonable for them to assume in good faith that such refinancing may be accomplished. However, if direct or indirect indications to the contrary exist as to (a) or (b), the company's board of directors, management board and managing director is under an obligation to ascertain on financial information available and obtainable, if a distribution is more likely to lead to situation immediately after, or in in the foreseeable future after, the distribution - typically a few months and rarely longer than half a year - where it is more likely that the company will be unable to continue paying its due debts than not.

If a company may be subject to asserted or unasserted contingent liabilities, the assessment ex ante the distribution should include an evaluation as to the likelihood, amount, and time of any recovery against the company, after giving due consideration to the extent to which the company is insured or otherwise protected against loss.

In any event, the ex-ante judgement of the hypothetical distribution must be based on financial information available and obtainable for that purpose, and members of the company's board of directors or management board as well as its managing director must never be held responsible as a matter of hindsight for unseen developments, if they have acted in good faith on such financial information available and obtainable.

Re 4) A decision by the general meeting is required for the distribution of the company's capital. However, subsection 3 contains a specific and additional protection as it is specified that the central governing body of the company has a responsibility to ensure that the distribution of capital is sound and does not harm the company or its creditors. This follows from the general rule of duty of care in Chapter 9, Section 2. The central governing body is in addition, also of course, responsible for insuring that reserves as specified by statute or the company's articles of association are covered. Such reserves include the minimum capital of the company, see Chapter 2, Section 20. This is also in accordance with article 38 of Directive 2012/30/EU. Furthermore, Section 3, subsection (1), of the EMCA determines that a decision to distribute dividends must be approved by the company's central governing body. See also Section 5, subsection (2).

Re 5) Subsection (5) clarifies what has been expressed earlier, namely that all shareholders consent to a particular distribution is not valid unless the distribution in question is legal according to the general rules concerning creditor protection in subsection (2)-(4) or, as the case might be, the special rules which apply to the particular distribution to shareholders.

If a charitable gift or otherwise a distribution of the company's assets take place to a third party, the distribution must be legal according to the very same general rules concerning creditor protection in Section 2, subsection (2)-(4) or, as the case might be, the special rules which apply to the particular distribution. The motive for this restriction is that from a creditor's point of view and, hence, instrumental to the intended creditor protection in the EMCA, it does not matter who receives the company's assets as a distribution. What matters is if a distribution from the company takes place. As indicated earlier, a distribution to a third party might occasionally be in substance an indirect distribution to a shareholder, for instance if the distribution is made to a legal person owned by the shareholder or a natural person such as a close relative.

PART 2  
ORDINARY AND EXTRAORDINARY DIVIDENDS

*Section 7.03*

**Distribution of Ordinary Dividends**

(1) The general meeting must decide how to distribute, by dividend, the amount available for distribution according to the approved annual report for the last financial period. The general meeting cannot decide to distribute dividends of a higher amount than that proposed or accepted by the company's central governing body.

In case of a distribution according to Subsection 2, the company's central governing body can only refuse a demand to this effect, if either the distribution would be illegal according to Section 2 or, in the opinion of the company's central governing body, a distribution of more than one half of the profits would be adverse to the company's financial position.

(2) At least one half of the profits of the last financial period, less the amounts not to be distributed under the articles of association, shall be distributed as dividend to all shareholders, if a demand to this effect is made at the ordinary general meeting by shareholders representing at least one tenth (1/10) of all shares before the decision on the use of the profit for the last financial period has been made. However, shareholders representing at least one tenth (1/10) of all shares cannot demand the distribution of profits in excess of ten per cent (10 %) of the aggregate of restricted and non-restricted reserves including the share capital of the company and the profit for the last financial period (equity), and may in any case never exceed what is available for distribution according to Section 2. Past distributions of profits of retained earnings less any losses during the financial period and before the ordinary general meeting shall be subtracted from the amount so calculated.

(3) Provisions on minority dividend different from those in subsection (2) may be included in the articles of association, if such provisions are more beneficial for the minority.

*Comments*

Re 1) Shareholders have an intrinsic right to share the company's profits. Usually the company takes the decision on the distribution of profits at the ordinary meeting. The decision to distribute profits is in most Member States taken by the general meeting. The decision requires a simple majority according to the EMCA Chapter 11, Section 12.

Section 3, paragraph 1 also requires that the decision regarding the dividend must be either proposed or approved by the general governing body of the company. A similar rule is found in Member States including Denmark, Finland and Sweden. The rationale behind the rule is that the general governing body of the company rather than the shareholders meeting, who decides in France for instance, have the knowledge and understanding of the company's financial position and future prospects as well as the task of ensuring the legality of distribution according to Section 2. Therefore, the general governing body should also have the right to propose or, if the shareholders meeting decides to distribute a higher amount to the shareholders than proposed by the general governing body of the company, accept or reject this higher amount.

Re 2) In most Member States, the minority has no right to receive dividends even though the company's economic situation allows for this. Thus, there exists a problem of so-called dividend starvation. In some countries this minority problem may be solved through general principles of minority protection. This is for example the case in Denmark according to the so-called general clause on minority protection. However, in other countries such as Finland and Sweden, there is a special provision in the Companies Acts, Chapter 18, Sections 11-12 and Chapter 13, Section 7 respectively, according to which, a minority of at least 1/10 may demand that a certain amount of a company's net profits are paid out as dividend. A somewhat reversed rule is found in Portugal, where the general meeting may decide not to distribute more than one half of the annual profits only by a resolution approved by super majority of 75 % of voting capital; see Article 294 of the Portuguese Companies Act.

The EMCA Group is of the opinion that minority shareholders should be protected in a more specific manner as regards their right to receive dividends from the company rather than the protection afforded by the general principles of minority protection. Legal standards or general clauses fulfil an important purpose in company legislation, in particular as regards minority protection. However, even well drafted standards or general clauses cannot conceal the fact that they require a substantial amount of judicial review to become effective as a device to protect minority shareholders. Besides, such standards or general clauses might be effective as a legal instrument for judicial review of individual transactions or arrangements in that it provides the judiciary with an instrument to reverse them, but are far less effective as an instrument to give minority shareholders a specific right to for instance dividend. For those reasons the EMCA Group has concluded that the EMCA should include a detailed rule which provides the minority with a specific right to dividend from the company.

The rule on minority dividend in Subsection 2 has been inspired by similar rules in the aforementioned countries.

Re 3) According to Subsection 2 at least one half of the profits of the last financial period, less the amounts not to be distributed under the articles of association, must be distributed as dividend to all shareholders, if a demand to this effect is made at the ordinary general meeting by shareholders representing at least one tenth of all shares before the decision on the use of the profit for the last financial period has been made. The right to demand a distribution of dividend according to this subsection (minority dividend) belongs to all shareholders irrespective of voting rights (whether they have shares with no voting rights at all or shares with less voting rights than other shares), irrespective of the nominal value or par-value of the shares and irrespective of the existence of preferential rights or not to profits. However, shares which have no dividend right at the particular general shareholders meeting which the demand could be made may not be invoked by minority shareholders to receive a dividend contrary to this absence of dividend right. The phrase shareholders representing at least one tenth of all shares refers to the number of shares and not their voting rights.

One or several minority shareholders cannot demand the distribution of profits in excess of ten per cent of the aggregate of restricted and non-restricted reserves including the share capital of the company and the profit for the last financial period (equity), and may in any case never exceed what is available for distribution according to Section 2. Section 2 is essential for the protection of the company's creditors and, hence, can under no circumstances be dispensed with by the shareholders; even if all shareholders agree to a distribution contrary to it.

The amount which shareholders representing at least one tenth of all shares may demand to be distributed at the general shareholders meeting is the profit for the last financial period, i.e. usually the last calendar year. The minority may demand that at least half of the profits for that financial period be distributed. The majority can at the general shareholders meeting either accept the demand or refuse it. In the former case, the general shareholders meeting may decide to distribute at least half of the profits for the last financial period or a higher amount. In the latter case, were the general shareholders meeting refuses the demand, the minority shareholders may institute legal proceedings against the company on the ground that the resolution whereby the majority refused the demand was contrary to the EMCA; see Chapter 11, Section 28. A court may in such case reverse the decision.

There are three legal restrictions which apply to a demand by minority shareholders at the general shareholders meeting. Firstly, the aforementioned creditor rules in Section 2 are mandatory. Secondly, shareholders representing at least one tenth of all shares cannot demand the distribution of profits in excess of ten per cent of the aggregate of restricted and non-restricted reserves including the share capital of the company and the profit for the last financial period (equity). Admittedly, this restriction is arbitrary in its nature, but similar rules are found in the Nordic legislation and, more importantly, there has to be some reasonable relationship between, on the one hand, the amount which minority shareholders may demand to be distributed out of the profits for the last financial period and, on the other hand, the aggregate of the equity in the company, i.e. restricted and non-restricted reserves including the share capital of the company and the profit for the last financial period. Ultimately, the financial stability of the company should be viewed as more important than a minority shareholders request for distribution of profits, and to that end the aggregate of the restricted and non-restricted reserves including the share capital of the company and the profit for the last financial period after a distribution matters.

The third legal restriction is found in subsection (1) according to which the company's central governing body can only refuse a demand by minority shareholders, if in the opinion of the company's central governing body a distribution of more than one half of the profits would be adverse to the company's financial position. As follows, the company's central governing body can never refuse a minority dividend of *exactly half of the profits for the last financial period* unless the aforementioned two legal restrictions apply. But the company's central governing body may refuse a minority dividend of *more than half of the profits for the last financial period*, if the distribution demanded by the minority would be adverse to the company's financial position.

In calculating the amount available for distribution as dividend, past distributions of profits of retained earnings less any losses during the financial period and before the ordinary general meeting must be subtracted.

Re 4) As a device to protect minority shareholders from “dividend starvation”, subsection 2 is a mandatory rule which the shareholders may not deviate from in the articles of association unless all shareholders decide otherwise in a particular situation where the consent is only valid for that situation. On the other hand, and as the case might be, shareholders might have good reason for inserting rules in the articles of association which provide for a more beneficial right to a dividend. The EMCA Group is of the opinion that such rules in the articles of association may have a practical use. Subsection 3 makes it clear that the shareholders may insert more beneficial rules in the articles of association. In determining whether a rule is more beneficial to minority shareholders and therefore valid, or less beneficial and therefore invalid as contrary to subsection (2), an assessment has to be made on basis of its material structure and content as well as its economic consequences with the minority perspective as a reference point. Again, the EMCA Group emphasizes that, with or without any rules of this nature in the articles of association, any distribution of profits may never exceed what is available according to the creditor rules in Section 2.

#### *Section 7.04*

#### **Distribution in Kind**

(1) Distribution to shareholders may be made by the company in assets other than cash, if the asset in question is of such nature that it easily can be converted into cash.

(2) If non-cash assets are distributed as dividends, a valuation report must be prepared (see Chapter 2, Section 11). The report must state that the amount of the dividend available for distribution corresponds to at least the value of the non-cash assets distributed. The company must publish the declaration in the Registrar's IT system no later than two weeks after the date of the resolution on the distribution (see Chapter 3, Section 5).

(3) Subsection (1) applies unless the articles of association provide otherwise or all the shareholders in the particular case agree to a distribution of assets of any nature other than cash.

#### *Comments*

Re 1) The payment of dividend typically occurs by payment of cash, but can also occur by payment of other assets. Historically, it was sometimes the case, even for short periods as it was unpopular (See the Dutch “*Verenigde Oostindische Compagnie*” or VOC established in 1602). For minority shareholders, a dividend in assets other than cash can pose a problem. For instance it is possible that majority shareholder may decide that the company will distribute property which for the majority shareholder is of substantial use in his or her business, but for minority shareholders is of no value or almost no value at all. In addition, even if assets so distributed proportional to majority and minority shareholders alike may formally be compatible with the principle of equality between shareholders, a majority shareholder may be in the position to convert the distributed non-cash assets easily into cash while this opportunity may not at all, or only with difficulty and additional transaction cost attached, be available to the minority shareholder. Therefore, the principle of equality between shareholders would not as a matter of fact be respected in those and similar situations. To avoid this, and other practical problems related to distributions in kind, distribution may be made in assets other than cash only if the asset in question is of such nature that it easily can be converted into cash, which for instance is the case with shares or commodities which are traded in a regulated market.

Re 2) Distributions in kind may also pose a problem in relation to creditors of the company. In particular, there is a need to protect the company's creditors if the valuation of the assets to be distributed is incorrect. A similar problem may occur if the minority shareholders agree to a distribution in kind to the majority shareholder while the minority shareholders are satisfied with a cash distribution, but then on the basis of a valuation which is incorrect. To ensure a proper valuation, Section 3 contains a requirement for a valuation report in the same way as for contributions in kind in connection with the formation of companies. The EU rules do not require a valuation report in connection with the distribution of values, and rules in this regard do not seem to occur in other Member States. For the purpose of protecting creditors and minority shareholders alike, a valuation must be made in accordance with Subsection (2).

A practical problem not uncommon in some Member States, and which the EMCA Group has considered, is the legality test of distributions in kind according to Section 2, Subsection (2). If the market value of an asset being the object of a distribution in kind is higher than the book value of the very same asset, one problem is if the market value or the book value of it should be compared and reduce the distributable reserves in the balance sheet. For practical reasons, and also against the legislative background that the creditor protection within the Directive 2012/30/EU is based on the balance sheet and the book value of assets therein, the EMCA Group is of the opinion that it is the book value which should be used for the legality test under Section 2, Subsection (2) (cf. § 30 in the German GmbHG).

But it must be stressed that the value of the distribution as such according to Section 1, Subsection 1, is the market value of the asset – never anything else. This means that even if the book value of an asset used for distribution to shareholders is used according to Section 2, Subsection 2, when the legality of the distribution is established *ex ante* according to the same Subsection, the value of the distribution for other purposes in the EMCA is the market value of the asset, for instance in relation to the principle of equality between shareholders. Thus, if for example one shareholder A receives a distribution in kind in return for dividend in cash to another shareholder B and with the consent of that other shareholder B, the principle of equality between shareholders requires that the dividend in cash to shareholder B must equal the market value, and not a lower book value, of the distribution in kind to shareholder A, unless shareholder A and B agrees to an unequal distribution applying the principle that all or some shareholders may consent to an act contrary to their interest. However, even if dividend in cash to shareholder B must equal the market value, and not a lower book value, of the distribution in kind to shareholder A according to the principle of equality between shareholders, the legality of the distribution under Section 2, Subsection (2), is to be tested against the book value of the aforementioned distribution in kind together with the value of the cash dividend.

Re 3) The EMCA Group is of the opinion that the shareholders may regulate distributions in kind in the articles of association. Even if this is not the case, the shareholders may, if all agree, make a distribution in kind of any kind of asset. But even in this latter case, a valuation report must be made as stated in Subsection (2).

#### *Section 7.05*

#### **Distribution of Extraordinary Dividend**

(1) An extraordinary general meeting may at any time decide to distribute dividends, but only after the company has approved at an ordinary general meeting an annual report for the last financial period (“extraordinary dividends”). However, an extraordinary general meeting may not decide to distribute dividends later than before the next ordinary general meeting at which the annual report for the next financial period is to be approved.

(2) The general meeting cannot decide to distribute extraordinary dividends of a higher amount than that proposed or accepted by the company's central governing body.

(3) The general meeting may authorize the central governing body to resolve to distribute extraordinary dividends. The authority may be subject to financial restrictions and time constraints.

(4) Extraordinary dividends under Subsection (1) and (2) may only be made up of the amounts referred to in Section 2, Subsection (2) less past distributions of profits of retained earnings less any losses during the financial period after the ordinary general shareholders meeting at which the last annual accounts were approved. Extraordinary dividends may not be made contrary to Section 2, Subsection (3)-(4).

(5) Section 4 applies mutatis mutandis to extraordinary dividends.

*Comments*

Re 1) To a varying degree companies may have a need to pay out dividends more than once during the year. Section 5 allows for the distribution of dividends at an extraordinary general meeting. Extraordinary general meetings convened in order to pay dividends may be convened in accordance with the rules in the EMCA Chapter 11. The legislations of the Member States contain various models which are designed to allow the companies to disburse funds during the year. Some Member States, such as the Danish Companies Act (s. 182), the Swedish Companies Act (17:4) and the Dutch Companies Act (Section 2:105/216) allow definitive extraordinary dividends and France, Greece, Italy, Lithuania and the UK allow for interim dividends. Many other Member States such as Finland have no provisions on interim dividends or extraordinary dividends.

The EMCA Group has understood that companies need to pay out dividends more than once during the year as primarily a need to distribute available profit from the last financial year as ascertained in the annual accounts approved by the last general shareholders meeting. Section 5 makes it possible for a company to do so. Extraordinary dividends may be paid out once or several times after the general shareholders meeting.

However, an extraordinary general meeting may not decide to distribute dividends later than before the next ordinary general meeting at which the annual report for the next financial period is to be approved. In practice this means that a company may at any time between the ordinary general meeting where the annual report for the last financial period was approved and the next ordinary general meeting at which the annual report for the next financial period is to be approved decide to distribute extraordinary dividends one or several times. The same applies if all the shareholders in the particular case agree to an extraordinary dividend during the same period.

The time restraint that extra ordinary dividends can only be made from the moment the company has approved at an ordinary general meeting an annual report for the last financial period until the moment before the company at the next ordinary general meeting at which the annual report for the next financial period is to be approved is a restriction which not can be dispersed with even if all shareholders agree to do so. The reference to the fact that any distribution must be made on the basis of the annual accounts for the last financial period approved by the ordinary general meeting is, against the background of Section 2, Subsection (2) and Article 17 (1) and 17 (3) of Directive 2012/30/EU and as previously stated, mandatory for the protection of the creditors of the company.

Re 2) The EMCA Group has, as previously mentioned, considered the rule in Article 17 (5) of Directive 2012/30/EU, according to which interim dividends under certain conditions are allowed. The view of the Group, however, is that there presently is a limited practical need for such a rule on interim dividends, and for that reason no rule concerning interim dividends has been included in the EMCA.

Re 3) Payment of extraordinary dividends requires the consent of the central governing body. It is also possible for the shareholders meeting to authorize the central governing body to decide if, and when, extraordinary dividends may be paid by the company to its shareholders. An authorization to the central governing body may be subject to financial restrictions and time constraints of any sort the ordinary or extraordinary shareholders meeting consider necessary.

Regardless if the shareholders meeting or the central governing body is the deciding organ for extraordinary dividends, there must be adherence to the creditor rules in Section 2. This is expressly stated in Subsection 4 of Section 5.

Re 4) An extraordinary dividend may be paid in other assets than cash. The cross reference to Section 4 in Subsection (5) clarifies that such distributions are legal under the same conditions as an ordinary dividend may be paid in other assets than cash.



PART 3  
GIFTS

*Section 7.06*  
**Charitable Gifts**

(1) The general meeting may only resolve to give gifts for charitable or similar purposes out of the company's funds if it is reasonable, having regard to the purpose of the gift, the company's financial position and the circumstances in general. For the purposes referred to in the previous sentence, the central governing body may give gifts out of the company's funds that are insignificant taking into account the company's financial position.

(2) Even if all shareholders agree to a gift from a company in contravention of Subsection (2), such an agreement is invalid.

*Comments*

Re 1) The provision in Section 6 is not based on EU law. The provision is similar to the Danish Companies Act Section 195 and the Swedish Companies Act Chapter 17, Section 5. The EMCA Group has considered whether a provision on charitable gifts should be included in the EMCA. The Group is of the opinion that such a rule fulfils a practical purpose, especially in the view that many Member States do not regulate charitable gifts in their Companies Act (eg France and Italy).

According to Section 195 of the Danish Companies Act, the general meeting may resolve to give gifts for charitable or similar purposes out of the company's funds if this is deemed reasonable, with regard to the purpose of the gift, the company's financial position and the circumstances in general. For the purposes referred to in this provision, the central governing body may also give gifts out of the company's funds that are insignificant in the context of the company's financial position.

Gifts may be given for social, cultural, scientific or humanitarian purposes. They may also be given for political reasons assuming the gift is not a donation for a particular political party or the like aligned with a majority of the shareholders, but rather is for a political goal closely related to the company's business such as a donation for lobbying. Admittedly, in the latter case, it may be more difficult to access when such donations can be considered reasonable compared to donations given for a more generally accepted 'good cause'. But given full disclosure to shareholders at the shareholders meeting concerning the nature of the gift either ex ante the decision by the same company organ or ex post a gift decided by the governing body of the company, it should be possible to establish whether it is a legal gift or not. The EMCA Group is of the opinion that Section 6 never may be used for political donations to a particular political party or the like without the consent of all shareholders.

Social arrangements for the company's employees and the granting of special bonuses and gifts for special occasions are a legal and common activity of a company and are usually outside the scope of this paragraph. The same may be said for a retirement benefit plan, job search assistance, etc., which are common activities in connection with for example. the restructuring of the company. Also other kind of benefits or payments such as donations for cultural or sports events including sponsorships is usually outside the scope of this paragraph, if commercially justifiable (cf. Section 1). Excluded however are golden handshakes where a company offers a compensation package to a member of the management leaving company in circumstances where the company is not obliged to do so or there are no legitimate commercial reasons for doing so.

Re 2) Subsection (2) clarifies what has been expressed earlier, namely that all shareholders' consent to a particular distribution – in this case a gift from the company - is not valid unless the distribution in question is legal according to the general rules concerning creditor protection in subsection (2)–(4).

PART 4  
OWN SHARES

*Section 7.07*

**Subscription for Own Shares**

- (1) The shares of a company may not be subscribed for by the company itself.
- (2) If the shares of a company have been subscribed for by a person acting in his or her own name, but on behalf of the company or to that effect, the subscriber shall be deemed to have subscribed for them for his or her own account.
- (3) Shares subscribed for in the company's name in contravention of Subsection (1) are deemed to be subscribed for by the promoters or, in case of a capital increase, by the members of the company's governing body at their own expense, and they will be jointly and severally liable for the subscription value. However, this does not apply to promoters or members of the company's governing body who can establish that they neither realized nor ought to have realized that the subscription for the shares was illegal.
- (4) Subsection (1) applies, with such changes as are necessary, to a company's subscription for shares in its parent company. The shares in the parent company will be deemed to be subscribed for by the members of the governing body of the subsidiary (see Subsection (3)).

*Comments*

Section 28 substantially implements articles 20 and 28 of Directive 2012/30/EU with minor technical adjustments.

*Section 7.08*

**Acquisition of Own Shares in Ownership or as Pledge**

- (1) The company may only make a decision to acquire its own shares for consideration, or enter into a transaction to that effect, in accordance with the rules in the EMCA.
- (2) The company may only acquire its own shares if they are fully paid up.
- (3) The company may only acquire its own shares for consideration in ownership.
- (4) If a company acquires its own shares as security, either by the company itself or through a third party acting in his or her own name, but on the company's behalf or to that effect, the acquisition shall be treated as an acquisition of its own shares in ownership.

*Comments*

Re 1) Articles 21-24 and 27 of Directive 2012/30/EU contains provisions on acquisition of own shares. As mentioned earlier in considerations, the rules on own shares was liberalized in 2006. Directive 2012/30/EU applies only to public companies. There are also great differences between the Member States' regarding rules on own shares in private companies. In some Member States such as France, Poland and Sweden, private companies are not allowed to purchase their own shares. In Denmark, Finland, Germany, Greece and the Netherlands, private companies are allowed to purchase own shares, but then with different restrictions attached to such purchase. A common restriction is that the purchase may not exceed distributable profits. In the Netherlands, a buyback of shares is allowed with the most important limitation being a solvency test (Companies Act 2:207).

The EMCA Group has considered the rules on own shares. As mentioned above, it is of the opinion that the legislation should be as flexible as possible and flexible enough to allow for capital outflow in the form the companies consider in their best interest, including distributions in the form of ordinary and extraordinary dividends, gifts, repurchase of own shares, financial assistance in connection with acquisition of shares in the company and capital reduction. Acquisition or disposal of own shares represent a less bureaucratic way to regulate the company capital compared with implementing capital reductions and capital increases according to the rules in this regard, respectively. Furthermore, and more importantly, repurchase of a company's own shares is in economic terms viewed by the market – although perhaps misguidedly so and sometimes for the wrong reasons - as an alternative to distribution of profits in the form of dividends.

The opinion of the EMCA Group is that even if the purchase of own shares is most common in public companies, especially those whose shares are traded on a regulated market, there is also a need to allow for purchase of own shares in private companies, for instance for succession purposes in a family company.

Against this background, the Group has reached the conclusion that the rules on own shares in the EMCA should allow both public and private companies to purchase its own shares. And further, the rules in Directive 2012/30/EU should be used as a model for the rules in this Chapter, but at the same time the very same rules should be made as simple as possible.

Section 8, Subsection (1) determines that the acquisition of own shares for consideration is allowed in principle in both public and private companies. Technically Subsection (1) has been phrased so as to include not only repurchase of shares for consideration in the traditionally way but also repurchase of shares through independent intermediaries such as banks and set-ups including swap-agreements. Thus, a company may acquire its own shares for consideration or enter into a transaction to that effect. But both types of repurchase of shares must follow the same rules in the EMCA.

Directive 2012/30/EU does not contain rules on how a repurchase or later sale of own shares shall take place, i.e. to whom, when and in what way the repurchase or later sale may be done. However, Article 46 of Directive 2012/30/EU contains a principle of equal treatment of shareholders who are in the same position. Many Member States contain explicit provisions on the acquisition or sale of own shares in their Companies Acts and in all cases, there must be compliance with this general principle of equality as a safeguard for minority shareholders' rights cf. the rules in the Swedish Companies Act Chapter 19, Section 14.

The EMCA Group has considered whether the EMCA should contain rules on acquisitions and sales of own shares. Even though the Group recognizes that explicit rules on acquisitions and sales of own shares have some advantages, such rules are also difficult to formulate and must be subject to a list of different exceptions with the result that the legislation becomes lengthy and technically complicating without, perhaps, adding much in substance to the intended purpose of protecting minority shareholders. For this reason the Group has decided not to include any rules on acquisitions and sales of own shares in the EMCA.

Re 2) Subsection (2) is an implementation of article 21 (1) of Directive 2012/30/EU.

Re3). Repurchase of shares for consideration may according to EMCA only be made in ownership. Any other type of "acquisition" of own shares such as legally and formalistically a "loan" or "renting" of shares for any form of consideration is illegal according to EMCA with the exception of acceptance of the company's own shares as security according to subsection (4). This follows from subsection (3).

Re 4) The EMCA Group has considered the possibility for a company to receive its own shares as security for consideration. One alternative is to prohibit such transactions altogether. Another alternative is to treat the acceptance of the company's own shares as security as an acquisition of own shares, which is the rule in article 27 of Directive 2012/30/EU. Since the Group is of the opinion that there might be situations when a company should have the option to accept its own shares as security, the second alternative is recommended in subsection (4).

*Section 7.09*

**Funds Available for Acquisition of Own Shares**

- (1) A company may only acquire its own shares for consideration out of funds available for distribution under Section 2.
- (2) If a company has acquired its own shares for consideration out of funds available for distribution under Section 2, either the shares are not to be included among the assets shown in the balance sheet of the company or, if the shares are included among the assets shown in the balance sheet of the company, a reserve of the same amount, unavailable for distribution, shall be included among the liabilities.
- (3) A company's holding of its own shares shall include shares acquired by a third party in its own name, but at the company's expense or to that effect.

*Comments*

Re 1) It follows from Section 9, Subsection (1), that the limitation regarding the acquisition of own shares only applies to acquisitions for consideration.

The rules on acquisition of own shares differ from one Member State to another. A number of Member States including Germany, Greece, the Netherlands, Portugal and Spain still have a 10 % limitation for public companies as it appeared in the 2<sup>nd</sup> Company Law Directive before the amendment in 2006. In Sweden, the acquisition of own shares are generally forbidden, however, a public company whose shares are traded on a regulated market may acquire its own shares. In that case the company may acquire 10 % of the companies' shares. In Poland, repurchase of own shares are generally prohibited with some exceptions in which case the total nominal value must not exceed 10 % of the share capital of the company. On the other hand, a number of Member States have made use of the liberalized 2<sup>nd</sup> Company Law Directive. Thus, in the Danish, Finnish, Italian, Ireland and UK Companies Acts, purchase of own shares is allowed with profits available for distribution.

The EMCA Group considered the 10 % limit in Directive 2012/30/EU. It is not convinced there is any need for such or any similar restriction. In addition, the Group considers it an advantage if the rules in the EMCA can be made as simple as possible without unnecessary exceptions. Therefore the Group is of the opinion that a restriction will suffice which limits repurchase of shares for consideration out of funds available for distribution under Section 2 and which is generally applicable to both private and public companies.

Re 2) A company may only purchase its own shares for the amount available for distribution on basis of the company's annual report for the last financial period approved by the general shareholder's meeting. This rule is partly based on the provision in articles 21 (1) cf. article 17 (1) of Directive 2012/30/EU. In addition, the cross reference in Subsection (2) to Section 2 means that a company is further restricted by Subsection (3) and (4) in this latter Section with regard to the solvency test and the reasonable test respectively.

One consequence of Section 9, Subsection (1), is that the company cannot acquire its own shares if the company solely has the required minimum capital, cf. EMCA Chapter 2 Section 7 (on minimum capital).

There are no voting rights attached to company's own shares. See Chapter 11, Section 10.

Re 3) Section 9, Subsection (2), is a partial implementation of article 24 (1) of Directive 2012/30/EU, but with the addition that Member States may instead apply the alternative rule that, if a company has acquired its own shares for consideration out of funds available for distribution under Section 2, the shares are not to be included among the assets shown in the balance sheet of the company. It should be noted that this latter solution is the preferred one in international accounting standards, See IAS 32 and the IFRS for Small and Medium-Sized Entities (IFRS for SMEs), Section 22.16.

Re 4) Section 9, Subsection 3, corresponds to article 21 (1) of Directive 2012/30/EU, but with an amendment to the effect that it also includes repurchase of shares through independent intermediaries such as banks and set-ups such as swap-agreements (cf. phrase "to that effect").

*Section 7.10*

**Authorizations for the Acquisition of Own Shares**

- (1) An acquisition of a company's own shares for consideration cannot proceed without the central governing body of the company obtaining authority from the general meeting, unless the conditions in Section 12 are met.
- (2) The authorization may be decided by a simple majority of the shareholders at an ordinary or extraordinary shareholder meeting.
- (3) The authority from the general meeting must be given for a specified time, which shall not exceed five years.
- (4) The authority must specify
  - (a) the maximum number of company's own shares which may be acquired; and
  - (b) the minimum and maximum amount that may be paid by the company as consideration for the shares.

*Comments*

Re 1) For practical purposes the central governing body of the company is the company organ which decides when, how, to what extent and for how much a repurchase of shares for consideration is to be made. However, as stated previously, a repurchase of shares is in economic terms often seen as an alternative to distribution of profits through ordinary or extraordinary dividends. Therefore, it is consequential that the decision to repurchase shares must be vested with the shareholders meeting. Hence, Section 10, Subsection (1), stipulates that an acquisition of a company's own shares for consideration cannot proceed without the central governing body of the company obtaining authority from the general meeting.

Member States has different majority requirements. Countries such as Finland and Sweden, for example, require a qualified majority of 2/3, whilst others such as Denmark, the Netherlands, Portugal and the UK only require only a simple majority.

The EMCA Group is of the opinion that since repurchase of shares in economic terms is viewed by the market as an alternative to a distribution of profits in the form of dividends, a repurchase of shares should be able to be decided by the same majority of shareholders which may decide to distribute the company's profits in the form of an ordinary or extraordinary dividend. From the wording of Subsection (1), second paragraph it is, however, intended that the articles of association of the company may require a higher majority such as 2/3 or 3/4 of the shareholders present and votes cast.

Re 2) The provision on the authorization period is consistent with article 21 (1) of Directive 2012/30/EU. Nevertheless, such a lengthy authorization period is questionable and – of course – arbitrarily set. Previously, the authorization period in the Directive was set to a maximum of 18 months, which, on the other hand, might be considered too short and – of course – was equally as arbitrary. That said, Section 5(2) of the Finnish Companies Act and Article 320 (1) (b) of the Portuguese Companies Act still retain a maximum 18 months authorization period.

With Directive 2012/30/EU, it is now possible to extend the authorization (but subject to more restrictive provisions in national law) to a maximum of 5 years. The EMCA Group has considered if there should be a more restrictive time limit in the EMCA, but has not presently identified any purpose which would justify such a restriction. Given the time limit of 5 years in Directive 2012/30/EU, the Group has chosen the same time limit in Subsection (3). From the wording of Subsection (3), it follows that a shareholders meeting, for instance, may instead choose to authorize the central governing body each year at the annual general meeting - a common practice before the amendment of the 2<sup>nd</sup> Company Law Directive.

In addition, the shareholders may condition the authorization in such a way that the governing body of the company does not have complete freedom in other ways. Particularly in listed companies, a conflict may arise between; on the one hand, an authorization by the general meeting to repurchase shares and, on the other hand, the principle in the Takeovers Directive concerning the general meeting's approval of defensive measures against hostile takeovers. In some corporate governance codes, such as the Danish Code, it is recommended that any authorization to purchase own shares may not be exercised when a takeover bid is made. Such a reservation could be an example of a condition inserted by shareholders in connection with the central governing body of the company obtaining authority from the general meeting.

Re 3) Subsection (4) contains only the minimum conditions which are set out in article 21 of Directive 2012/30/EU which the authorization from the general meeting to the governing body must specify. Some Member States such as Finland, stipulate further conditions which must be specified in the authorization, and to that end also information to the shareholders.

Again the EMCA Group considered whether to add further conditions which must be specified in the authorization from the general meeting to the governing body of the company, and again the Group has taken the minimalistic approach in formulating the rules as regards capital outflow. The authorization may be given without any further limitations than those set out in Subsection (4) i.e. the maximum number of company's own shares which may be acquired and the minimum and maximum amount that may be paid by the company as consideration for the shares. Nevertheless, the general meeting may set whatever limitations the shareholders consider appropriate, for example regarding the purpose for which the acquisition of own shares are made. The articles of association may also include limitations and conditions concerning the repurchase of shares.

#### *Section 7.11* **General Exception**

(1) Notwithstanding Sections 8 to 10, companies may, directly or indirectly, acquire their own shares for or not for consideration

- (a) in connection with a reduction of the share capital (see Sections 25 to 32) or redemption of shares (see Chapter 5, Section 15) ;
- (b) in connection with a transfer of assets by merger, division or any other universal succession;
- (c) as a gift from a shareholder or otherwise free of charge or by banks and other financial institutions as purchasing commission;
- (d) in satisfaction of a statutory takeover obligation of the company or a statutory exit right in particular circumstances for minority shareholders in the company or associated companies;
- (e) in connection with the purchase of fully paid-up shares in a forced sale for the satisfaction of a claim held by the company;
- (f) from a shareholder in the event of failure to pay them up.

#### *Comments*

Section 11 substantially implements article 22 (1) of Directive 2012/30/EU.

Re 1 (f). This exception must be understood against the requirement that only 25 per cent of the nominal value of the company capital or in the absence of a nominal value, their accountable par and any premium, must be paid before registration. See Chapter 2, Section 10.

*Section 7.12*

**Exception from Authorization**

(1) When it is necessary in order to avoid significant and imminent harm to the company, the central governing body may acquire the company's own shares on behalf of the company for consideration under Section 10, without the authority of the general meeting.

(2) If the company has acquired its own shares under paragraph (1), the central governing body must notify the next general meeting of:

- (a) the reason for and the purpose of the acquisition;
- (b) the number of the shares acquired;
- (c) the nominal value or, in the absence of a nominal value, the accountable par, of the shares acquired;
- (d) and the proportion of the subscribed capital which they represent; and
- (e) the value of the consideration paid for the acquired shares.

*Comments*

Re 1) Section 12 implements article 21 (2) of Directive 2012/30/EU.

The exception solely concerns the authorization requirement in Section 10. The remaining provisions on acquisition of own shares for consideration must therefore be fulfilled in a situation covered by Section 12. The derogation has in practice become less significant after the general access to acquiring own shares has been extended pursuant to rules similar to sections 8-10 supra and on basis of Directive 2012/30/EU. The most likely situation where Section 12 could be used is probably in an expected hostile takeover situation (but see Article 9 of the Takeovers Directive 2004/25/EC).

*Section 7.13*

**Subsidiaries' Acquisition of Shares in Parent Companies**

Sections 8-10 apply, with such modifications as necessary, to a subsidiary's acquisition of shares in its parent company in ownership or as security.

*Comments*

Section 13 implements article 28 of Directive 2012/30/EU.

*Section 7.14*

**Disposal of Legally Acquired Own Shares**

(1) Shares acquired in accordance with Section 12, Paragraphs b) to f), must be disposed of as soon as possible without causing harm to the company, but no later than within the time limit in Subsection (2).

(2) Shares acquired in accordance with Section 12, Paragraphs b) to f), must be disposed of no later than three years after the acquisition.

*Comments*

Re 1) Section 14 regulates the situation where own shares are acquired legally according to the rule on general exceptions in Section 12 and is basically an implementation of article 22(2) Directive 2012/30/EU.

*Section 7.15*

**Disposal of Illegally Acquired Own Shares**

(1) Shares acquired in, or treated as acquired in, ownership in contravention of Section 8 to 13 must be disposed of as soon as possible and no later than one year after the acquisition of the shares.

(2) Any transaction which includes an acquisition of shares in, or is treated as an acquisition in, ownership in contravention of Section 8 to 13 and which has not been executed is invalid.

*Comments*

Re 1) Section 15 implements article 23 of Directive 2012/30/EU.

The Directive contains a time limit of 1 year. In certain countries the time limit is shorter. This is the case for example in Denmark and Sweden where it is 6 months. The EMCA Group is of the opinion that there is no need for a time limit of less than 1 year.

Re 2) The EMCA Group has concluded that even if the rule in Subsection (1) is an adequate and efficient sanction once shares has been illegally acquired in, or treated as acquired in, ownership in contravention of Section 8 to 13 by a company, there will exist situations where the transaction has not yet been executed, for instance by way of exchange of shares for consideration. It is the opinion of the Group that such transactions should be treated as invalid and, thus, should not be legally enforceable. Although this problem might be solved in national law either explicitly or implicit through applying general principles of civil law (cf. 134 § BGB in German law), there is no guarantee that this will be case. The Group is of the opinion that the EMCA should include an explicit rule stating that illegal acquisition is not legally enforceable.

*Section 7.16*

**Cancellation of Acquired Shares**

If any shares have not been duly disposed of as provided by Sections 15-16, the central governing body of the company must ensure that such shares are cancelled and that the cancellation results in a corresponding reduction of the subscribed capital.

*Comments*

Section 16 implements Article 22 (3) of Directive 2012/30/EU.

*Section 7.17*

**Consequences of Holding Own Shares**

Voting rights may not be exercised by a company where they attach to shares held by a company itself, or to shares in a parent company that are held by a subsidiary. Such shares are to be excluded where the validity of any resolution or the exercise of any power is subject to the consent of all shareholders or to a certain majority of votes of either the shares represented at the general meeting or of the entire share capital of the company.

*Comments*

Re 1) Section 17 implements Article 24 (1) (a) of Directive 2012/30/EU. Some Member States such as Denmark (Companies Act Section 85), France (Article L. 225-210 of the Commercial Code) Greece (Companies Act Article 16 (8)), Italy (Article 2357-ter of the Civil Code) Lithuania (Companies Act Article 54 Part 7), the Netherlands (Companies Act Section 2:118 (7) and 228 (6)), Poland (Companies Act Article 363 § 4) and Portugal (Companies Act Article 324 (1) (a)) explicitly state that voting rights may not be exercised in respect of own shares. Section 17 is similar to Section 85 of the Danish Companies Act.

Art 24 (2) of Directive 2012/30/EU requires the company's annual report to contain information regarding acquisitions of own shares. Such requirements are found for instance in Section 76 of the Danish Financial Statements Act. The EMCA Group assumes that national legislators implement this rule as appropriate in national legislation and see no need for it in the EMCA.

PART 5  
FINANCIAL ASSISTANCE

*Section 7.18*

**Financing of Purchase of Own Shares**

- (1) A company may directly or indirectly advance funds, make loans or provide security for a third party's acquisition of the company's shares or shares in its parent company in accordance with the provisions in Subsection (2)-(3).
- (2) The company may directly or indirectly advance funds, make loans or provide security according to paragraph 1 if the following requirements are fulfilled:
- (a) approval by the general meeting (cf. Section 19);
  - (b) reasonableness of the resolution (cf. Section 20);
  - (c) report by the central governing body (cf. Section 21); and
  - (d) fair market conditions (cf. Section 22).
- (3) The company's central governing body must ensure that any third party receiving financial assistance is credit worthy or, in the case of multiparty transactions, each party involved in the transaction is credit worthy. The credit worthiness must be based on a thorough economic due diligence (cf. Section 22).

*Comments*

Re 1) The original 2<sup>nd</sup> Company Law Directive contained a prohibition against self-financing. However, Article 25 of Directive 2012/30/EU allows a company to, either directly or indirectly, advance funds or make loans or provide security, with a view to the acquisition of its shares by a third party. The conditions under which such transactions are allowed are set out in Article 25 (2)-(5).

The EMCA Group has contemplated not including rules in the EMCA on financial assistance. One argument against such rules is that it is not clear if the rules in reality provide any protection for the company's creditors and shareholders. Another argument is that they add complexity to the law, at an additional and substantial transaction cost, which may nevertheless be circumvented by an individual who is determined to do so. For this reasoning, the Netherlands abolished rules on financial assistance for private companies in 2012 and the UK did so a few years earlier. However, and with hesitation, the Group decided to include rules on financial assistance in the EMCA based on Article 25 of Directive 2012/30/EU for no reason other than that the Directive stipulates financial assistance rules for public companies. But the Group does not recommend that Member States include such rules in their legislation for private companies.

According to certain minimum conditions, Section 18 allows for self-financing. The conditions are found in the following Sections 19 to 22 of the EMCA. Section 18-22 must be interpreted on the basis of Article 25 of Directive 2012/30/EU. In particular such interpretation must be made with due regard to the purposes of the rules on financial assistance, and does not mean, as it sometimes is understood by practicing lawyers in Member States, that financial assistance provided 1, 3 or 6 months after the purchase is legal. The critical question is whether the purpose of financial assistance is, or was, to directly or indirectly facilitate a third party's acquisition of the company's shares or shares in its parent company.

Article 25 of Directive 2012/30/EU regulates direct and indirect financial assistance. Section 18 also includes financial assistance to a third party by a subsidiary for the purpose of acquiring shares in the parent company, which does not follow from Article 25. The EMCA Group added this rule since Article 25 could otherwise easily be circumvented and, furthermore, because creditors face the same risk regardless whether a company offers financial assistance to acquire shares in that company or its parent company.

Re 2) Subsection (3) is a partial implementation of Article 25 (2) of Directive 2012/30/EU. Cf. also Section 22.

*Section 7.19*

**Approval by the General Meeting**

(1) Financial assistance under Section 18 is subject to approval by the general meeting. As a condition for an affirmative resolution by the general meeting, the company's central governing body must in advance present a written report to the general meeting, including information about:

- (a) the reason for, and the nature of, the proposed financial assistance;
- (b) the company's interest in entering into the transaction;
- (c) the conditions on which the transaction is entered into;
- (d) the consequences of the transaction, including the risk, for the company's liquidity and solvency; and
- (e) the price at which the third party is to acquire the shares.

(2) The general meeting must pass the resolution required to approve the financial assistance under paragraph (1) by a majority of no less than two-thirds of the votes of the shares present and cast at the general meeting.

(3) The report to be presented under subsection (1) must be received by the Registrar for the purpose of publication under Chapter 3, Section 5 within four weeks after the date of approval by the general meeting

*Comments*

Section 19 implements Article 25 (3) of Directive 2012/30/EU.

*Section 7.20*

**Extent of Financial Assistance**

(1) The aggregate of financial assistance granted by the company to third parties under Section 19 may at no time exceed what is available for distribution according to Section 2, and taking into account any reduction of the net assets of the company that may have occurred through the acquisition, by the company, or on behalf of the company, of its own shares in accordance with Section 9 to 17.

(2) The company shall include, among the liabilities in the balance sheet, a reserve, unavailable for distribution, of the amount of the aggregate financial assistance.

*Comments*

Section 20 is an implementation of Article 25 (4) of Directive 2012/30/EU but with the additional protection for creditors provided by Section 2 of the EMCA concerning distributions.

*Section 7.21*

**Fair Market Conditions**

Where a third party acquires shares in the company with the financial assistance of a company, such assistance must be granted at arm's length and at fair market conditions, including, but not limited to, the interest received by the company and with regard to the security provided the company for the loans and advances. The same applies if a third party subscribes for shares in connection with an increase in the subscribed capital.

*Comments*

Section 21 implements Article 25 (2) and 25 (5) of Directive 2012/30/EU.

Section 21 implies that it is the responsibility of the company's central governing body to ensure financial assistance is only provided at arm's length and at fair market conditions. At arm's length and at fair market conditions includes, but is not limited to, the interest received by the company and the security provided to the company for the loans and advances. At arm's length and fair market conditions also relates to the credit worthiness of the third party or the parties involved, but this already follows from Section 18, Subsection (3). Even without Section 21, the same principle would follow from the duty of care and the duty of loyalty which is owed to the company by the members of the company's central governing body. Thus, failure to comply with this standard by any such member may result in a liability for damages for that member.

*Section 7.22*

**Exception for Banks and Other Financial Institutions**

Sections 18 to 21 do not apply to transactions concluded by banks and other financial institutions in the normal course of business.

*Comments*

Section 22 implements Article 25 (6) of Directive 2012/30/EU.

*Section 7.23*

**Exception for Employees**

- (1) Sections 18 to 21 do not apply to transactions effected with a view to the acquisition of shares by or for the company's employees or employees of an associate company.
- (2) Minutes of meetings held by the central governing body must include information on any transaction falling within Subsection (1).
- (3) Transactions falling within Subsection (1) may only be made if the value of the transaction does not exceed what is available for distribution according to Section 2.

*Comments*

Section 23 also implements Article 25 (6) of Directive 2012/30/EU, but within the framework of the improved creditor protection provided by EMCA, Section 2.

*Section 7.24*

**Consequences of Illegal Financial Assistance**

- (1) Any transaction which includes financial assistance in contravention of Sections 18 to 21 and which has not been executed is invalid.
- (2) Any transaction which includes financial assistance in contravention of Sections 18 to 21 and which has been executed must immediately be reversed. Any financial assistance so granted in the form of direct or indirect advancement of funds or loans must immediately be returned to the company together with interest that accrues annually at the rate specified in national law with the addition of 2 %.
- (3) Any transaction which includes financial assistance in the form of direct or indirect security in contravention of Sections 18 to 21 is only binding for the company, if the contracting party did not know, or ought not have known, that the transaction constituted illegal financial assistance.
- (4) If a transaction which includes financial assistance cannot be immediately reversed or financial assistance cannot be immediately returned, members of the company's central governing body who have agreed to or allowed any transactions in contravention of Sections 18 to 21 will be liable for any deficiency as a result of unsuccessful restitution according to Subsection (2)-(3).

*Comments*

Re 1). Section 24 does not implement any EU rules. The value of the rules on financial assistance in Directive 2012/30/EU is debatable. However, assuming that such rules fulfil a necessary purpose in protecting creditors and shareholders, there is a need for an effective sanction. On that basis, the EMCA Group has concluded that the EMCA should contain an additional rule which concerns the consequences of illegal financial assistance. Section 24 is to some extent inspired by provisions in the Danish Companies Act (Section 215) and the Swedish Companies Act (Chapter 21, Section 11).

Re 2) Subsection (1) states the first main principle that a promise by a company of financial assistance in contravention of Sections 18 to 21 cannot be legally be enforced with the exception of financial assistance in the form of security, if the contracting party was acting in good faith about the illegality of the transaction; see Subsection (3).

Re 3) If, and only if, a transaction which includes financial assistance in contravention of Sections 18 to 21, has been wholly or partially executed, the second main principle applies, which is that the transaction must be reversed immediately on the basis that it is illegal and invalid. The first sentence relates to all forms of direct or indirect financial assistance regardless of whether it has taken place in the form of direct or indirect advancement of funds, loans or security. The second sentence in Subsection (2) specifies the consequences of reversing the transaction if the financial assistance has been granted in the form of direct or indirect advancement of funds or loans. In those two cases, and assuming the financial assistance has been provided in money, it must be returned to the company together with interest that accrues annually at the rate specified in national law with the addition of 2 %.

Re 4) Financial assistance in the form of direct or indirect security in contravention of sections 18 to 21 may be provided to a financial institution or other third party who is not aware of the illegality of the transaction. Therefore, and in order to avoid unnecessary transaction cost for third party as well as unwanted consequences, Subsection (3) provides protection for a third party who did not know, or ought not have known, that the transaction constituted illegal financial assistance.

Re 5) As an additional safeguard in ensuring that the rules on financial assistance is adhered to, Subsection (4) states that if a transaction which includes financial assistance cannot be immediately reversed or financial assistance cannot be immediately returned, members of the company's central governing body who have agreed to, or allowed, any transactions in contravention of Sections 18 to 21 will be liable for any deficiency as a result of unsuccessful restitution according to Subsection (2)–(3).

PART 6  
REDUCTION OF CAPITAL

*Section 7.25*

**Methods of Reduction of Capital**

- (1) Reduction of capital in the EMCA may be affected with or without a distribution of assets to shareholders.
- (2) Reduction of capital by way of distribution to shareholders may be in the form of:
  - (a) reducing the nominal value or accountable par, and/or
  - (b) reducing the number of shares.
- (3) Reduction of capital without a distribution to shareholders may be in the form of:
  - (a) setting off losses against the capital, and/or
  - (b) setting off capital to distributable or non-distributable reserves.

*Comments*

Re 1) In Section 1 the term “distribution” includes any transfer of money or money’s worth without due consideration directly or indirectly to a shareholder or third party in the absence of a genuine commercial purpose such as, for example payments in connection with capital reductions. Section 25, Subsection 1, follows this definition, but clarifies that a capital reduction may or may not include a transfer of money or money’s worth to a shareholder.

Article 34 (2) of Directive 2012/30/EU requires that the notice convening the meeting must specify at least the purpose of the reduction and the way in which it is to be carried out. The companies’ acts in some Member States such as Poland (Companies Act article 455) merely restate Article 34 (2). In other Member States, the purposes the reduction must be further specified. Subsection 2-3 specifies the purposes for which a reduction of capital with or without distribution to shareholders may be made.

Re 2) Technically, the reduction of share capital by way of distribution to shareholders may be made in two different forms, which are specified in Subsection (2). Those are: reducing the nominal value or accountable par; and/or reducing the number of shares. A reduction of the number of shares may be in the form of redemption of shares following the rules in Chapter 5, Section 15. The words “and/or” are used to clarify that a company may do either of the described methods or combine them.

Re 3) Redemption of capital without a distribution to shareholders is in practice typically done to set off losses against the capital. However, depending on the circumstances, a company may set off capital for other reasons. Whenever a company sets off capital, the amount by which the capital is reduced must be transferred to distributable reserves or non- distributable reserves. Again the words “and/or” are used to clarify that a company may do either of the described methods or combine them. The EMCA Group also notes that there is nothing to prevent a company from combining a reduction of capital with only a partial distribution of assets to shareholders. See Subsection (3).

*Section 7.26*

**Resolutions on Capital Reductions**

- (1) Any resolution reducing the share capital must be passed by the general meeting by a majority of no less than two-thirds of the votes of the shares present and cast at the meeting unless the reduction of capital is ordered by a court.

Where there are several classes of shares, the decision by the general meeting concerning a reduction of the subscribed capital shall be subject to a separate vote, at least for each class of shareholders whose rights are affected by the reduction of capital.

(2) The provisions of Chapter 6 Section 2 on the procedure to be followed in connection with resolutions on capital increases apply, with such changes as are necessary, to resolutions on capital reductions. The notice of the meeting must in particular specify at least the purpose of the reduction and the way in which it is to be carried out.

*Comments*

Re 1) Article 34 and the following articles of Directive 2012/30/EU contain a number of provisions on capital reduction.

Re 2) According to Chapter 11, Section 29, changes to the articles of association requires a two third majority of the votes of the shares present and cast at the meeting. A number of Member States require a larger majority when changing the articles and reducing the share capital. For example in Germany, Poland, Ireland and the UK a three quarters majority is required. The EMCA Group is of the opinion that a requirement of a two third majority is enough in the balance between majority and minority shareholders, which is the minimum rule found in article 44 of Directive 2012/30/EU.

The second sentence of Subsection (1) is an implementation of Article 35 of Directive 2012/30/EU.

Re 3) Section 26, Subsection (2), is not based on EU law. Chapter 6, Section 2 provides that the resolution should include all the information necessary for shareholders and investors to take an informed decision. Section 26, Subsection (2), provides that equivalent information must be disclosed in connection with a capital reduction. It is possible to deviate from the duty to disclose the documents if all shareholders agree to this. This could in particular be the case in companies with only a few shareholders.

Subsection (2), second sentence, is an implementation of article 34 of Directive 2012/30/EU.

*Section 7.27*

**Authorization of Capital Reduction to the Central Governing Body in Private Companies**

In private companies, the general meeting may, by way of either a provision in the articles of association or a decision of the meeting, authorize the central governing body to reduce the capital to a specified amount. In that case, the time limit prescribed in Section 31 runs from the date of the resolution to exercise the authority.

*Comments*

Re 1) Directive 2012/30/EU applies only to public companies. According to EMCA's Chapter 6, Section 5, it is possible to authorize the management to carry out capital increases. A logical step is to allow for authorization to the central governing body for capital reductions although this is not possible for public companies because of the rule in Article 34 of Directive 2012/30/EU. Article 34 states that the decision must be taken by the general meeting. By contrast, an authorization rule can be implemented with regard to private companies. Such authorization rule is set out in Section 27.

*Section 7.28*

**Approval of the Central Governing Body to a Decision to Reduce Capital**

The general meeting of a company may only pass a resolution for the purpose of reducing the capital by way of distribution of assets to shareholders or setting off capital to distributable reserves or non-distributable reserves, if the central governing body proposes or accepts a resolution to that effect.

*Comments*

Re 1) The provision is not based on EU law.

Disbursing the capital reduction amount for distribution to the shareholders or setting off capital to distributable or non-distributable reserves, which later would be available for distribution, poses a risk to the company's creditors. Therefore, and based on the assumption that capital provides some kind of protection for creditors, there is a need to secure the creditors interests if and when a reduction of a company's capital is made. Obviously, the central governing body of the company has far more knowledge of and insight into the financial status of the company than most, if not all, shareholders.

Against this background, Section 28 requires that the central governing body of the company either proposes or approves a proposal for a resolution for the purpose of reducing the capital by way of distribution of assets to shareholders or setting off capital to distributable or non- distributable reserves.

*Section 7.29*

**Distribution in Kind**

- (1) Distribution to shareholders may be made by the company in assets other than cash, if the asset in question is of such nature that it easily can be converted into cash.
- (2) If non-cash assets are distributed in a capital reduction, a valuation report must be prepared (see Chapter 2, Section 11). The report must state that the amount of the capital reduction plus any premium corresponds to at least the value of the non-cash assets distributed. The company must publish the declaration in the Registrar's IT system no later than two weeks after the date of the resolution on the distribution (see Section Chapter 3, Section 5).
- (3) Subsection (1) applies unless the articles of association provide otherwise or all the shareholders in the particular case agree to a distribution of asset of any nature other than cash.

*Comments*

Re 1). Section 29 is not based on any EU law. Section 29 is a parallel to Section 4 regarding distribution of dividends of non-cash assets. See in extenso the commentary to Section 4, supra.

PART 7  
REDUCTION OF CAPITAL AND CREDITOR PROTECTION

*Section 7.30*

**Request to Creditors and Creditor Protection**

(1) If the amount of the reduction is to be used, in whole or in part, for the purpose of:

- (a) distribution to the shareholders; or
- (b) setting off capital to distributable reserves or non-distributable reserves

the company's central governing body must make a request for the purpose of publication in the national Registrar's IT system after a decision to that effect (cf. Section 31). The company's central governing body must give immediate notice of the reduction to creditors of the company whose claims antedate the publication of the decision on the reduction, but which have not fallen due by the date of that publication.

(2) No notice to creditors needs to be made under subsection (1) if at the same time the capital is increased by the same amount as the amount of the reduction. Neither is a notice to creditors required if a written declaration from an auditor is available, stating that the reduction does not entail any risk to the creditors of the company.

(3) With the exceptions listed in Subsection (2), creditors whose claims antedate the publication of the decision on the reduction, but which have not fallen due by the date of that publication, have the right to either obtain payment in full or security from the company for their claims. Creditors who wish to obtain payment in full or security from the company must exercise this right within 4 weeks of the publication in the national Registrar's IT system.

(4) Creditors may apply to a court or other authority as defined in national law for adequate safeguards provided that they can credibly demonstrate that due to the reduction in the subscribed capital, the satisfaction of their claims is at stake, and that no adequate safeguards have been obtained from the company.

(5) No reduction, in whole or in part, for the purpose of:

- (a) distribution to the shareholders; or
- (b) setting off capital to distributable reserves or non-distributable reserves

may be made unless the requirements in Section 2, Subsection (3)-(4) are met.

(6) A reduction according to Subsection (1) may not be made, and any such reduction is invalid as well as a decision to that effect being void, unless creditors have obtained satisfaction or no such satisfaction is required or a court or other authority has decided that the creditor's application should not be acceded to.

*Comments*

Section 30 implements Articles 36, 37 and 38 of Directive 2012/30/EU. Section 30 contains the main protection of creditors in connection with a capital reduction, if a reduction is to be used, in whole or in part, for the purpose of a distribution to the shareholders or setting off capital to distributable reserves or non-distributable reserves. The creditors must be given the opportunity to either payment in full or security for their claim. Section 30 does not apply if the purpose of the reduction is to offset losses incurred by the company.

Re 1) Both the publication and notification requirement in Subsection (1) follows from Articles 34 and 36 of Directive 2012/30/EU Cf. Section 31.

Re 2) The first sentence of Subsection (2) is a logical conclusion based on the legislative-theological idea that the share capital provides protection for the company's creditors. If the share capital de facto is not reduced after two successive decisions – one to reduce the share capital and one to increase it with the same amount as the preceding reduction – the creditors of the company are not in any way negatively affected, not even hypothetically. Therefore, there is no need to require any notice to the creditors (cf. article 38 of Directive 2012/30/EU).

The second sentence of Subsection (2) is an implementation of Article 36 (1) of Directive 2012/30/EU which requires Member States to safeguard the rights of the creditors. However, such safeguards are not necessary if - despite the reduction - the assets of the company can satisfy the claims of the creditors. In some Member States this is implemented as no notice to creditors is required if a written declaration from an auditor is available stating that the reduction does not entail any risk to the creditors of the company because of the remaining assets of the company after the reduction is satisfactory. The EMCA Group is of the opinion that the EMCA should include a similar rule to facilitate reductions of capital which in no way entail any practically quantifiable risk for the company's creditors.

Re 4) Subsection (4) is also an implementation of Article 36 (1) of Directive 2012/30/EU. The general principle when a reduction is made for the aforementioned purposes is that creditors whose claims antedate the publication of the decision on the reduction, but which have not fallen due by the date of that publication, have the right to obtain either payment in full or security from the company for their claims. But it should be noted that this rule does not apply if the conditions in Subsection (2) are met.

The second paragraph of Subsection (3) too is an implementation of Article 36 (1) of Directive 2012/30/EU and is a protection for creditors in as much as they may apply to a court or other authority as defined in national law for adequate safeguards provided that they can credibly demonstrate that due to the reduction in the subscribed capital the satisfaction of their claims is at stake, and that no adequate safeguards have been obtained from the company.

Re 5) Subsection (5) is a logical extension of the creditor protection in Section 2, Subsection (3)-(4).

Re 6) Subsection (6) is an implementation of Article 36 (2) of Directive 2012/30/EU.

### *Section 7.31*

#### **Registration of Capital Reductions**

(1) An application for registration must be filed no later than four weeks after the date of the resolution (see Chapter 3, Section 5).

(2) Resolutions on capital reductions must be registered immediately.

(3) The resolution to reduce the share capital is invalid if no application for registration is filed with the Registrar within four weeks after the date of the resolution or no registration is made directly thereafter.

### *Comments*

Re 1) According to Article 34 of Directive 2012/30/EU, the decision to reduce the subscribed capital must be published in accordance with the rules of the 1<sup>st</sup> Company Law Directive (2009/101/EU). Section 31, Subsection (1)-(2) is an implementation of this requirement.

Re 2) Section 31, Subsection (3) is inspired by Section 191 of the Danish Companies Act. Further, it is similar to provisions in the Finnish Companies Act (Chapter 14 Section) and the Swedish Companies Act (Chapter 20, Section 22). According to the Nordic Companies Acts, the resolution is invalid if no registration or application for registration is filed with the Registrar within the time limit. This is contrary to section 644(6) of the UK Companies Act, according to which a failure to deliver the required documents to the Registrar within the time limit does not affect the validity of a resolution concerning reduction of share capital. In all Member States, there is a duty to file the decision on capital reduction, but the consequences of failure to register vary. The EMCA Group prefers to follow the Nordic solution.

If the capital reduction cannot be implemented, a registration must still take place, see Section 32 below.

*Section 7.32*

**Implementation of Capital Reductions**

(1) Capital reductions are deemed to be finally implemented after the expiry of the time limit of four weeks for the filing of claims against the company under Section 30, Subsection (3), unless creditors have applied to a court or other authority as defined in national law for adequate safeguards. The first sentence does not apply to capital reductions in connection with redemption of shares (Chapter 5, Section 15).

(2) The company's central governing body must, before the expiry of the time limit in Subsection (1), notify the Registrar if the capital reduction cannot be implemented on the basis that the resolution has been withdrawn or changed.

(3) If a private limited company has decided to authorize its central governing body to reduce the capital up to a certain amount (see Section 27), the capital reduction will only be deemed to be finally implemented when it has been registered that such authority has been exercised.

*Comments*

Re 1) If a request to the creditors is to be issued in accordance with Section 30, and if the creditors file claims, the company may decide not to go through with the capital reduction. In that case and other cases where the decision to reduce capital is withdrawn or changed, a registration to that effect must take place. See Subsection (2). This is also the case if any claims by creditors have not been paid in full or adequate security has not been provided for them. See Section 30, Subsection (3)-(4). However, in most cases the decision to reduce capital is implemented as initially decided. Section 32, Subsection (1) therefore determines that the capital reduction is considered final after the expiry of the time limit of four weeks for the filing of claims against the company under Section 30, Subsection (3).

Re 2) Subsection (2) is a logical consequence of Section 27.

PART 8  
GENERAL PROVISION ON ILLEGAL DISTRIBUTION AND RESTITUTION AND  
LIABILITY FOR MEMBERS OF THE GOVERNING BODY

*Section 7.33*

**Restitution of illegal distribution and Liability for Members of the Central Governing Body**

(1) If any distribution to shareholders or other persons has been made in contravention of the principles and rules of the EMCA, the articles of association of the company or a decision by the shareholders meeting, such distribution must be restituted to the company. However, distribution of an ordinary dividend or extraordinary dividend, distribution in the form of gifts and distribution to shareholders in connection with a reduction of capital need only be restituted if the shareholder or third party realized or ought to have realized that the distribution was illegal.

(2) Subsection (1) does not apply if the consequence of the particular type of illegal distribution is regulated differently in the EMCA.

(3) Any member of the company's central governing body who have agreed to or allowed a distribution in contravention of the principles and rules of this Act, the articles of association of the company or a decision by the shareholders meeting shall be liable for any deficiency as a result of an unsuccessful restitution according to Subsection (1).

*Comments*

Re 1) Section 33 is partially an implementation of Article 18 of Directive 2012/30/EU but with a wider scope in its application as regards both the different types of illegal distribution which it applies to and the protection provided for a shareholder or third party who receives an illegal distribution. Provisions on restitution or repayment are generally found in national company law legislation, for example, in the Danish Companies Act (Section 194), the French Companies Act (Article L. 223-40 of the Commercial Code), the German Companies Act (§ 62) and the Swedish Companies Act (Chapter 17, Section 6). The EMCA Group emphasizes that the EMCA does not protect a shareholder or third party who has received an illegal disguised distribution.

Re 2) Subsection (2) is not based on any EU legislation. However, similar rules are common in national European legislation and can even be found in the MBCA, § 8.33. The company's central governing body has a fundamental role in being a guardian ensuring that the principles and rules in EMCA on capital outflow are respected and followed, in particular the intended creditor protection in Section 2, but also for example the principle of equality between shareholders (cf. Articles 17 and 46 of Directive 2012/30/EU). For that reason, the EMCA includes a rule on liability of members of the company's central governing body. Any member of the company's central governing body who have agreed to or allowed a distribution in contravention of the principles and rules of this Act, the articles of association of the company or a decision by the shareholders meeting shall be liable for any deficiency as a result of unsuccessful restitution according to Subsection (1).



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## General Comments<sup>50</sup>

### 1. EU law

EU law contains no binding rules on the management structure of public companies. In 1972, the Commission proposed a 5<sup>th</sup> Company Law Directive (OJ L 73, 27.3.1972) concerning the structure of public companies. The recommendations suggested a choice for companies between one-tier or two-tier board structures. However, the draft was eventually withdrawn by the Commission.

The SE (*Societas Europaea*) Regulation (Council Regulation (EC) 2157/2001) allows for both one-tier and two-tier structures. Articles 43-45 of the SE Regulation contain a description of the one-tier board system and Articles 39-42 provide for a description of the two-tier board system. According to Article 38(b), the SE Regulation only allows for these two systems, although both systems can be accommodated to suit corporate structures that do not fit this dichotomy. Common rules applying to both systems are stated in Articles 46-51 of the SE Regulation.

Management structures of private companies are not regulated in the EU. The Draft Directive of 2014 on single-member private limited liability companies only proposes that a *Societas Unius Personae* (SUP) should have a management body (composed of a single director or several directors) but leaves it to the Member States to provide for a SUP to have a supervisory board.<sup>51</sup>

The Commission's 2003 Action Plan recommended offering additional organisational freedom to listed companies.<sup>52</sup>

In the Commission's 2012 Action Plan,<sup>53</sup> the Commission acknowledged the coexistence of these different board structures, which are often deeply rooted in the country's overall economic governance system, and signalled no intention to challenge or modify these arrangements. This reflects the view expressed in the 2011 report of the Reflection Group on the Future of EU Company Law that different corporate governance systems and structures should be seen as a treasure-trove of time-tested solutions to be used by business.<sup>54</sup>

Further, the 2012 Action Plan stressed that there is a need to improve the effective oversight of executive directors and management boards by non-executive directors and supervisory boards.

The Commission opined also that (supervisory) boards should give broader consideration to the entire range of risks faced by their companies. Extending the reporting requirements with regard to non-financial parameters would help in establishing a more comprehensive risk profile of the company, enabling a more effective design of strategies to address those risks.

This additional focus on non-financial aspects would encourage companies to adopt a sustainable and long-term strategic approach to their business.

In order to encourage companies to enhance board diversity and give greater consideration to non-financial risks, in 2014 a directive was adopted to strengthen disclosure requirements with regard to board diversity policy and risk management through amendments to the Accounting Directive (Directive 2013/34/EU).<sup>55</sup>

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<sup>50</sup> The working group of Chapter 8 was chaired by Professor Harm-Jan de Kluiver (University of Amsterdam, The Netherlands) and Professor Joti Roest (University of Amsterdam, The Netherlands).

<sup>51</sup> Proposal for a Directive of the European Parliament and of the Council on single-member private limited liability companies (COM(2014) 212 final), Article 22 (version dated 21 May 2015, 8811/5).

<sup>52</sup> Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward (COM(2003) 284 final), pp. 15-16.

<sup>53</sup> COM(2012) 740 final, pp. 5-6.

<sup>54</sup> Report of the Reflection Group on the Future of EU Company Law, Brussels 5 April 2011, p. 11-12.

<sup>55</sup> Directive 2014/95/EU Of The European Parliament And Of The Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15.11.2014, p. 1.

On 9 April 2014, the Commission presented a proposal for the revision of the Shareholders' Rights Directive (2007/36/EC)<sup>56</sup> and Directive 2013/34/EU.<sup>57</sup> On the same date the Commission presented a Recommendation to improve the quality of corporate governance reports, and in particular the quality of explanations provided by companies when they depart from requirements of the relevant corporate governance code.<sup>58</sup>

## 2. National law

Originally, supervision of management was in most companies left to the annual general meeting of shareholders. However, the understanding of the need to monitor management continuously provided for certain jurisdictions to allow for establishment of permanent supervisory bodies most often comprised by shareholders. In the late 19<sup>th</sup> century, Germany introduced a two-tier structure based on a clear separation of supervision and management, each function allocated to a separate company body: the supervisory board (*Aufsichtsrat*) and a management board (*Vorstand*). The division was strict and no double mandates were allowed. In the Nordic system, non-executives serve a dual function: to make the overall strategic decisions and to supervise the daily management carried out by the executives. Consequently, the notion of a two-tier system is based upon a clear separation of supervision and management, often reinforced by ensuring that the supervisory body cannot engage in management decisions or usurp management decisions and a prohibition against double mandates whereby a person can serve on both organs. Many systems differ in the degree to which they place importance on supervision. They can be viewed as modified one-tier systems to the extent that they view management as divided between strategic and daily tactical management and they allow double mandates.

Thus, at present two basic corporate governance concepts can be found in the EU Member States: the one-tier and the two-tier system. As concerns the legal regulation of governance structures, only a one-tier system exists (except for the *Societas Europaea*) in Member States such as Belgium, Greece, Ireland and the UK, while in other Member States, such as Austria and Germany, a two-tier system is mandatory. In addition, at least for public companies, there are Member States such as France (since 1966), Italy (since 2003), the Netherlands (since 2013) and Luxembourg (since 2006) that allow shareholders to decide whether to adopt a one or two-tier system, according to the articles of incorporation. Finally, there are Member States, which have introduced systems in between such as the Nordic countries with their modified version of a one-tier system.

### 2.1. One-tier system

The UK is normally used as the typical example of a one-tier system. In the UK, both private and public companies have a single tier board of directors. The board has actual authority to manage the company as determined by the articles. The shareholders exercise control over the company at the general meeting and decide on those matters for which they have responsibility either under the articles or the Companies Act 2006.

For public and private companies, the appointment of non-executive directors (NEDs) on the board of the company is optional. As far as listed companies are concerned, the UK Corporate Governance Code requires that the board includes executive and NEDs. Executive board members carry on the business and monitor the execution and performance of the company's activities. NEDs, also called "outside directors", have the dual function of developing strategy, and monitoring the execution of the business. NEDs scrutinize the performance of management in meeting agreed goals and objectives and they monitor the reporting of performance. Thus, the division between supervisory and managing directors is created within a single tier board.

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<sup>56</sup> On 9 December 2016, the EU presidency and the EU Parliament agreed on the final version of the new Shareholders Rights Directive.

<sup>57</sup> Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, COM(2014) 213 final, amended by the European Parliament 8 July 2015.

<sup>58</sup> Commission Recommendation of 9 April 2014 on the quality of corporate governance reporting ('comply or explain') (2014/208/EU) OJ L 109/43, 12.4.2014.

## 2.2. Two-tier system

Germany is normally used as the typical example of a two-tier system (in public companies).

### *Public companies*

In Germany, the control of a public company is divided into two tiers: the *management board (Vorstand)* is entrusted with the task of managing the company, while the *supervisory board (Aufsichtsrat)* has only a controlling function. The German Stock Corporation Act (*Aktiengesetz*) calls for a clear separation of duties between management and supervisory functions and therefore prohibits simultaneous membership on both boards.

According to the German Corporate Governance Code (as amended in 2015):

Section 3.1: *“The Management Board and Supervisory Board cooperate closely to the benefit of the enterprise”.*

Section 3.2: *“The Management Board coordinates the enterprise’s strategic approach with the Supervisory Board and discusses the current state of strategy implementation with the Supervisory Board in regular intervals”.*

Section 5.1.1: *“The task of the Supervisory Board is to advise and supervise the Management Board in the management of the enterprise. It must be involved in decisions of fundamental importance to the enterprise”.*

Section 5.4.4: *“Management Board members may not become members of the Supervisory Board of the company within two years after the end of their appointment unless they are appointed upon a motion presented by shareholders holding more than 25 % of the voting rights in the company. In the latter case appointment to the chairmanship of the Supervisory Board shall be an exception to be justified to the General Meeting”.*

According to the German two-tier system, the supervisory board and the management board interact intensively.

The management board is entrusted with full responsibility for managing the company. The board can consist of one or more persons. If the management board consists of more than one member, all the members will have to act jointly when representing the company, unless otherwise stipulated in the articles of association. The managers are required to report their activities to the supervisory board on a regular basis.

German law requires the management board to take appropriate action in order to detect detrimental developments which might endanger the survival of the company. In particular, the management board is obliged to establish a risk management system (§ 91(2) German Stock Corporation Act). The management board is required to inform the supervisory board on all issues important to the company with regard to corporate planning.

The main functions of the supervisory board are the appointment and dismissal of the members of the management board, the supervision of the management board and the approval of the accounts and other transactions, as set out in the articles of association.

The supervisory board is required to monitor and assess the established risk management system. This ensures that members of the supervisory board become more sensitive to, and aware of, the need to monitor risky business decisions and to make a contribution to risk precaution.

The supply of information strengthens the advisory function of the supervisory board, because a better-informed supervisory board is significantly more capable to advise the management board on fundamental issues of corporate strategy. Knowledge of corporate planning data provides the supervisory board with an insight into the prospective business policy of the company, and it improves its competence to promptly detect and prevent corporate malfeasance.

According to Section 110(3) of the German Stock Corporation Act, the supervisory board is required to meet twice in a semi-annual period. Section 171(2) provides for an “incentive rule”, requiring the supervisory board to inform the general meeting which committees it has established and how often the supervisory board and its committees have actually met. This requirement makes the monitoring process of the supervisory board more transparent. Moreover, the provision aims to incentivize the supervisory board to establish an appropriate number of committees since it is accountable to the general meeting. Which committees the supervisory board establishes and how often it and its committees actually meet, depends on the size, structure etc. of a given company, as well as on the size and structure of the supervisory board.

Several provisions of the German Stock Corporation Act require that the supervisory board receive adequate accounting- and auditing-related information from the auditor(s). It is responsible for making the audit assignment which improves the independence of the auditor vis-à-vis the management board.

Section 5.4.2 of the German Corporate Governance Code requires the supervisory board to consist of “*an adequate number of independent members.*” It is assumed that conflicts of interests that may interfere with the supervisory board members’ monitoring duty vis-à-vis the management board are avoided when independent supervisory board members monitor the business decisions of the management board.

The members of the supervisory board are appointed by the shareholders at the general meeting. In codetermined companies, special rules apply to the representatives of the employees on the supervisory board. The rights and duties of the supervisory board apply equally to all its members. See below Part 4, Section 31 on employee representation.

#### *Private companies*

In Germany, the legal framework for private companies is not as strict as that for public companies and it permits a high degree of flexibility in the drafting of the articles of association. Only two compulsory corporate bodies are required: the managing directors and the shareholders’ meeting. Further, the companies may determine whether to establish advisory boards or shareholder committees. The duties of such committees are to be defined in the articles of association. The managing directors (one or more) are responsible for managing the company. The shareholders’ meeting has overall competence on all matters related to the company on which it wishes to decide. However, in the event that the company has more than 500 employees in Germany, the two-tier board structure is mandatory and a supervisory board must be established.

### **2.3. Systems in between/Modified systems**

As noted earlier, some countries, such as the Nordic countries, have systems that fall in between the one-tier and two-tier systems. In other words, within the aforementioned two systems mentioned, modifications are possible. In Denmark, for example, companies have been allowed to choose between different governance systems since 2009. Every limited liability company must have an executive board (*direction*) that is responsible for the day-to-day management of the company. Public companies may choose between the traditional Nordic model, which is described as a modified one-tier structure, where a board of directors (*bestyrelse*) performs the dual function of making strategic decisions and supervising the executive board, or an alternative management structure inspired by the German two-tier structure where all executive powers are vested with the management board and supervision is left to a supervisory board. In the former one-tier system, double mandates are allowed, whereas in the latter two-tier system, they are not.

The traditional Nordic governance system is generally characterized as a modified one-tier system. It consists of a board structure with an executive board and a board of directors. While the board of directors is the superior executive body of the company, the executive board is in charge of its day-to-day management and is subject to the instructions of the board of directors. Compared to the German two-tier system, there is no clear allocation of rights and duties between the different company organs and the system is very flexible. The executive board is responsible for the daily management of the company but the executive board may not, such as the German management board (*Vorstand*) does, claim exclusive rights over individual tasks. The board of directors, as the upper level of management, maintains responsibility for the overall strategic management and control function.

Private companies in the Nordic countries do not have to have an executive board but can rely on the board of directors as the single management body. They may, however, choose the same systems as public companies and introduce an executive board to handle day-to-day management, in which case the board of directors will assume the dual function of overall strategic management and supervision. If employee representation exists, a private company must have the latter system, because employee representatives must be directors in the upper management body, the board of directors. In Finland, public companies enjoy the same right as private companies to choose whether to have one management, the board of directors and an executive board, or just on single management body, the board of directors.

Like the Nordic system, the *Italian and Portuguese systems* are based on an optional approach. The shareholders can choose one of three different systems: (1) the traditional system with a management board and a board of statutory auditors (which has a similar role as a supervisory board); (2) a German style two-tier system; or (3) an Anglo-Saxon style one-tier system in which non-executive directors are appointed.

The establishment of a supervisory board is discretionary in France, Lithuania, Luxembourg and Portugal.

In the *Netherlands* a so-called ‘large company regime’ exists. This regime applies both to private and public companies in which the equity exceeds EUR 16 Million and the total number of employees in the company (and its subsidiaries) is 100 or more while a works council has been established. Such large companies may choose between either a two-tier regime or a one-tier system in which non-executive directors are mandatory. One third of the members of the supervisory board or the non-executive directors may be nominated by the works council. The supervisory board or the non-executive directors do have special powers apart from supervising and advising the management board/executive directors. The supervisory board (or the non-executives in a one-tier structure) appoints (and dismisses) the members of the management board (or the executive directors in a one-tier structure) unless an exemption applies which may be the case in international groups (Sections 2:152-164a/262- 274a Dutch Companies Act).

The decision whether to choose a pure one- or two-tier-system or a modified one- or two-tier system should be made either in the national Companies Acts or otherwise the Companies Acts should authorize the companies to make the decision.

Regarding the role of the general meeting (and the division of responsibilities between shareholders and management), the positions in national law are very different. In a number of Member States the management board is exclusively responsible for the administration of the company’s affairs. This is the case for example in Austria, Belgium, France, Germany, Hungary and Italy (for the public company). In Ireland and the UK, the role of the general meeting in principle is a matter of the company’s constitution. In the Nordic countries, the general meeting has the ultimate power in the company and since dominant ownership is widespread even in publicly traded companies, shareholders can and do exercise considerable influence on the management.

A characteristic of the typical two-tier system is that it is not possible for the same person to have a dual role (i.e. be represented in both the management board and supervisory board). This is for example the case in Bulgaria, Finland, France, Germany, Italy, the Netherlands, Poland, Portugal and Slovakia. In systems like the Danish and the Swedish ones, it is possible to be represented on both boards.

Chapter 8 contains rules on board composition and function of the board. All Member States have rules on these matters but the rules differ in detail, see further in the comments to various sections in Chapter 8.

Director’s duties and director’s conflicts of interest are dealt with in Chapter 9. Chapter 10 contains the rules on directors’ liability.

A major difference between the Member States’ is that some countries include provisions on employee representation in their Companies Acts. This is the case for example in Austria, the Czech Republic, Denmark, Finland, Germany, Hungary, the Netherlands, Slovakia, Slovenia and Sweden. In other continental European countries, provisions on employee representation are to be found in the labour code (France, Luxembourg). Also, in Ireland, Lithuania and the UK, the question of employee influence on the company’s affairs is a part of labour law and hence in most companies it has no direct influence on the corporate structure.

Even if there is employee representation on the company's boards, there are major differences in detail. The most extensive system is found in Germany where half of the members of the supervisory board in large companies (more than 2000 employees) must be employee representatives.

### 3. Considerations

According to Section 3 of Chapter 1 of the EMCA, a company may be public or private. Section 3 states that “*the shares of a private company may not be offered to the public.*” A private company is thus any company that is not a public company.

*Public companies*, although there are far fewer of these than private companies, are very significant from an economic perspective. These companies are designed for larger enterprises which have access to all the capital markets for raising finance, both in terms of equity capital from shareholders and loan capital from bondholders. However, public companies are sometimes employed for the purpose of family businesses that may not seek access to the capital markets. Public companies may have a large number of shareholders but this is not necessarily the case.

Public companies are subject to far greater controls in such areas as mergers and creditor protection. In legal terms, the common characteristics of public companies include the free transferability of shares and securities, a detailed system of control and minority shareholder protection, control measures on raising and maintaining equity capital, the necessity to disclose information to members and to the public, and detailed rules regarding auditing and accounting. Because of the enactment of EU Directives, there is significant degree of similarity between the laws governing public companies in the various Member States of the EU.

According to the EMCA, a traded company is defined as a publicly traded company whose securities are listed or traded on a regulated market or a multilateral trading facility, cf. Section 2 of Chapter 1. Traded companies are not only subject to company law but also to securities regulation, which to some extent overlaps with company law. They tend to have dispersed ownership, or at least dispersed minority shareholders, and the markets on which their shares are traded provide an external disciplinary mechanism.

*Private companies* are usually thought to be suitable for small and medium-sized enterprises, which do not require access to public funding. Financing comes usually from contributions by the members themselves or alternatively by bank finance. However, private companies may be used for other purposes, especially as holding companies and subsidiaries. Often, large companies take the form of a private company. Private companies are subject less to the provisions of EU Directives than are public companies.

The EMCA Group agrees – in accordance with the Commission's Action Plan (2012) - that the Member States should be free to choose between different board structures according to the need of the company and national traditions. However, in practice, there is something of a convergence between the two basic systems. Thus, the UK one-tier system is divided in a way that some directors have executive functions and the others are acting on a non-executive basis, thereby having stronger supervisory positions. Thus, Chapter 8 is divided into four parts: Part 1 deals with the one-tier systems and Part 2 deals with two-tier systems and Part 3 contains rules common to all systems. The same structure can be found, as mentioned above, in the SE Regulation.

The rules on the company's management are in various ways different regarding private and public companies. Thus, Chapters 8 and 9 contain special provisions regarding private and public companies including publicly traded companies (see the EMCA Chapter 1, Section 2).

Regarding employee representation, which is found in Part 4, the national traditions on employee representation are very strong and the EMCA Group considers that it is not possible to develop a common rule in this area, see further in Section 31.

*Section 8.01*

**The Company's Corporate Governance Structure**

- (1) The company's corporate governance structure shall comprise of:
  - (a) The general meeting of shareholders, and
  - (b) The company's management structure.
- (2) The company's management structure should be determined in the articles of association. A company can choose between the following management structures:
  - (a) A one-tier system according to the provisions in Part 1 of this Chapter.
  - (b) A two-tier system according to the provisions in Part 2 of this Chapter.
  - (c) Systems in between according to the provisions in this Chapter.

*Comments*

The majority of Member States apply the two-tier system in public companies. In private companies, on the contrary, Member States do not generally have rules compelling the companies to use the two-tier management structure. An exception is the Dutch large company regime that, as described above, contains mandatory rules for both public and private companies. In some Member States private companies can choose between a one-tier and a two-tier system, this is for example the case in Denmark, Finland, Germany, Italy and the Netherlands. The typical structure of the one-tier system is described above.

Most companies in Europe are small private companies and there are many fewer public companies. Thus, the regulatory approach concerning the (EU) distinction between public and private companies suggests that private companies are companies with few(er) shareholders and less capital. Therefore, such companies need simpler and more flexible management structures.

However, as mentioned before, private companies are not necessarily small companies. The distinction between private and public companies is that only public companies can offer shares to the public, see Chapter 1, Section 3.

Traded companies can offer shares to the public either on regulated markets or on an alternative market. In both cases the consequence is a division between a (large) number of shareholders and the management of the company.

Large private companies face many of the same management problems as large, public companies including: principle/agent problems; a need for a specialized management/supervision structure; and a need for regulation regarding decisions taken by company organs. Consequently, private companies may choose the same management structure as public companies.

The EMCA allows companies to choose between different board structures, including a one-tier system, a two-tier system and a system in between. This is in line with the trend that can be observed in the different Member States. In addition, there is no evidence that one system is better than the other.

PART 1  
ONE-TIER SYSTEMS

*Section 8.02*

**Appointment of the Board of Directors**

- (1) Directors shall be appointed by the general meeting. The articles of association may stipulate that one or more members of the board of directors shall be appointed by specific shareholders or third parties.
- (2) The number of board members shall be determined in the articles of association. In a public company, the board of directors shall comprise of no fewer than three members. A private company shall have at least one director.
- (3) In public companies, the majority of the board of directors shall be appointed by the general meeting unless national law provides otherwise.
- (4) In a public company, prior to an appointment to the board, the candidates shall provide the general meeting with information regarding their positions in other companies as well as any other fact that may cause a potential conflict of interest.

*Comments*

The shareholder meeting elects the board of directors with a simple majority, according to Chapter 11, Section 26. This means that the majority can elect the whole board. However, the articles of association may provide that minority shareholders have a right to be represented on the board. The latter is in line with the Companies Acts in Member States such as Denmark, Finland, Germany, Italy (in listed companies), Greece, Spain and Portugal.

Re 1) Member States may enact specific provisions, for example regarding state-owned companies, which provide that the national government may directly appoint directors. In such cases, the articles of association of course should be consistent with such provisions. Also, in relation to the appointment of directors in Section 2(1) and (3), national laws may have enacted specific provisions for example on co-determination, see below Part 4.

All board members should be natural persons, see Section 18.

Re 2) In various national corporate governance codes, it is stressed that the number of board members should not be incompatible with the efficient working of the board. This should be considered as good practice in all companies, but the EMCA Group does not consider that the EMCA should contain a regulation on the maximum of board members.

Re 3) Appointment of the board in private companies should be decided by the shareholders in accordance with the articles of association. According to a principle of flexibility in private companies, there should be no limitations regarding appointment of the board. However, in public companies the EMCA Group considers that it is important that the appointment of the board is a matter for the shareholders. The number of board members to be appointed other than by the general shareholders' meeting should hence be fewer than half of all members. The EMCA Group considers that in public companies, keeping with the principle of shareholders' democracy (Chapter 1, Section 1.12), decision rights on all-important matters relating to the company should always be reserved for the shareholders. Hence, on each matter, the shareholders should be able to reassess the company's focus and management by appointing a new board majority. This is the reason for Section 2 (3). A similar rule is found in the Danish Companies Act Section 120(1) and the Swedish Companies Act Chapter 8, Section 47.

Re 4) Section 2(4) intends to give the shareholders an opportunity to consider whether a candidate to the board is able to fulfil his or her duties in the company taking into account any existing or potential conflicts of interest. See further on directors' conflicts of interest in Chapter 9, Part 2.

The EMCA Group has considered whether the duty to inform the shareholders of other positions should be limited to publicly traded companies, or whether it should apply to all public companies. Since there are a substantial number of public companies of a size or structure similar to publicly traded companies, the Group considers that paragraph 4 should apply to all public companies.

### *Section 8.03*

#### **Chairman of the Board of Directors**

- (1) The board of directors selects a chairman, unless otherwise stated in the articles of association.
- (2) The chairman is responsible for the leadership of the board and ensuring its effectiveness in all aspects of its role.
- (3) In traded companies, the roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, and agreed by the board.

### *Comments*

Re 1) Private companies with a one-tier system must have at least one director, see for example the Danish Companies Act, the German GmbH-Gesetz, and the UK Companies Act. However, private companies may also choose to have more directors. According to the UK Companies Act, the board in public companies must have at least two directors. In other Member States there is no minimum number of board members. Of course, the question of a chairman of the board is only relevant if there are more board members. A larger board is especially relevant in large companies, especially publicly traded companies.

The chairman's position may be described further in the articles of association or in the board rules on procedure.

Re 2) This provision is taken from the UK Corporate Governance Code (2014), Main Principle, A.3.

Re 3) In many companies, it would be suitable to have a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. This principle is expressly stated in the UK Corporate Governance Code (2014), as mentioned above, which applies to traded companies.

One of the main issues in corporate governance is the separation of the roles of a chairman and executive directors. Even if the company has a one-tier system, it is important that there is a division of responsibilities between the chairman and the (other) board members. In the UK system, it is common to divide the board members in executive and non-executive directors (see below in Section 4). The UK Corporate Governance Code (2014) under A.2. states the main principle regarding division of responsibilities as follows: "There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision." The Danish Companies Act Section 114 expresses a similar view.

In the UK Corporate Governance Code, Main Principle A.3, the chairman's role is described as follows: "the chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role" while the main principle of the non-executive directors (A.4) is described as follows: "as part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy".

Most Member States do not have a provision akin to Section 2(3). However, the EMCA Group is of the opinion that it is useful to accept a principle of division of responsibilities.

### *Section 8.04*

#### **Executive and Non-executive Directors**

In traded companies, the board structure shall be divided into executive and non-executive directors. The number of executive and non-executive directors should be stated in the rules of procedure, according to Section 7 below.

### *Comments*

As mentioned in the General Comments under national law, the board in a one-tier system should exercise all management tasks, which in the two-tier system are assigned to the supervisory board and the management board. Therefore, the division is mandatory according to Section 4 for publicly traded companies, see below. However, the principle is also recommended for adoption by other companies but it is not mandatory due to the very different structures of these other companies. Therefore, national law may introduce a similar rule as a default rule.

This Section also deals with the corporate governance question of the separation of functions between management and supervisors as well as problems concerning conflicts of interest.

As noted earlier, in the UK-system, the boards of medium-sized and larger companies typically comprises both *executive directors* involved in the day-to-day management of the company, and *non-executive directors* (NEDs) supervising the former. Thus, the division between executive and non-executive corresponds to the division between the responsibility for the running of the company's business and the supervisory function of the supervisory board in the two-tier system.

Further details on the function of the executive/non-executive directors should be stated in company's rules on procedure, see below in Section 7.

Section 4 is in line with the Commission's Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.

The UK Corporate Governance Code (2014) Section B.1. states that "The board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking." The UK Corporate Governance Code distinguishes between large and smaller companies.

The EMCA Group considered if there should be a fixed percentage of executive/non-executive directors (according to the UK model at least half must be independent non-executives). The Group agrees that there might be differences between large and small companies. However, the definition of large and small companies varies between Member States. Therefore, it is not possible to determine a fixed balance between executive and non-executive directors in the EMCA. Instead, the EMCA clarifies that the balance should be determined in the rules of procedure.

The Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, the UK Corporate Governance Code as well as other national corporate governance codes further demand that a sufficient number of non-executive board members are independent, see Section 5.

### *Section 8.05*

#### **Independent Directors**

(1) In traded companies, the board should comprise an appropriate balance of independent non-executive directors. The number of independent non-executive directors should be stated in the rules of procedure, see below in Section 7.

(2) A director should be considered to be independent only if he or she is free of any business, family or other relationship with the company, its controlling shareholder or the management that creates a conflict of interest such as to impair his or her judgement.

### *Comments*

Section 5 follows the Commission's Recommendation 2005/162/EC Section II 3(1) according to which there should be "an appropriate balance of executive/managing and non-executive/supervisory directors such that no individual or small group of individuals can dominate decision-making on the part of these bodies".

The EMCA Section 5 does not define an “appropriate balance” of independent non-executive directors. According to the UK Corporate Governance Code at least half must be independent non-executive directors. According to provision B.1.2. “except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.” (A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.)

For the same reasons as mentioned in the comments to Section 4, company laws of the Member States contain different rules based on the size of the company, and therefore the EMCA Section 7 prescribes that the rules of procedure specify the balance of non- executive/executive board members.

Section 5(2) follows the Commission’s Recommendation 2005/162/EC in Section III (13)(1). According to Section III 13(3)(2), the criteria for independence should be laid down in national corporate governance codes, see for example the Danish Corporate Governance Code (point 5.4), the Lithuanian Corporate Governance Code (point 3.7) and the UK Corporate Governance Code (under B.1.1). The EMCA Group agrees that the more detailed definition of independence should be left to national corporate governance codes.

Employee representatives are not independent in the sense of the definitions in Section 5(2). Therefore, the claim for independence in Section 5(1) only applies regarding board members elected by the shareholders.

#### *Section 8.06*

### **Resignation and Dismissal of Members of the Board of Directors**

- (1) A member of the board of directors may resign from the board of directors at any time.
- (2) A member of the board of directors may be dismissed at any time without cause by those who have appointed the member.
- (3) A member of the board of directors who is not elected by the general meeting may be dismissed at any time by the general meeting for a good cause.
- (4) If there is no alternate member available to replace the former member, the other members of the board shall take measures necessary to appoint a new member of the board. The new member shall hold office until the next general meeting where his or her appointment must be confirmed by those entitled to appoint the member. The election may be deferred until the next annual meeting, provided that the board of directors is quorate with the remaining members and alternate members.

#### *Comments*

Re 2) A simple majority is sufficient for a dismissal according to the general rule in Chapter 11. This is so without prejudice to any rights to compensation or damages (abusive dismissal, lack of respect of defense rights... ) payable in respect of the termination of their appointment as director. See for example the UK COMPANIES ACT(2006) Section 168.

National law may contain the provision that a director is entitled to be heard on the resolution to dismiss him or her. See for example Section 2:117(4)/227(7) Dutch Companies Act and the UK Companies Act Section 169 (2). French case law adopts the same view.

Specific provisions in national law on co-determination may provide for alternatives regarding dismissal of employee board members. See also below in Part 4.

Re 3) A “good cause” is a violation of directors’ duties according to Chapter 9. For example, this could be disloyal behavior like a breach of contract, breach of duty of care, or simply diverging views on the management of the company. The director can be asked to leave but the courts may determine whether the dismissal is legitimate. See correspondingly above in comments to Section 2.

A dismissal could give rise to a claim for compensation (but not reinstatement) if the court considers that there was no good cause for the dismissal.

Re 2) and 3) A dismissal could also result in an obligation to pay compensation based on labour law. Such labour law aspects are not regulated in the EMCA and are left to national law.

Re 4) On alternate directors, see below, Section 15.

Greek Companies Act Article 18 provides that the remaining members may continue to form a valid board, if the articles of association so provide. Section 6(4) of EMCA goes further making it unnecessary to include such a provision in the articles of association. Thus, the other members do not need to take measures to appoint new members of the board for the remaining part of the term.

German law makes a distinction between private and public companies with regard to the possibility to dismiss directors. Private companies usually apply a one-tier system. The shareholders are appointing the directors and have the right to dismiss them at any time without cause (Sec. 38 German GmbH-Gesetz). In public companies, the two-tier system applies, see Section 13 below.

#### *Section 8.07* **Rules of Procedure**

(1) The board of directors shall adopt written rules of procedure. The rules of procedures should address the division of tasks among the members of the board of directors, including: the number of executive/non-executive directors; the role of the chairman; the frequency and form of meetings of the board of directors; how alternate members shall participate in the board of directors; supervision of the day-to-day business, and where relevant, monitoring the day-to-day business; reviewing the accounts; and securing the necessary foundations for auditing.

(2) The provisions of the first paragraph shall not apply where the board of directors only comprises a sole member, cf. Section 2.

(3) The board shall, in written instructions, state the allocation of the tasks between the board and sub-committees or other special committees established by the board.

#### *Comments*

Re 1) Section 7 is not based on EU law. Section 7 is inspired by the Swedish Companies Act Section 8:46a. A similar provision is found in the Danish Companies Act Section 130. The Danish provision, however, is more flexible both compared to the Swedish Companies Act and especially compared to the previous provision in the Danish Companies Act, which included 10 mandatory items to be included in the rules of procedure. Following the Danish provision, Section 7(1) has no mandatory minimum requirements, but instead it recommends some items which should be considered by the board. Other countries, like Germany, at least provide for a basic rule that the board may adopt rules on procedure in order to set a stable framework for its cooperation in day-to-day business (see Sec. 77(2) German Stock Corporation Act and the Lithuanian Companies Act Article 34 Part 15). Other Member States are silent on the issue of written rules of procedure but do not prohibit them, so that they are certainly possible (e.g. France and Italy).

The reason for implementing the provision on rules of procedure in Denmark and Sweden is that there has been a number of cases where the management has not met its obligations. The Danish and Swedish Companies Acts have general provisions describing the directors' duties, which is also the case according to the EMCA Chapter 9, Part 1. The provisions on rules of procedure in the Danish and Swedish Companies Acts are intended to specify the board's duties, and in that way facilitate holding the board liable in cases of omission or neglect to comply with directors' duties.

The EMCA Group considered whether the EMCA should include a provision on rules of procedure or such a rule should be left to national corporate governance codes. Looking at the existing national corporate governance codes, there are great differences regarding precise recommendations on how the board works. Therefore, the Group considers that it is appropriate for a model act to include a provision such as Section 7 (and 12).

The Companies Acts and the articles of association contain general provisions on how the board of directors functions. The rules of procedure are a supplement to the articles of association but created by the board, and the board can also change them. There are a number of topics, which may be worth considering when drawing up rules of procedure, depending of course on the nature and requirements of the individual company. Small (private) companies usually do not need comprehensive rules of procedure. The purpose of the rules of procedure is, among other things, to ensure that the duties of the board are discharged in an appropriate manner. If there are any discrepancies between the rules of procedure and the articles of association, the articles of association always prevail, and the rules of procedure cannot attribute to the members of the management board or the supervisory board new powers and rights which they have not been granted by the articles of association.

If the rules of procedure are changed, the company's nature and purpose must be taken into account.

The board shall consider – taking into account the actual needs of the company – whether and to what extent the rules of procedure should contain provisions on the constitution, the division of labour, the function of executive/non-executive directors, including the supervision of the daily management, accounting, the requirement to take minutes, the holding meetings, the duty of confidentiality, alternates, monitoring the accounts, signing the auditors' records, and safeguarding the necessary basis for auditing.

Re 2) According to Section 2, a private company may have only director. Therefore, many private companies do not need to make written rules of procedure.

Re 3) Section 20 includes provisions on board committees. Further regulation of board committees can be made in the articles of association or in the rules of procedure.

PART 2  
TWO-TIER SYSTEMS

*Section 8.08*

**Management Board and Supervisory Board**

(1) In a two-tier system, the management system includes a management board and a supervisory board. The management board shall be responsible for managing the company. The supervisory board shall supervise the management board. The supervisory board may not itself exercise the power to manage the company. The management board and the supervisory board shall have the duties and responsibilities stated in this Section and Chapter 9, Section 2.

(2) The articles of association may determine that specific, important transactions may be entered into only with the approval of the supervisory board. The articles of association may also state that the supervisory board shall determine the company's business policy.

*Comments*

The two-tier system is particularly applied in public companies. However, a number of Member States' Companies Act's also allow private companies to use a two-tier system. This is for example the case in Austria, the Czech Republic, Denmark, Germany, Latvia, Lithuania, the Netherlands and Poland.

Part 2 contains rules for Member States that choose a two-tier system. It includes provisions referring to "pure" two-tier systems, such as provided for in the Austrian, French, German and Polish legislation, but it also includes modified two-tier systems, such as the Dutch two-tier system. The decision whether to choose a pure two-system or a modified two-tier system should either be made in the national Companies Acts or otherwise the Companies Acts should authorize the companies to make the decision.

Part 2 gives a high degree of freedom to organize the two-tier system but at the same time, Part 2 contains an extensive regulation which may be of greater help than regulation with a large discretionary content.

Re 1) This provision defines the basic idea of a two-tier system which consists in a separation of the functions of management and supervision to be vested in two different organs. The basic definition of the different functions can be found in Section 8, which is similar to the definition in the Regulation on the *Societas Europaea* (SE Regulation). Article 39 of the SE-Regulation states that "the management organ shall be responsible for managing the SE" and Article 40 of the SE- Regulation states that "the supervisory organ shall supervise the work of the management organ. It may not itself exercise the power to manage the SE".

Re 2) This provision makes it possible to strengthen the role of the supervisory board and at the same time enhance its responsibility. There is a comparable rule in Germany, allowing the articles or even the supervisory board itself to determine the types of transactions that require the prior approval of the supervisory board (Section 111 (4) German Stock Corporation Act). German law, however, does not allow the supervisory board to determine the company's business policy since, from a German point of view, this would blur the division of powers and responsibilities between the management and the supervisory board. French law follows the same approach.

According to Section 8(2), members of the management board can be required to provide large and extraordinary transactions to the supervisory board for approval. The articles of association may specify the circumstances in which the approval of the supervisory board is required, as well as the rules of procedure. The supervisory board may also decide on it by means of an ad hoc decision.

According to Section 8(2), the articles of association may also decide that the management board must also receive the approval of the supervisory board before entering transactions involving higher risks.

According to Section 12 the supervisory board must adopt written rules of procedure.

*Section 8.09*

**Overlap of Functions**

- (1) A member of the management board shall not at the same time be a member of the supervisory board.
- (2) In companies with a modified two-tier system, the articles of association may determine that managing directors may be elected also as members of the supervisory board. The majority of members of the supervisory board shall not be members of the management board.

*Comments*

Re 1) This is the system in “pure” two-tier systems such as Austria, France, Germany and Poland.

Re 2) For companies in modified two-tier systems, the articles of association may permit a limited overlap of personnel in the management system. However, to secure a division of tasks as well as an effective supervision, the majority of members of the supervisory board should not be members of the management board.

*Section 8.10*

**Appointment of the Management Board/Supervisory Board**

- (1) The supervisory board appoints the members of the management board unless the articles of association provide that the management board is appointed by the shareholder meeting.
- (2) Members of the supervisory board shall be appointed by the general meeting. The articles of association may stipulate that one or more members of the supervisory board shall be appointed in another manner.
- (3) In public companies, the majority of the supervisory board shall be appointed by the general meeting unless national law provides otherwise.
- (4) In a public company, prior to an appointment to the board, the candidates shall provide the general meeting with information regarding their positions in other companies as well as any other fact that may cause a potential conflict of interest.
- (5) The number of board members of the management board as well of the supervisory board shall be determined in the articles of association. The supervisory board shall comprise of no fewer than three members. The articles of association may limit the numbers of members of the managing board or the supervisory board of a company.
- (6) Section 10 (1)-(5) does not apply when national law provides otherwise.

*Comments*

Paragraphs 3 and 4 applies to public companies, whereas paragraphs 1, 2 and 5 applies to both public and private companies that employ a two-tier system,

Re 1) Section 10(1) is in line with the Companies Acts in most Member States, for example the Polish Commercial Companies Code Article 368 for public companies. In Germany, the supervisory board appoints the members of the management board in public companies (Sec. 84 German Stock Corporation Act), but there is no possibility for the articles to deviate from this provision. French law, which was inspired by Germany, follows the same approach (Article L. 225-59 of the Commercial Code).

Re 2) The main rule in those Member States which allow two-tier systems is that the supervisory board is appointed by the general meeting, cf. for example the Dutch Companies Act (Article 2:142/252), the French Commercial code (Article L. 225-75), the German Stock Corporation Act (Section 101) and the Polish Commercial Companies Code (Article 215 for private companies and Article 385 for public companies). Those provisions usually, with the exception of Germany, also allow for an alternative procedure for appointing members of the supervisory board.

Re 3) The purpose of Section 10(3) is to ensure that the shareholders have the decisive influence in the company. In Germany, the rules on employee co-determination in very large companies require that half of the members of the supervisory board must be employee representatives. Apart from that, it is possible to grant particular shareholders the right to appoint members to the supervisory board of a public company. This right may be granted only with respect to a maximum of one third of the supervisory board members (Section 101 (2) German Stock Corporation Act). In the Netherlands, according to the large company regime, the number of employee representatives is limited to one third (Sec. 2:158/268 (6) Dutch Companies Act).

Re 4) Section 10(4) determines that the duty to inform the company regarding the candidate's other positions is limited to the positions in the management board and the supervisory board. National Corporate Governance Codes should contain specific rules in order to reveal other position such as in foundations, cooperatives and associations.

Re 5) Section 10(5) states that the articles of association must include the number of the members of the management board and of the members of the supervisory board. In some Member States there are upper and lower limits to the number of members. In France, for example, the maximum number of members of the management board (*directoire*) is 5 and, for listed companies, 7 (Article L. 225-58 of the Commercial Code). The German Stock Corporation Act Section 95 maximizes the number of members of the supervisory board according to the size of company's share capital to 21.

Re 6) Section 10(6) will be relevant if national law provides for specific rules on the appointment of directors as discussed in Section 2 of this Chapter (co-determination of employees).

#### *Section 8.11*

### **Chairman of the Supervisory Board**

- (1) The supervisory board selects a chairman, unless otherwise stated in national law or in the articles of association.
- (2) The chairman shall preside over the work of the supervisory board and monitor the performance by the board of its duties as set forth in Chapter 9.
- (3) The chairman may not be a member of the management board.
- (4) In traded companies, the chairman of the supervisory should not exercise the same tasks as the managing directors. The division of responsibilities between the chairman and managing directors should be clearly established, and agreed by the board.

#### *Comments*

Re (1): The supervisory board should have a chairman, see for example the Danish Companies Act Section 122, the French Commercial Code (Article L. 225-81), the German AktG Section 107, the Lithuanian Companies Act Article 31 Part 1 and the Swedish Companies Act Chapter 8 Section 17. However, the articles of association may provide otherwise.

The articles of association may require,

- that a chairman is not appointed,
- that a specific person, who is a member of the supervisory board, may be appointed as chairman,
- that a certain group of persons may not be appointed as chairman.

Special laws on, especially on co-determination, may provide for rules on the chairman, see Part 4.

Re 3 and 4) The chairman does not constitute a company organ but is characterized as the primus of the institution. The chairman of the supervisory board may not be a member of the management board and may not act as if he or she was a member of the management board. In the pure two-tier system, this prohibition is clear from the separation and specification of the responsibilities of the supervisory board, cf. Section 9(1). For modified two-tier systems, a division of functions is underlined by Section 11(4).

The chairman's role may be specified in the rules of procedure, see below, Section 12.

*Section 8.12*  
**Rules of Procedure**

- (1) The supervisory board shall adopt written rules of procedure which may include the division of tasks among the members of the board of directors, the role of the chairman, the frequency and form of meetings of the board, whether alternate members shall participate in the board of directors, supervision of the day-to-day business, and where relevant, monitoring the day-to-day business, reviewing the accounts, and securing the necessary foundations for auditing.
- (2) The provisions of the first paragraph shall not apply where the supervisory board only comprises a sole member, cf. Section 2.
- (3) The board may, in written instructions, further specify the allocation of tasks between the board and sub-committees or other special committees established by the board.

*Comments*

The supervisory board shall adopt its own rules of procedure, for example the number of meetings, electronic meetings, duty of confidentiality, alternate members etc.

See further comments to Section 7.

The rules of procedure may also describe the division of tasks between the supervisory board and the management board and between the board and possible committees. See on committees below, Section 20.

National corporate governance codes, national legislation on auditors, regulation of financial institutions etc. contain further rules on sub-committees, such as nomination committees, remuneration committees, and audit committees. Thus, most Member States have implemented the Commission's Recommendation (2005/162/EEC) in their national corporate governance codes. The Rules of procedure may be based on the corporate governance codes.

*Section 8.13*  
**Resignation and Dismissal of Members of the Management Board/Supervisory Board**

- (1) A member of the management board / supervisory board may resign from the management board / supervisory board at any time.
- (2) A member of the management board / supervisory board may be dismissed at any time *without cause* by those who have appointed the member unless otherwise provided in the articles of association.
- (3) A member of the supervisory board not elected by the general meeting may be dismissed at any time for a good cause by the general meeting.
- (4) If there is no alternate member available to replace the former member, the other members of the board shall take measures to appoint a new member of the board. The new member shall hold office until the next general meeting where his or her appointment must be confirmed by those entitled to appoint the member. The election may be deferred until the next meeting, provided that the board is quorate with the remaining members and alternate members.

*Comments*

Re 2) dismissal of the supervisory board.

The elected members of the supervisory board who have been elected by the general meeting can be dismissed at any time by the general meeting. This means, according to the general rule in Chapter 11, that a decision by a simple majority is sufficient. This is in line with the principle of shareholders' democracy (Chapter 1, Section 1.12).

The provision deviates from the rule applicable under German law. According to Section 103 (1) German Stock Corporation Act, members of the supervisory board can be dismissed by the shareholder meeting only by super majority of three quarters of the votes cast. This relates to the intention of the German legislation to create stability within the management system of a public company (see already comments to Section 6).

Re 2 and 3) According to Section 10, the articles of association may stipulate that one or more members of the supervisory board shall be appointed in another manner. The articles of association may also provide that such members may not be dismissed. However, subparagraph 3 indicates that such members can be dismissed by the general meeting for good cause, for example, in the case of a breach of contract or where a member misuses his or her position in the company.

Section 13 (2) also includes rules on the dismissal of (members of) the management board. The management board is appointed by the supervisory board unless the articles of association provide that the management board is appointed by the general meeting, cf. Section 10(1). In case the articles of association provide that the management board is appointed by the general meeting, the general meeting has the power to dismiss a member of the management board. So, unless the articles of association contain a provision to the contrary, members of the management board are dismissed by the supervisory board.

In case the supervisory board has the power to dismiss members of the management board, the general meeting has no power to dismiss a member of the management board directly. The general meeting may, however, instruct the supervisory board to dismiss a member of the management board.

Dismissal of a member of the management board could result in an obligation to pay compensation, see the comments to Section 6.

German law makes a distinction between private and public companies as regards the possibility of dismissing directors. In private companies, directors are appointed by the shareholders and the general meeting has the right to dismiss them at any time without cause (Sec. 38 German GmbH-Gesetz). In public companies, members of the management board can only be dismissed by the supervisory board for a good cause (Sec. 84 German Stock Corporation Act). One reason for this distinction lies in the different shareholder structure of private and public companies. In private companies, the shareholders usually are closely related to the business and are carefully monitoring the directors; they therefore will have the ultimate power to dismiss the directors at any time. In public companies, shareholders may be dispersed and may not have the time and the capability to monitor the management – which in the two-tier system is the duty of the supervisory board – and therefore are less reliable to take a well-founded decision when dismissing the management. Given the fact that only a minority of shareholders attend shareholder meetings at all, a power to dismiss the management without any reason could lead to arbitrary decisions and thereby be a disincentive for management to follow long-term management strategies. The supervisory board may, however, take into account a vote of no confidence (*Vertrauensentzug*) of the shareholder meeting as a reason to dismiss the management board (Sec. 84(3) German Stock Corporation Act).

PART 3  
RULES COMMON TO ALL SYSTEMS

*Section 8.14*  
**Term of Directors**

- (1) In a public company, members of the board of directors (one-tier systems) or members of the management board / supervisory board (two-tier systems) are appointed for the period determined in the articles of association. However, the period should not exceed four years.
- (2) In a private company, the term can be indefinite.

*Comments*

Re 1) This provision is intended to ensure a continuous renewal of the company's management. The period of tenure is determined by the provisions in the articles of association. There is no prohibition against re-election. A number of Member States have a maximum term for board members. For example, in the Czech Republic (5 years), France (6 years), Germany (6 years), Greece (6 years), Italy (3 years), Denmark (4 years), Poland (5 years) and Sweden (4 years).

The EMCA Group considers that the EMCA should strive towards a balance between continuity and shareholder influence on the composition of the board. On one hand, the period should allow board members to acquaint themselves with the company's matters and obtain sufficient experience, on the other hand, the period should not be so long that the shareholders lose their control over the management. A more reduced term than in several Member States, as seen above, is in line with the principle of shareholders' democracy which the EMCA Group supports (Chapter 1, Section 1.12). This balance should also be seen in the light of the recent discussion regarding short-termism. A number of corporate governance codes regarding traded companies recommend that the board members elected by the general meeting stand for re-election every year at the annual general meeting, see for example the Danish Corporate Governance Code 2013, Section 3.1.5.

The UK Companies Act 2006 has no time limit but the UK Corporate Governance Code Section B.7. expresses as a main principle that "all directors should be submitted for re-election at regular intervals subject to continued satisfactory performance". It also requires that, for FTSE 350 companies, all directors should be subject to annual election by the shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and the re-election thereafter at intervals of no more than three years. Non-executive directors who have served longer than nine years should be subject to annual re-election.

The EMCA Group is of the opinion that the corporate governance principles expressed in the UK and Danish Corporate Governance Code are sound. The national corporate governance code may – like the UK Corporate Governance Code – have more strict limitations for large traded companies but also in other public companies the shareholders should have the opportunity to elect directors regularly.

*Section 8.15*  
**Alternate Directors**

- (1) Alternates may be appointed as substitute board members in accordance with the articles of association.
- (2) The provisions of the EMCA regarding members of the board of directors shall apply when relevant also to alternate members.
- (3) If a board member cannot participate in a board meeting because of a conflict of interest or for some other temporary reason, an alternate may attend.
- (4) In the case of a temporary absence, a board member can grant a proxy to another member of the board. The same obligations will apply to the proxy as to the member represented.

*Comments*

Re 1) The articles of association will determine if an alternate for a board member may be appointed. Thus, it is not mandatory for companies to appoint alternates. This is in line with the situation in most Member States. An exception is the Swedish Companies Act Chapter 8, Section 3, which states that where a board of directors has less than three members, there shall be at least one alternate. It may be decided whether there should be an alternate for each board member or more alternates for the whole board. A number of Member States have no provisions on alternates in their Companies Acts. This is for example the case in Poland and Czech Republic.

As mentioned, it is up to the company to decide whether there should be alternates. In the UK, the Model Articles for public companies clarify the alternate's position. The Model Articles for private companies make no provision for alternates in order to discourage the use of alternates in private companies.

The UK position shows that the company should consider if there is a real need for alternates or if alternates merely pose an unnecessary complication for the company.

The alternate may be selected as a substitute for a specific board member or for any member of the board. The articles of association should decide whether the former or the latter should be the case. The first option is particularly relevant if individual board members have been appointed in a way to represent particular interests.

The alternate enters the board if the concerned board member resigns from the board before the expiry of the election period, cf. Section 13(4) of this chapter. In this way it will not be necessary to hold an election. The alternate has the right to temporarily enter into the board in case of a member's absence. By absence is not only meant permanent absence but also cases where a director is only prevented from appearing at a single or a few meetings. It is not necessary to call an alternate merely because a board member is prevented from attending a single or a few meetings. In isolated cases, a board member can give the power of attorney to another board member instead of calling an alternate, if this is adequate in respect of the subject of the discussion. The rules of procedure of the board may lay down rules on the general practice which is followed in the company.

As to the situation where there is no alternate and one or more directors are dismissed, see Section 6(4).

Re 2) This is in line with the Danish Companies Act (Section 111 (4)), Greece (without express provision) and the Swedish Companies Act (Chapter 8, Section 3). In the UK, the Model Articles for public companies provide that, except the articles specify otherwise, alternate directors 'are deemed for all purposes to be directors' (Section 26(2)(a)).

Re 3) In case of temporary absence, the board as well as the alternate can demand the alternate be present.

Re 4) This scheme is in accordance with Austrian, Danish, French, German and Lithuanian company law.

Section 15 does not include rules on alternates for employee representatives, see further on employee representation below in Section 30.

*Section 8.16*

**Meetings of Directors**

(1) The chairman of the board shall ensure that meetings are held when necessary. Notice of board meetings must be given to all directors.

(2) Meetings of the board shall always be called where requested by a board member, or the company's auditor. Notably, when a board member calls a meeting of the board of directors, the meeting shall be held within two weeks from the date of which notice thereof has been given. If any such request made by two or more board members should not be complied with, such members may themselves call a meeting of the board of directors upon stating these facts.

(3) A managing director, even if he is not a member of the supervisory board, has the right to be present and to speak at the supervisory board meetings, unless otherwise decided by the supervisory board.

*Comments*

Re 1) A chairman of the board is selected according to articles of association, see Section 3 and 11. According to those sections, the chairman is responsible for the leadership of the board. Therefore, one of their tasks is to ensure that meetings are held when necessary. There is no provision regarding the number of meetings in the EMCA. The rules of procedure may state how often meetings are to be held. National corporate governance codes also often include more specific provisions on the number of meetings.

Of course formal meetings of the board of directors need not be held where the board consists of only a single member, as is often the case in private companies. The supervisory board, however, should always consist of more members. It might sometimes be regarded as necessary to hold formal meetings in a company with only or a small number of shareholders. Decisions may already have been taken through private contact between the members. It should, however, be emphasized that decision must also be recorded in minutes, so that it is subsequently possible to determine what was decided. On minutes, see Section 19.

Re 2) The auditor mentioned in Section 16(2) is the auditor elected by the company's general meeting, see below in Chapter 12. According to Chapter 12, not all companies have a duty to elect an auditor, for example small companies. However, such companies may choose to elect an auditor.

Re 3) For practical reasons, it is important that a managing director is present at the supervisory board's meetings as he or she is usually best acquainted with the company. This is of pivotal importance in pure two-tier systems, where the managing director cannot be a member of the supervisory board. German law expressly stipulates reporting obligations of the management board to the supervisory board (see Sec. 90 German Stock Corporation Act).

Subparagraph 3 is inspired by the Swedish Companies Act Section 8:19 and, similarly, the Danish Companies Act Section 123.

The board of directors/supervisory board can decide to invite persons other than members of the board to attend a board meeting.

Minutes from the meeting must be kept, see below Section 19.

*Section 8.17*

**Decision Making in the Board**

(1) The board is quorate where more than one-half of the total members of the board or a higher number as stated in the articles of association participate in the meeting.

(2) Unless the articles of association prescribe a specific voting majority resolution of the board, decisions shall be adopted by simple majority of the members participating in the resolution. In the event of a tied vote, the chairman shall have the casting vote, unless prescribed otherwise in the articles of association.

(3) Resolutions of the board of directors can be passed electronically and in writing in so as far as the articles of association do not provide otherwise. A written resolution shall be sent to all members of the board. However, a board member may demand an oral discussion.

(4) Resolutions may not be adopted in a matter unless all board members, where possible, have been afforded the opportunity to participate in the decision making process and have received satisfactory information in order to reach a decision in the matter.

*Comments*

Re 1) Section 17(1) contains a demand for quorum. The articles of association can prescribe stricter voting rules. If the demand for quorum has not been met, the decision is invalid. If a member is prevented from appearing, an alternate can be called up, see Section 15. If the member is only absent at a single or a few meetings, a board member can give a power of attorney to another board member instead of a calling an alternate, see comments to Section 15.

Re 2) In case of a tied vote, the chairman of the management board should have the casting vote. Provided that the demand for quorum according to subparagraph 1 is met, a decision is made by the attending members of the board.

Subparagraph 2 contains a default rule concerning the situation of a tied vote. A similar rule is found in the Danish Companies Act Section 124, the French Commercial Code (Article L. 225-37), the Lithuanian Companies Act Article 35 Part 3 and the Swedish Companies Act Section 8:22.

Re 3) Generally, the EMCA supports the use of information technology at both board meetings and at general meetings. However, the use of information technology solutions is not fully developed in all Member States. Therefore, subparagraph 3 mentions both written and electronic solutions. While, as mentioned above, the starting point is that decisions are made at actual meetings, it is often suitable or necessary for decisions to be made in another manner. In order to ensure that the board member keeps in touch with the job and the associated responsibility, a board member can demand that an oral discussion takes place. Oral means that the participants are able to communicate directly. This could be in a physical meeting or a video conference, etc... Hence, it is not necessary to demand an actual meeting. It is the opportunity to interact freely and verbally, which is of vital importance, not the means by which it occurs. This provision is inspired by the Danish Companies Act Section 125 and the Portuguese Companies Act, Article 410(8). German law contains a similar provision: Resolutions of the supervisory board may be taken without an actual meeting unless a member of the board disagrees with this procedure (Section 108 (4) German Stock Corporation Act).

Re 4) Section 17(4) is inspired by the Swedish Companies Act Section 9:21, and partially also the Danish Companies Act Section 124. It must be decided in each individual case whether defects regarding compliance with paragraph 4 may cause invalidity. As indicated, it may be necessary to make quick decisions and thereby deviate from the provision in paragraph 4.

#### *Section 8.18*

### **Disqualifications from Serving as Directors**

Legal persons, minors, persons under guardianship and bankrupts may not serve as members of a board, unless national law provides otherwise.

#### *Comments*

Having taken due account of the diversity of companies, the EMCA Group does not consider it possible to draw up precise qualifications for the position of director. The EMCA does not contain thus positive demands for qualification in the sense of minimum skill requirements etc. However, some people are disqualified by virtue of their status – as minors, bankrupts etc.

The Commission Recommendation 2005/162/EC Sections III (11) and (12) demands qualifications and commitment of the board. National corporate governance codes include provisions on these issues but these only apply to traded companies. The EMCA Group considered whether the EMCA should contain rules on qualification of directors for traded companies as well as for other companies but took the view that the best means for developing the qualification demands for traded companies is corporate governance codes.

For all companies, the provisions describing the liability rules and the duties of directors set some minimum standards for directors' qualification.

In many Member States, no residency requirements apply to directors. For example, since 2004, in Denmark, there has been no residence requirement for members of the board and this has not given rise to any problems. The 2014 proposal of directive on the single-member private limited liability company, creating the *Societas Unius Personae* (SUP) also provides that there should not be a residency requirement.<sup>59</sup> The EMCA follows the same approach.

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<sup>59</sup> COM(2014) 212 final.

Section 18 sets out a number of circumstances in which directors are disqualified from serving as directors. Section 18 applies to the members of the supervisory board and the members of the management board; the two-tier system as well as members of the board of directors in the one-tier system.

There are provisions on disqualification of directors in some Member States, but not all. Provisions on disqualification are found for example in France, Germany, Portugal, Ireland, UK, Italy, Sweden and Denmark. In the Netherlands a bill on directors' disqualification was submitted to parliament in 2014 and entered into force in 2016. There are no rules in Austria, the Czech Republic, Greece, Hungary and Poland.

Only natural persons can be members of the board. The company laws of the Member States may provide otherwise. According to Dutch company law for example, a legal person can be a member (or the only member) of the management board. Only natural persons can serve as members of the supervisory board (Sec. 2: 140/250 Dutch Companies Act). The term "bankrupt" refers to the term used in the Member State's national Insolvency Acts. Such acts may contain provisions, which would actually allow continuing as a director. The consequence of a director's bankruptcy is that he or she must either automatically deregister as a director, or he or she must obtain court permission to continue to act as a director. The former is chosen by the Swedish Companies Act and the latter is chosen in the UK Directors' Disqualification Act. Section 11 of the latter disqualifies a director if he or she is an "undischarged bankrupt". A third ground for disqualification which is chosen in Denmark and a number other Member States, arises where the court under certain circumstances may decide to disqualify a director – for example in case of criminal offences where there is a danger that the director will abuse his position as a director. Such rules are also included in the UK Company Directors' Disqualification Act.

#### *Section 8.19* **Minutes of the Meetings**

- (1) Minutes shall be taken of all proceedings at meetings of the board. Minutes shall be signed by all board members present.
- (2) The members of the board present at the meeting are entitled to have dissenting opinions recorded in the minutes.

#### *Comments*

Re 1) Section 19 determines that all proceedings must be evident from the minutes. Thus, the minutes must state the place and date of the meeting, the persons attending, the items on the agenda, the essential nature of the proceedings and the resolutions of the board, cf. for example the German Stock Corporation Act Section 107 (2). This is necessary in order to document the discussions. The contents of the minutes can also become important for subsequent liability in matters where managerial responsibilities are asserted.

In some Member States, it is considered sufficient that the minutes are signed by the chairman. This is considered as standard practice which need not be stated in the Act. However, case law from Denmark, for example, shows that fraud can go undetected because board members have not seen the minutes. Therefore, the EMCA Group considers that all board members present should sign the minutes. Similar rules are found in the Danish Companies Act Section 128 and the Swedish Companies Act Section 8:24.

Minutes must be taken not only in formal meetings but also regarding decisions taken outside a formal meeting, see comments to Section 16 above.

Re 2) The opportunity to enter a dissenting opinion in the record of the meeting may provide individual members with an opportunity to release themselves from any joint responsibility for decisions made.

If a member has not participated in a meeting, he or she is not completely exempted from liability arising from the management's decisions at a later stage.

*Section 8.20*  
**Board Committees**

(1) The board can appoint committees that may hold meetings and may make recommendations to the board on certain issues.

(2) The articles of association may provide for the committees and the articles of association or the rules of procedure may define the tasks that such committees may perform.

*Comments*

The Companies Acts in most Member States do not include provisions on board committees. However, the establishment of committees is commonplace. The UK Model Articles Section 5 and 6 for private and public companies include provisions on directors' delegation of power and on committees.

German law allows sub-committees with different functions. One function is to prepare particular decisions of the supervisory board. Particular powers may be delegated to committees and the committee may be allowed to take the final decisions. However, there is a provision setting out particular powers (e.g. the power to appoint the management board), which may not be delegated to a sub-committee, leaving to the committee only the function of preparing such decisions (cf. German Stock Corporation Act Section 107 (3)).

Certain committees are mandatory by law, for example audit committees for listed companies (See. Article 39, Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts). The EMCA Group considered the right to delegate and to use committees. The Group considered that the board of directors can delegate duties to one or more board members or to a non-member. The board cannot, however, through such delegation relieve itself of the ultimate responsibility for the company's organization and management or the responsibility to ensure satisfactory control of the company's accounting, funds management and finances.

The EU Commission's Recommendation of 2005/162/EC on the role of (independent) non-executive or supervisory directors of listed companies and the committees of the (supervisory) board has been implemented in the corporate governance codes of several Member States. As stated above, an *audit committee* is mandatory for listed companies in line with Directive 2006/43/EC. Other committees such as *nomination committees* and *remuneration committees* are only recommended in corporate governance codes. The EMCA recommends the use of committees in large companies even though they are not traded companies.

As mentioned, national corporate governance codes include details regarding the composition of the committees, the tasks of the committees etc. For traded companies, provisions in the corporate governance codes supplement the rules in Section 20.

Re 1) Section 20 makes clear that the board may appoint committees and define the role of the committees as limited to preparing meetings and making recommendations to the board. Thus, the committees may not be used to circumvent the rules which provide that it is the management that is responsible for managing the company or the supervisory board for supervising the management. This ensures that members of the board – including employee representatives – have continued influence. In Germany, for example, this is established by Supreme Court decisions and it is also mentioned in the legal literature in other countries, like Denmark.

Re 2) Committees may be standing committees as mentioned in the EU-Recommendation and ad hoc committees.

*Section 8.21*  
**Duty of Confidentiality**

Directors must not make unauthorized disclosure of confidential information acquired in the course of holding the office of director. A duty of confidentiality should also extend to members of board committees and their alternates.

*Comments*

Some Member States' Companies Acts have provisions on directors' duty of confidentiality, for example the Danish Companies Act Section 132, the German Stock Corporation Act Sections 93 and 116, the Lithuanian Civil Code Article 2.87 Part 2 and the Greek Companies Act Article 22a (3)<sup>60</sup>. In the Portuguese Companies Act Article 444-A, the duty of confidentiality is only expressly provided for the members of the supervisory board. In the UK and Ireland, a duty of confidentiality arises as a matter of common law, but most executive directors will in any event be bound by express contractual obligations of confidentiality.

The duty of confidentiality also includes alternate directors; see above Section 15(2).

The duty of confidentiality is a consequence of the duty of loyalty, which rests with the company's directors. Hence, the duty of loyalty must be used as a benchmark when deciding whether the disclosure of information is legitimate in specific cases. By default, the board of directors/management/supervisory board can decide that certain information is subject to the duty of confidentiality. Regarding the question of securities regulation, the duty of confidentiality is of great importance in determining whether information is inside information. The company law consequence of the decision in the EC case C-384/02, *Grøngaard & Bang* is to allow employee representations to disclose information to the labour unions if it is necessary to fulfil their tasks as members of the supervisory board. It is necessary to be informed and to be advised of the relevant law.

*Section 8.22*

**Competence to Determine Remuneration**

- (1) In a company with a one-tier board, a remuneration committee shall be set up in order to determine the remuneration for the executive directors.
- (2) In a company with a two-tier board, the supervisory board (or a remuneration committee formed by the supervisory board) shall fulfill this function with regard to the remuneration of the management board.
- (3) The remuneration of the supervisory board shall be determined by the articles of association or set by the shareholders' meeting.
- (4) The general meeting shall decide on a remuneration policy of directors.

*Comments*

Particularly after the financial crises the discussion of the remuneration of the management has become a key issue in the debate on company law. The discussion revolves around issues such as who has the authority to determine the remuneration as well as form of and limits for the remuneration. The EMCA includes three provisions concerning remuneration: Section 22 concerns the authority to determine remuneration, Section 23 stipulates, in general, the form of and limits for remuneration, and Section 24 includes specific provisions on incentive schemes in traded companies.

According to the Commission's 2012 Action Plan, effective and sustainable shareholder engagement is one of the cornerstones of listed companies' corporate governance model. Well-functioning remuneration policies stimulate longer-term value creation and genuinely link pay to performance, whereas poor remuneration policies and/or incentive structures lead to unjustified transfers of value from companies, their shareholders and other stakeholders to executives. Therefore, and taking into account existing oversight possibilities, shareholders should be enabled to exercise better oversight of remuneration policies applying to directors of listed companies and the implementation of those policies.

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<sup>60</sup> This provision was inadvertently abrogated, but there is no doubt that the confidentiality has to be observed.

The Commission has enacted two Recommendations on remuneration policies in the financial services sector (2009/384) and the regime for the remuneration of directors in listed companies (2009/385). The latter supplements two recommendations from 2004 and 2005 (2004/913/EC and 2005/162/EC). Except that the recommendation regarding the financial services sector is subject to special regulation and supervision, the fundamental ideas in the two recommendations are the same. In general, the Recommendations are implemented in the Member States' national corporate governance codes. Even though the financial crisis has revealed weaknesses regarding remuneration in traded companies, the EMCA Group considers that it is also important to secure the shareholders' insight into, and influence on, the management's remuneration in non-traded companies. Hence, the Group encourages companies and directors to avoid misuse and excessive remuneration and encourages long-term thinking.

According to the 2014 Proposal of the Commission to amend the Shareholders Rights directive,<sup>61</sup> Article 9a (1) (as amended by the European Parliament), *Member States shall ensure that companies establish a remuneration policy as regards directors and submit it to a binding vote of the general meeting of shareholders. This Article also states that [a]ny change to the policy shall be voted on at the general meeting of shareholders and the policy shall be submitted in any case for approval by the general meeting at least every three years.*

Member States may, however, provide that the votes by the general meeting on the remuneration policy are advisory.

Currently, not all Member States give shareholders the right to vote on remuneration policy and/or the remuneration report, and information disclosed by companies in different Member States is not easily comparable. This is also due to the fact that the management systems in the Member States vary considerably between one-tier systems, two-systems and in-between systems, cf. above. Some of the Member States which have taken action to promote shareholder voting with regard to remuneration issues are Belgium, Denmark, Germany, Ireland, Lithuania, the Netherlands, Slovakia and the UK.

Generally, the competence to determine the remuneration of a supervisory board should be left to the general meeting. This is the case under German law. According to Section 113 German Stock Corporation Act, the remuneration of the supervisory board is determined by the articles or by the general meeting. Similar provisions can be found in the Danish Companies Act's rules and the Swedish Companies Act in Section 23a. Otherwise, determining the remuneration of the supervisory board would be a self-dealing transaction. Regarding executive directors (German *Vorstand*)/managing directors, the competence to decide on remuneration is left to the supervisory board, if such a board exists. In private companies with only one director, the remuneration must be decided by the general meeting.

The remuneration should be decided at the annual general meeting.

From experience, it is clear that incentive schemes, especially in traded companies, have caused unjustified transfer of values to executives as pointed out in the Commission's Action Plan 2012. Such misuse has been seen in respect of both the supervisory board and the management board. Therefore, there is a special need for such schemes to be transparent for the shareholders in order for them to decide on the merits of the schemes. Hence, Section 24 below includes a special rule regarding incentive schemes in traded companies. The directors of UK traded (quoted) companies are required to draw up a detailed directors' remuneration report. According to the UK Companies Act 2006 Section 439 and 439A, the remuneration report must be submitted to the annual general meeting for shareholder approval.

In the UK, directors' remuneration is a matter for the board to determine and this is the case for both directors' fees and payments for services. Special rules on mandatory shareholder approval were introduced in 2013 for traded companies, see below, Section 24.

Inspired by Dutch law on public companies (Section 2:135 Dutch Companies Act), the EMCA requires the company to have a policy for the remuneration of the board of directors. The policy should be decided on by the general meeting.

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<sup>61</sup> Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, COM(2014) 213 final, amended by the European Parliament 8 July 2015.

*Section 8.23*

**Remuneration Limits**

- (1) Directors may receive remuneration for their services. The fees and compensation received may not exceed the amount that is justifiable by the company. The remuneration shall bear a reasonable relationship to the duties of the members of the board and to the condition of the company.
- (2) The remuneration may be fixed or include variable components. The structure of directors' remuneration should promote the long-term sustainability of the company and ensure that remuneration is based on performance.
- (3) If the situation of the company deteriorates so that a continued payment of remuneration would be unreasonable for the company, the competent body or, in case of instituted insolvency proceedings, the court, shall reduce remuneration to a reasonable level.
- (4) If insolvency proceedings have been instituted over the company's assets and the liquidator has terminated the employment contract of a director, such director may claim compensation of damages arising as a result of such termination only for the period of two years following termination of the employment, notwithstanding any provision to the contrary in the contract of employment.

*Comments*

Section 23 contains the general rule on director's remuneration. Section 24 below contains special rules regarding the use of incentive schemes in traded companies. Section 23 applies to all companies, not only to traded or public companies. More detailed regulations are usually found in national corporate governance codes and the listing rules of stock exchanges.

Information on directors' remuneration may be found in the national Financial Statement Acts, for example, the Danish Financial Statement Act Section 98 b.

Re 3 and 4) Subparagraph 3 and 4 are inspired by the German Stock Corporation Act Section 87.

If a company becomes insolvent and a director's employment as a consequence is terminated, the director's contract may include a claim for compensation (golden parachutes including prolonged terms of notice etc.). Section 23(4) limits the period for which the director may claim compensation. Thus, Section 23(4) supplements rules that may be included in the Member States' Bankruptcy Acts.

*Section 8.24*

**Incentive Schemes in Traded Companies**

- (1) In a traded company, the directors or the remuneration committee shall set general guidelines for the director's incentive-based remuneration. The guidelines shall be considered and adopted by the general meeting.
- (2) Specific agreements for incentive-based remuneration under Subsection (1) shall be entered into after publication of the guidelines, as adopted, on the company's website, and not before. When entering into specific incentive agreements, the existing guidelines, as adopted, must be observed.

*Comments*

The EU Recommendation 2009/385/EC on remuneration of directors of traded companies, is partly implemented in the various Member States. In Denmark, for example, the recommendation is found in the Companies Act Section 139, and in Germany there is a right for shareholders to vote on the remuneration policy on a non-binding basis (“Say on Pay”, Stock Corporation Act § 120(4)). Another model is found in the UK where, for listed UK companies, remuneration is a matter for a remuneration committee composed of independent non-executive directors (UK Corporate Governance Code, Section D). The company has to provide a directors’ remuneration report for the annual meeting (Companies Act 2006, Section 420) and shareholders are entitled to a vote on the report (Companies Act 2006, Sections 439 and 439A). Since 2013, UK shareholders in traded UK companies have a binding vote (previously only advisory) on whether to accept the remuneration policy of the company as set out in the remuneration report; if the shareholders reject the policy, any payments made under the rejected policy are invalid and may be reclaimed by the company. The contents of the remuneration report are prescribed in great detail in the regulations and, in particular, the remuneration must contain a single total remuneration figure for each director and it must give a detailed explanation of payments made to any director for loss of office. In Member States such as Finland and Ireland rules on remuneration are found in the corporate governance codes.

A way to ensure independence is to form a remuneration committee, cf. Article 3 of Directive 2009/385/EC. The EU Recommendation only applies to traded companies.

The EMCA Group notes that the Commission’s Proposal to amend the Shareholders Directive (COM(2014) 213 final) contains detailed rules on both the remuneration policy and the remuneration report. As noted above, a final text for the amendment was agreed by the EU Presidency and the Parliament in December 2016.

Article 9a(2) contains a provision that the remuneration policy must be clear, understandable and in line with the business values and long-term interests of the company and must incorporate measures to avoid conflicts of interests.

According to Article 9a(3) the policy shall set clear criteria for the award of fixed and flexible remuneration, including all bonuses and all benefits (in whatever form). It shall indicate the appropriate relative proportion of the different components of fixed and variable remuneration. The policy shall explain how the pay and employment conditions of employees of the company were taken in to account when setting the policy or directors’ remuneration. For variable remuneration, the policy shall indicate the financial and non-financial performance criteria. According to an amendment of the European Parliament, the Member States shall ensure that the value of shares does not play a dominant role in the financial performance criteria. The policy shall indicate the main terms of the directors’ contracts including duration, notice periods, payments linked to termination (golden parachutes) and (included by amendment of the European Parliament) the characteristics of supplementary pension or early retirement schemes. Also to amendment by the European Parliament, the policy shall specify the company’s procedures for the determination of the remuneration of directors, including the role and functioning of the remuneration committee.

Article 9b contains provisions on the remuneration report. Member States must ensure that the company draws up a clear and understandable remuneration report, providing a comprehensive overview of the remuneration, including all benefits in whatever form granted in according with the remuneration policy, to individual directors. Article 9b(1) sub a – f contain specific elements that should be included in the report. According to Article 9b (3), Member States must ensure that shareholders have the right to hold an advisory vote on the remuneration report of the past financial year during the annual general meeting.

Currently, not all Member States give shareholders the right to vote on remuneration policy and/or the report, and information disclosed by companies in different Member States is not easily comparable. The Commission’s Action Plan (2012) Section 3.1 states that the shareholders should have better oversight of remuneration policy. Thus, shareholders should be able to express their views on the matter, through a mandatory shareholder vote on the company’s remuneration policy and the remuneration report, providing an overview of the manner in which the remuneration policy has been implemented, see the comments to Section 22 and above.

The EMCA Group discussed whether the issue of remuneration should be regulated by law (in the EMCA) or in national corporate governance codes. The Group is of the opinion that the EMCA should ensure that the main principles of directors' incentive schemes should be agreed upon by the shareholders. In principle there are two possible approaches;

- Require shareholder approval in advance (“Say on Pay” as in Denmark and Germany).
- A mandatory remuneration report for the annual meeting (as in the previous UK model).

From experience, it seems the previous UK-model was not satisfactory, hence it was changed to a strong version on “say on pay”, see above. Therefore, the EMCA Group prefers the first solution. According to Section 24 the general meeting must approve the guidelines on incentive schemes. However, the final amount to be granted to the directors is decided according to the rule in Section 22. According to Section 24(2), specific agreements cannot be entered into until the guidelines have been approved by the general meeting.

The guidelines, which should be approved, should contain specific information that can be understood by the shareholders.

#### *Section 8.25* **General Clause**

Members of the board shall not enter into any transaction that is clearly capable of providing certain shareholders or others with an undue advantage over other shareholders or the company. Members of the board must not comply with any resolution passed by the general meeting or any other governing body if that resolution is invalid or contravenes the law or the company's articles of association.

#### *Comments*

Chapter 11 on general meetings contains a general clause on minority protection, see Section 30. A similar general clause is contained in Section 25. The reason for this is that abuse of minority rights may not only take place by decisions at the general meeting but it may be even more likely to take place by directors' decisions or actions.

Section 25 does not implement EU law, but the provision is inspired by provisions in the Nordic Companies Acts.

#### *Section 8.26* **Agreements with Sole Shareholder**

Save for agreements made on usual terms in the ordinary course of business, agreements entered into between a sole shareholder and a limited liability company are valid only if drafted in a manner that can subsequently be verified.

#### *Comments*

Section 26 is inspired by Article 5 of the 12<sup>th</sup> Company Law Directive (2009/102/EEC). The 12<sup>th</sup> Company Law Directive merely concerns private companies, but according to article 6 of the Directive, it can also be applied where Member States allows public companies to be a one- man company. The EMCA presupposes that public companies may be owned by a sole shareholder. Therefore, Section 26 also applies to public companies.

It is not necessary that agreements with sole shareholders are in writing. It is sufficient if they can be documented, for example by electronic means.

Agreements “on usual terms” mean agreements on arm's length terms.

*Section 8.27*

**Right of Representation and Power to Bind the Company**

- (1) Members of the board of directors have the power to represent the company in relation to third parties.
- (2) The company is bound by agreements made on behalf of the company by the entire board of directors or by a single board member. Members of the supervisory board have no power to bind the company.
- (3) The power of each member of the board of directors to bind the company may be restricted by the articles of association so that it can only be exercised by members acting jointly or by one or more specific members acting jointly or alone. No other restrictions on the power to bind the company may be registered.

*Comments*

The provisions of Section 27-29 apply to private as well as public companies.

Article 2(d)(i) of the 1<sup>st</sup> Company Law Directive<sup>62</sup> demands publication of the identity of persons authorized to represent the company in dealings with third parties and in legal proceedings. This authorization is established in the company's articles of association. The reason for this is that it is important for third parties to be able to see who has the power to represent the company.

Article 9 and 10 of the 1st Company Law Directive (Directive 2009/101/EC) contain rules on representation. Section 27 distinguishes between the right of representation and the power to bind the company.

Publication regarding completion of the formalities of disclosure of the particulars concerning the persons who, as an organ of the company, are authorized to represent it shall constitute a bar to any irregularity in their appointment being relied upon as against third parties unless the company proves that such third parties had knowledge thereof, see below in Section 30.

Section 27 distinguishes between the power to represent the company and the power to bind the company. The power to represent the company legitimizes the members of the management to act on the behalf of the company in relation to third parties, but it does not legitimize the members to enter into legal transactions. The power to represent the company which, as opposed to the power to bind the company, cannot be limited, is especially relevant in connection with court proceedings. For instance, a subpoena can be served on any member of the management just as any member of the management can appear in court on behalf of the company.

Re 1) Subparagraph 1 concerns the right of representation. It provides the board of directors with the right to represent the company in relation to third parties, but not to bind the company in legal transactions. The right to represent the company implies that directors have the authority to represent the company in every situation with third parties.

This authority is general and cannot be limited or be denied from the person concerned by the articles of association.

The rights to represent the company according to Section 8 only applies to members of the board, registered as such in the Company Register, according to the rules in Directive 1st Directive, cf. EMCA Chapter 2, Section 17.

Re 2) Subparagraph 2 concerns the power to bind the company. It deals with the authority to bind the company in legal transactions. The provision determines that the entire board of directors, as well as a single member of the board of directors, can bind the company.

Section 27(2) provides for the model of collective representation. While it is assumed that the representation of the company is generally exercised by all board members jointly, the articles of association may include deviating provisions. In case a declaratory act, such as a declaration of intent or a claim, is given to the company, Section 27(2) states that it is sufficient if only one member of the management board is representing the company.

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<sup>62</sup> Replaced by Directive 2009/101 EC, OJ L 285/11 of 1.10.2009.

Re 3) Subparagraph 3 determines that the authority to bind the company in legal transactions which is vested in the individual members of the board of directors can be subject to restrictions according to the articles of association. In case of a company having more than one director, the directors' authority to bind the company in legal transactions could be limited in so far that a director may only sign documents together with one or more members of the board of directors, or so that only a certain director, may bind the company in legal transactions alone. However, the authority of the board of directors to bind the company in legal transactions jointly may not be restricted. Section 27(3) is consistent with Article 10(3) of the 1<sup>st</sup> Company Law Directive, which states that the legislation in the Member States can decide how deviations from the power to bind the company can take place.

The provision in Article 10(3) states that “the authority to represent a company may, in derogation from the legal rules governing the subject, be conferred by the statutes on a single person or on several persons acting jointly”. This authorization has been exercised differently in the Member States. For private companies, legislation in Member States such as Belgium, France, Germany, Italy and the Netherlands stipulate that each manager, or two or more managers acting together, may enter into binding transactions on behalf of the company. In Sweden and Poland (Section 272 and 273), there must be at least two managers. Spanish legislation stipulates that if there are several directors acting jointly, the power of representation is exercised jointly by at least two of them, in accordance with the provisions of the articles. If there is a board of directors, it acts as a single body. For public companies, Belgian, German and Spanish legislations provide that directors are empowered to represent the company in respect of all activities that fall within the company's objects.

Section 27(3) follows the provision in the Danish Companies Act Section 135(3).

Only registered directors may be authorized by the articles of association to carry out the general right to bind the company in legal transactions. Individuals outside the board of directors may not be assigned with the general right to sign documents by the articles of association. Whether the acts of such persons bind the company is a matter for national Contracts Acts/Agency laws. National laws, including contract law, usually contain rules on authorization, including procuration.

It is important that the right to bind the company in legal transactions is clearly stated in the articles of association and that the individuals concerned are clearly identified in the articles of association, see Chapter 2, Section 17.

Authorization as referred to in Section 27 or a revocation of such authorization shall be effective from the date by which the Registrar has received the notification or revocation, or such later date as stated in the authorization or the decision regarding revocation.

#### *Section 8.28*

#### **Right of Representation and Power to Bind the Company**

(1) Any agreement or commitment that is made on behalf of the company by persons authorized to bind the company will be binding on the company, unless:

- (a) the persons authorized to bind the company have not acted within the limitations of their powers as provided by the EMCA;
- (b) the agreement or commitment does not fall within the objects of the company, and the company proves that the third party knew or could not in view of the circumstances have been unaware of it; or
- (c) the person authorized to bind the company has exceeded his authority or has seriously failed to act in the company's interests, and the third party knew or should have known this.

(2) It will not be sufficient evidence under subparagraph 1(b), of this provision that the company has published a statement of its objects, as provided by the articles of association, in the Registrar's information technology system.

*Comments*

Section 28 is inspired by Article 10(1) and (2) of the 1<sup>st</sup> Company Law Directive (Directive 2009/101/EC). Thus, once an agreement is entered into with a third party, the company is bound with respect to third parties, even in the case of an action falling outside of the objectives of the company or in the case of the director exceeding the limitations placed on his or her power by the articles of association or by the general meeting. The starting point is that the company is bound by any agreement by persons authorized to bind the company, see Section 27.

Re 1) Section 28(1)(a) provides that if the company law includes limitation on the powers of the authorized persons, the company is not bound. This for instance is the case regarding decisions that legally are required to be taken or approved by the general meeting or decisions which are unlawful. Since the law should be known by all, the third person cannot be said to be acting in good faith.

Section 28(1)(b) deals with situations where the articles of association include a provision on the objects of the company. The Companies Acts in most Member States include a provision according to which the articles of association should contain the objects of the company, see similarly Chapter 2, Section 17(e). The limitation in subparagraph 1(b) implements Article 10(1), second sentence of the Directive. This limitation originates in the former UK Companies Act. However, the recent UK Companies Act (2006) no longer requires the companies' objects to be stated. Thus, a company's objects may be unrestricted, see UK Companies Act Section 31(1). A similar change was made to the Irish Companies Act 2014 in respect of private companies limited by shares. If it becomes common for other Member States Companies Act's not to have an object clause, the provision in Section 30(1)(b) should be reviewed.

Section 28(1)(c) states - in line with general contract law – that the company is not bound if the person authorized to bind the company has overstepped his or her authority or significantly disregarded the interests of the company and if the third party knew or should have known about this. In case C-104/96, *Rabobank v. Minderhoud*, the European Court of Justice established that the provisions in Article 7-9 of the 1<sup>st</sup> Company Law Directive are not exhaustive as regards cases where the company can plead that an agreement, which has been entered into by a member with the power to bind the company, is void. Hence, national law may introduce supplementary provisions. Thus, Section 28(1)(c) specifies that common contractual rules can apply. The provision is inspired by the Danish Companies Act Section 136(1)(3). Similarly applies according the Swedish Companies Act Chapter 8, Section 20. Ad 28(2). This provision is an exception to the common principle that all information published in the Registrar's information technology system is deemed to have been communicated to third parties, see thus Chapter 3, Section 6.

*Section 8.29*

**Right of Representation and Power to Bind the Company**

Where an election or appointment of members of the management of a company has been published in the Registrar's IT system in accordance with Chapter 3 Section 6, no defect in the election or appointment may be relied upon against any third party, unless the company proves that the third party had knowledge of that defect.

*Comments*

Section 29 is inspired by Article 9 of the 1<sup>st</sup> Company Law Directive (Directive 2009/101/EC).

According to this provision, the burden of proof regarding the third party's bad faith (knowledge) rests with the company.

The dismissal of board members must be registered. From the time the dismissal is published in the Registrar's information technology system, the dismissal should be considered to have been communicated to third parties.

*Section 8.30*  
**Capital Loss**

If it is established that the equity of a company represents less than half of the subscribed capital, or in the case of negative net assets, the management of the company must ensure that a general meeting is held within six months. At the general meeting, the board must report the financial position of the company and, if necessary, submit a proposal for measures that should be taken, including a proposal for dissolution of the company.

*Comments*

Section 30 is based on Article 19 of the 2<sup>nd</sup> Company Law Directive.<sup>63</sup> The Directive only applies to public companies but the EMCA Group considered that a similar rule is also needed in private companies.

Most Member States stipulate the requirement that the shareholder's meeting has to be called by the management if a certain portion of the registered share capital – usually 50 % - is lost. The shareholders' meeting will have to decide on the appropriate measures to be taken. In Italy, the management will be obliged to call the shareholders' meeting after a loss of 1/3 of the share capital. Under current Swedish law (Sections 25:13 - 25:20) the company may be forced to go into liquidation due to a capital deficiency. The Swedish Companies Act has a specific and comprehensive procedure in these cases. The former Finnish and Danish Companies Acts also contained a rule on involuntary liquidation in case of capital loss but since their amendment, there is only a duty to call a general meeting to decide what should be done.

The EMCA Group considered in line with the majority of Member States that there should only be a duty to call a general meeting without specifying a duty to liquidate the company. The consequence of not meeting the requirements in Section 30 may be that the management could be liable if the conditions for liability are met, see below in Chapter 10.

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<sup>63</sup> Replaced by Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 OJ L 315/74 of 14.11.2012.

PART 4  
EMPLOYEE REPRESENTATION

*Section 8.31*

**Employee Representation**

- (1) The company shall be subject to the rules on employee representation on the board of the company, if any, to the extent they are laid down by national law.
- (2) In the case of the transfer of the registered office of a company, Chapter 13 shall apply.
- (3) In the case of a cross-border merger of a company with another company registered in another Member State, the provisions of the laws of the Member States implementing Directive 2005/56/EC of the European Parliament and of the Council shall apply.

*Comments*

The participation of employees in a company has to be considered from two different angles. On the one hand, employees may participate in certain operational decisions – e.g. arising from consultation requirements in case of dismissals and restructurings – through union, work councils (*Betriebsrat*, *Comité d'entreprise...*), etc. These aspects traditionally form part of the labour law and have no direct influence on the corporate structure. On the other hand, a considerable number of Member States also provide for employee participation at the level of corporate bodies of companies. In these countries, a number of employee representatives are granted membership at (management or supervisory) board level with all duties and liabilities of an ordinary board member, thereby giving the employees a considerable degree of influence on the corporate decision making process.

Employee representation on corporate boards of private companies is alien to Belgium, Cyprus, Estonia, France (for private companies only), Greece, Ireland, Italy, Latvia, Lithuania, Malta, Poland, Portugal, Spain and the UK. The countries which provide for employee representation in corporate boards are Austria, the Czech Republic, Denmark, Finland, France (in public companies since 2014) Germany, Hungary, Luxembourg, the Netherlands, Slovakia (with regard to stock corporations only), Slovenia and Sweden. The board members representing the employees are usually either directly appointed by the employees or nominated by them and formally appointed by the shareholders. Whilst the aforementioned countries all have in common the aspect of employee representation in companies, they differ considerably as to the applicable thresholds triggering the requirement and as to the level of influence given to the employee representative.

It is not possible to formulate common rules in the EMCA on employee representation. Hence, in this area it is necessary to refer to national rules on employee representation.

The general principle, derived from the Directive on cross-border mergers (2005/56/EC), is that the company is subject to the rules concerning employees' representation on the supervisory or management board of the Member State where it has its registered office. Accordingly, a company established under a national law modelled according to EMCA will, as regards employee participation, be no more and no less attractive than comparable national companies.

Cross-border mergers involving a company are governed by the Directive on cross-border mergers.

Special rules are required in the case of the transfer of the registered office of a company; cf. Chapter 13.

## CHAPTER 9 DIRECTORS’ DUTIES

### PART 1 DIRECTORS’ DUTIES

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## General Comments<sup>64</sup>

### 1. EU law

This Chapter consists of two parts. Part I on general provisions contains the main principles of directors’ duties including a general description on the duties of the board, the principle of duty of care and the duty of loyalty. Part II contains provisions on conflicts of interest.

According to the general principles expressed in Chapter 1, Section 11, a director of a company has a duty of care and a duty of loyalty.

There is no specific EU regulation defining the general duties of directors. However, the Commission has devoted significant time to corporate governance issues in recent years. Among other things, the Commission published in 2011 a Green Paper on the EU Corporate Governance Framework (COM(2011) 164 Final). Based on the Green Paper and the report from the Reflection Group on the Future of EU Company Law and the Action Plan 2012, the Commission intends to modernize the company law and corporate governance framework. The Action Plan stresses, “Effective corporate governance is of crucial importance, because well-run companies are likely to be more competitive and more sustainable in the long run”. The Action Plan further stresses that the “effective oversight of the executive directors or the management board by the non-executive directors or supervisory boards leads to successful governance of the company.” The Commission believes also that (supervisory) boards should give broader consideration to the entire range of risks faced by their companies. Extending the reporting requirements with regard to non-financial parameters would help in establishing a more comprehensive risk profile of the company, enabling more effective design of strategies to address those risks. The additional focus on non-financial aspects would encourage companies to adopt a sustainable and long-term strategic approach to their businesses.

Specific rules on directors’ duties may be found in national corporate governance codes. All Member States have such codes. The contents of the codes vary considerably. Until now the Commission has not tried to develop a common EU Corporate Governance Code. However, the Commission has considered national corporate governance codes and especially the way these national codes apply the “comply or explain” principle. The Commission has indicated it will take an initiative, possibly in the form of a recommendation, to improve the quality of corporate governance reports, and in particular, the quality of explanations to be provided by companies that depart from the corporate governance codes.

With regard to Part 2 of the Chapter on conflicts of interest, there is no specific EU company law. An attempt was made in 1983 to amend the proposal for a 5<sup>th</sup> Company Law Directive, which dealt with conflicts of interest, among other things. However for several reasons, especially the question of employee representation, the Commission was unable to reach an agreement on the Directive. Hence, various EU company law Directives and recommendations deal with different aspects of conflicts of interest, and EU securities regulations contain rules on shareholder transparency, which have a preventive effect.

The Takeover Bids Directive (2004/25/EC) provides for a particular situation in which a conflict of interest may occur and must be avoided. In a takeover situation, the directors of a target company are obliged to advise the company’s shareholders as to whether or not to accept a takeover bid. The directors have a duty to make a statement setting out their views on the bid and providing certain other key information. See further EMCA Chapter 13 on re-organization.

The Market Abuse Regulation (Regulation (EU) No 596/2014) governs companies whose securities are traded on a regulated market. It includes rules on the notification of transactions relating to a company’s shares by persons with managerial responsibilities in the company. The Market Abuse Directive (2003/6/EC) which preceded it led to the implementation of similar rules in Member States including in Section 28a of the Danish Law on securities trading. Section 37(1) of the same Law requires companies whose shares are traded on a regulated market to draw up internal rules on their management members’ dealing in the company’s shares. The general prohibition of insider trading and market manipulation also applies to the company’s management.

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<sup>64</sup> The working group on Chapter 9 included Professor Brenda Hannigan (University of Southampton, UK) and Professor José Engrácia Antunes, (Catholic University of Portugal, Porto, Portugal).

It has been said that compensating directors by giving them stocks and stock options is a conspicuous encouragement of conflicts of interest. The EU Commission is certainly aware of this. Commission Recommendation 2009/385/EC concerns the remuneration of directors of listed companies. Recital 6 of the Recommendation says that the structure of directors’ remuneration should promote the long-term sustainability of the company and ensure that remuneration is based on performance. The Recommendation contains various recommendations for avoiding conflicts of interest. These include the establishment of remuneration committees (cf. Commission Recommendation 2005/162/EC), and recommendations to ensure that the shareholders control the remuneration policy and individual compensation through shareholder approval (say-on-pay). Recommendation 2009/385/EC says that the establishment of remuneration committees plays an important role in preventing conflicts of interest by designing a company’s remuneration policy, and it recommends that directors who hold shares in the company should be obliged to retain a part of their shares until the end of their mandates in order to prevent conflicts of interest. Remuneration committees are further considered in Section II (6.1.) in Recommendation 2005/162/EC. See more on remuneration and say on pay in Chapter 8.

There has been a strong movement for independent directors to be appointed to company boards. This movement started in the UK and was taken up by the Commission in Recommendation 2005/162/EC which recommends that a ‘sufficient number’ of independent directors be elected to the board. Preventing conflict of interests is one of the justifications for having independent directors. Also, the introduction of independent directors seeks to outweigh the voting power of shareholders with large blocks or even the majority of shares. A director is only considered to be independent if they are free of any family, business or other relationships with the company, its controlling shareholder or the management that creates a conflict of interest such as to impair their judgement. The EU has not developed a common corporate governance code, but in most Member States the issue of independent directors is dealt with in corporate governance codes, for example in the Danish Corporate Governance Code, Section 3.2., and the German Corporate Governance Code, Sec. 5.4.2. Both the Commission’s 2011 Green Paper and its 2012 Action Plan point to conflicts of interest as an area where regulation should be improved, both regarding directors and proxy advisors, when proxy advisors also act as corporate governance consultants to investee companies. This latter area has been addressed in the proposed amendment of the Shareholders’ Rights Directive agreed with the Parliament in December 2016.

## 2. National company law

### 2.1. Directors’ duties

In all Member States, there is a wide range of duties with which the board must comply. As a common basis, however, the directors have to act with reasonable care, skill and diligence. Whereas the primary duties on an abstract level are all very similar throughout the EU, there are significant national differences when considering the specific duties, the applicable standards for measuring compliance, as well as the extent of any potential liability.

All Member States’ Companies Acts have a provision which imposes on the board the ability, but also, the obligation to decide on the management of the company, the administration of its assets and the pursuance of the company’s objects in general, see for example the German AktG Section 76, the Greek Companies Act Section 22, the Polish Commercial Companies Code Section 368 (regarding management board) and Section 382 (regarding supervisory board), the Portuguese Companies Act Section 405 (1), and the Spanish Companies Act Section 209. The Polish Commercial Companies Code states very concisely that “*the management board shall manage the affairs of the company and represent the company/the supervisory shall exercise permanent supervision over all areas of the activities of the company*”. This is also the approach in the Netherlands, with the explicit provision that the management board and the supervisory board have to act in the best interest of the company and all its stakeholders (Companies Act Sections 2:129/239(5) and 2:140/250 (2)). The most comprehensive statement of directors’ general duties is found in the UK’s Companies Act 2006 Sections 171-177.

According to the provisions in EMCA Chapter 11 on general meetings, the general meeting makes decisions on company matters. The directors execute the decisions of the general meeting, see further below in Chapter 11.

## 2.2. *Conflicts of interest*

National law in the Member States has no common definition of conflicts of interest. However, under the generally accepted principle of the duty of loyalty, the management must act in good faith. This primarily means that the management must act in the company’s best interests when taking management decisions. This includes the duty to avoid conflicts of interest.

There are substantial differences as to how the EU Member States regulate directors’ conflict of interest.

In some Member States, there are general rules on conflicts of interest, as in Greece, the Netherlands, Poland (in the Corporate Governance Code), Slovakia, Spain, Ireland and the UK. In other Member States, a similar result seems to be achieved by referring to the general duty of loyalty, as in Denmark, Germany and Portugal.

### *Excluding persons from becoming directors on grounds of conflicts of interest*

The appointment of executive directors is made by the supervisory board in companies with a supervisory board. In private companies with only a director, the appointment is made by the shareholders. In both cases, the supervisory board and the shareholders, respectively, should consider whether an appointment may give rise to a conflict of interest. Being a member of the executive board is normally a fulltime job. The contract of employment, if any, will normally include provisions requiring the director to devote all of his or her working time to the company. The contract will also usually contain provisions governing competing positions.

The supervisory board is appointed by the general meeting. Thus, the question is in which way the general meeting should consider whether members of the supervisory board are in positions of conflict or potential conflict.

No national rules exclude persons from becoming directors on the grounds of a conflict of interest. However, in France, no more than one third of the members of the board of directors can have a contract of employment with the company (this rule does not apply to the supervisory board). This only applies to companies with a one-tier system. In Portugal, no member of the board of directors may have a contract of employment with the company or with an affiliated company.

Generally, it is up to the supervisory board and the shareholders, who appoint the managing directors and the supervisory board respectively, to assess whether the candidates’ business or personal relations may lead to a conflict of interest. Several Member States require the disclosure of information about the candidates’ business or personal relations with the company which could cause a conflict of interests. This applies, for example, in France, Germany (for listed companies), and Greece. In the Netherlands, this applies to members of the supervisory board. Where the supervisory board appoints the managing director, it should not only assess the director’s managerial qualities but also whether situations could arise where there could be a conflict of interest, and the contract of employment may include provisions regulating such issues.

In some Member States, such as Austria, Denmark, Lithuania (both management board and supervisory board) and the Netherlands, there is a duty to disclose to the general meeting information about the positions of the members of the supervisory board in other companies. This is obviously to give the shareholders the opportunity to consider whether there might be a potential conflict of interest and, if so, to decline to elect the member. See for example Section 120(3) of the Danish Companies Act.

In most of the Member States a director can be dismissed without cause at any time by those who have appointed them. This means that a director can be removed if they fail to avoid a conflict of interest. In Germany, this is true for private companies (see Limited Liability Corporation Act § 38), whereas in a public company members of the management board may only be removed by the supervisory board for good cause (Stock Corporation Act § 84). A vote of no-confidence by the shareholders meeting may constitute good cause for the supervisory board to dismiss members of the management board.

If executive directors, with a contract of employment, fail to avoid conflict of interest, they may be in breach of their contract. In this case, the director may be liable under the rules on liability.

### *Duty to avoid conflicts of interest*

As mentioned, the UK Companies Act 2006 states that a director has a duty to avoid conflicts of interest. A failure to avoid a conflict of interest does not necessarily mean that a decision is contrary to the interest of the company, only that there is a risk of it being so. Section 175(1) of the UK Companies Act 2006 states that ‘a director of a company must avoid a situation in which he has, or can have, a direct interest that conflicts, or possibly may conflict, with the interest of the company’. This Section states the general principle, and in the succeeding sections it is supplemented by provisions on typical situations of conflicts of interest. The Section covers both actual and potential conflicts.

Directors have a general and enduring duty to consider whether there may be a conflict of interest, and examples of such situations are given in the special provisions. If a director considers there is a possible conflict of interest, he or she must inform the other directors or the shareholders.

There are different ways to avoid a conflict of interest. According to Section 175 of the UK Companies Act, directors must always consider whether they are in a situation where a conflict of interest may occur. If so, they must disclose the risk of conflict and transfer the decision to the next level, either from management to the supervisory board, or from interested directors to disinterested directors, or from directors to the general meeting – depending on the board structure of the company.

Having considered whether there is a conflict of interest and having disclosed a conflict of interest to the other directors, a director will have satisfied his or her obligations. The decision then becomes a matter for the other directors or the general meeting, depending on the structure of the company’s governance system. For example, if a private company only has a director and a general meeting, approval should be given by the general meeting.

#### *Duty to disclose conflicts of interest*

Several Member States have rules which require any conflict of interest relating to the company to be reported to the board or the general meeting : for example Section 22a(3)(b) of Greece’s Companies Act, or Section 229(3) of the Spanish Companies Act. Section 171(2) of the German AktG requires the supervisory board to examine the company’s annual report and report to the shareholders at the general meeting on how it has examined the management of the company which includes reporting if any conflicts of interest occurred and how they have been handled. The Dutch Corporate Governance Code which applies to listed companies also requires that conflicts of interest are reported (Chapter II.3 (management board) and III.6 (supervisory board)).

A number of Member States explicitly state that a director has a duty to disclose any conflict of interests to the other members of the management. This is the case in France (in certain situations), Germany, Ireland, Italy, Spain and the UK.

According to Sections 177(1) and 182(1) of the UK Companies Act, directors have a duty to disclose an interest in a proposed transactions or arrangements with the company. This catches situations such as where a newly appointed director has interests in the company’s existing transactions or arrangements, for example because they are a shareholder in one of the company’s suppliers.

According to Section 177 of the UK Companies Act, a director who has an interest in a proposed or existing transaction or arrangement with the company must declare the ‘nature and extent’ of that interest to the other directors before the company enters into the transaction or arrangement.

The conflict of interest can be direct or indirect. In an indirect transaction, the director need not be a party to the transaction; it is enough that they are a shareholder of a company or a member of a partnership that is a party to the transaction.

Section 177 of the UK Companies Act requires prior disclosure to the other directors where the transaction is with the company and the director has a direct or indirect conflict of interest. However, certain specific transactions require shareholder approval in addition to disclosure to the other directors. In Member States such as Denmark, Finland and Sweden, there are no specific rules on prior disclosure to the other directors but there are rules on prior authorization for special transactions between the company and the directors; see further below.

### *Competition with the company*

The duty of loyalty sets limits as to how, or to what extent, a director may compete with their company. This problem arises both while a director is in office and after they have resigned. For executive directors, it is common to have a “non-compete clause” in the director’s contract of employment. For non-executive directors and members of supervisory boards, it is up to the shareholders who elect them, or company law to decide the matter.

Several Member States have special rules that prohibit members of the management engaging in any trade or entering into any transaction in competition with the company. This is the case in the Czech Republic, Germany (AktG/Corporate Governance Code), Greece, Italy, Poland (Corporate Governance Code), Portugal, Slovakia and Spain (in the latter case, unless explicit authorization from the general meeting pursuant Section 230). Other Member States, such as Finland, France, Germany, the Netherlands and the UK, deal with this under the general duty of loyalty. Alternatively, or additionally, there can be a rule requiring the disclosure of directors’ other managerial posts prior to election to the supervisory board; see Section 120(3) of the Danish Companies Act and below. Such a rule is particularly relevant for public limited companies.

### *Corporate opportunities*

Several Member States have special rules prohibiting directors from taking advantage of the company’s corporate opportunities. In the UK, Section 175(2) of the Companies Act prohibits the ‘exploitation of any property, information or opportunity (regardless of whether the company could take advantage of the property, information or opportunity’. In Spain, Section 229(1)(d) of the Spanish Companies Act also prohibits directors to take advantage of corporate opportunities. A specific rule on corporate opportunities applies to Italian public companies as well. In other Member States such a prohibition is covered by the general duty of loyalty. This is the case in France, the Netherlands, Poland (Corporate Governance Code), Portugal and Slovakia. In Germany, corporate opportunities are also dealt with in the corporate governance code. In some important respects, the UK Companies Act extends liability to former directors (see Section 170(2)(a)).

The UK Companies Act has no definition of a corporate opportunity. The corporate opportunity doctrine was developed in US case law. The American Law Institute (ALI) Principles of corporate governance § 5.05(b) contains the following definition:

*“(1) Any opportunity to engage in a business activity of which a director or senior executive becomes aware, either, In connection with the performance of functions as a director or senior executive, or under circumstances that should reasonable lead the director or senior executive to believe that the person offering the opportunity expects it to be offered to the corporation; or*

*Through the use of corporate information or property, if the resulting opportunity is one that the director or senior executive should reasonably be expected to believe would be of interest to the corporation; or*

*(2) Any opportunity to engage in a business activity of which a senior executive becomes aware, and knows is closely related to a business in which the corporation is engaged or expects to engage.”*

## **3. Considerations**

### **3.1. Directors’ duties**

As mentioned above, the UK Companies Act contains the most comprehensive regulation on the general duties of the directors. This is the following:

- Duty to act within their powers (Section 171)
- Duty to promote the success of the company (Section 172)
- Duty to exercise independent judgement (Section 173)
- Duty to exercise reasonable care, skill and diligence (Section 174)

All the duties, other than the duty of care, skill and diligence in Section 174, are so-called fiduciary duties which reflects the common law of negligence.

The EMCA Group is of the opinion that the duties enumerated above are, and should be, accepted in EU Member States. Therefore, Part I is widely inspired by UK regulation. The statement of duties in Chapter 9, Part I is not exhaustive. It merely sets out the general duties. However, directors are subject to various other duties including duties with respect to specific conflicts of interest governed by Chapter 9, Part II, statutory duties (such as the duty to maintain accounting records and prepare accounts governed by accounting rules), and duties under the general law such as employment law or health and safety legislation.

The director’s duties, as described in Chapters 8 and 9, are the fundamental basis for deciding director’s liability.

### *3.2. Conflicts of interest*

There is a link between directors’ duties and directors’ conflict of interest. The closest link is the relation between the general principle of directors’ loyalty and directors’ conflict of interest. Thus, according to Section 175 of the UK Companies Act 2006, directors are under a fiduciary duty not to place themselves in a position in which there might be a conflict between personal interest and their duty to the company. This rule is said to apply to any exploitation of any property, information or opportunity. It is immaterial whether the company could take advantage of the property, information or opportunity.

It is possible to deduce more specific rules on conflict of interest or develop case law from the principle of directors’ loyalty. However, the EMCA Group has found it useful for the EMCA to include provisions on typical examples of conflict of interest.

The following considerations only concern the directors’ conflict of interest. See Chapter 11 on shareholders’ conflict of interest. The EMCA Group is of the opinion that the EMCA should have some general rules on conflict of interest supplemented by a limited number of more specific rules.

The EMCA Group has discussed the choice between disclosure rules and substantive rules such as a prohibition on a director attending or voting at a board meeting where transactions between him or her and the company are discussed. Generally, the Group considers that directors should have a duty to disclose potential conflicts of interest to other (independent) members of the board in order to ensure unbiased decisions. Thus, the Group decided to include such a provision in the EMCA (Section 5 of this Chapter).

In connection with appointment and removal of directors, there should be a rule requiring proposed directors to disclose to the shareholders whether they hold other posts, thus giving the shareholders a possibility to assess whether there will be a conflict of interest now or in the future. See further in EMCA Chapter 8, Sections 2 and 6 on appointment and removal of directors and EMCA Chapter 10 on directors’ liability.

The EMCA Group discussed the choice between a general provision limiting directors in voting in certain circumstances and specific rules which demand that certain types of decisions should be taken by the shareholders. On the one hand, it is simpler if a general provision on a limitation of voting can cover situations which may cause conflicts of interest. On the other hand, there is also a need to ensure that shareholders decide on important matters.

The balance between the above mentioned two provisions should, according to the EMCA Group, be achieved by a combination of a general rule on limitation of voting and a limited number of provisions requiring shareholder approval. The rule on limitation of voting is thus found in Section 9. The rules on shareholder approval are covered either by Section 9 or by special provisions on shareholder approval on Sections 5-7 and in Chapter 11 of the EMCA.

An example of a specific provision is the requirement to obtain shareholder approval regarding principles of directors’ remuneration, see above.

The EMCA Group discussed whether the EMCA should include a specific rule on competition or whether rules on limitation of voting etc. in connection with the appointment of directors is enough. The Group decided to apply a special rule on competition specifying that shareholder approval is necessary, see Section 7.

From the principle of duty of loyalty follows the requirement that directors must not exploit the company’s corporate opportunities. The EMCA Group also discussed the need for a special provision on corporate opportunities. Corporate opportunities may be protected either by case law applying the general duty of loyalty or by special provisions. As noted above, there is no legislative definition of corporate opportunities such as that given in the ALI Principles. It is difficult to give a legal definition of corporate opportunities which is both precise and not too comprehensive. In particular, it is difficult to determine when an opportunity is a ‘corporate opportunity’ and who might authorize a director to exploit such opportunity. The inclusion of provisions on corporate opportunities in companies’ legislation may cause problems of interpretation and application, but it seems even more difficult to develop consistent and precise case law on this issue. However, in the light of the overall aim of fostering European convergence, the EMCA Group was of the opinion that rules on corporate opportunities should be included in the EMCA, see Section 6.

Even if the company law literature and the case law in the Member States consider benefits a breach of duty, the EMCA Group was of the opinion that it is preferable to create a common European rule on benefits. In the UK, the issue of benefits was separated from the main prohibition in Section 175 of the Companies Act 2006 presumably, to ensure that disinterested director authorization is not possible. A similar rule is found in the EMCA Section 8.

Regarding independent directors, the EMCA Group was of the opinion that this is an issue which should be regulated in the national corporate governance code, which is also the case in the majority of the Member States.

The EMCA Group considered the need for a special rule on conflict of interest regarding the duty to advise shareholders about a takeover bid. This issue is dealt with in Chapter 13.

PART 1  
DIRECTORS’ DUTIES

*Section 9.01*  
**General Duties**

- (1) The company’s directors are responsible for the management of the company’s affairs.
- (2) The court may identify as a director a person that acts as such while not having been formally appointed (a “de facto director”) or a person in accordance with which instructions the board is accustomed to act (“shadow director”).
- (3) The duties of directors shall be owed to the company.

*Comments*

Re 1) The duty to manage the affairs of the company appears often to be regulated in Member States’ national company laws not as a matter of directors’ duties but as a matter of legal powers or competence of directors *via-à-vis* the general meeting of shareholders.

Re 2) Paragraph 2 allows the courts to impose the duties of directors also on persons who, though not appointed as directors, purport to act as such. The importance of this arises mainly in relation to the question of liability. Thus, for example, shareholders who act as directors may be liable if they breach the duty of directors, see further below in Chapter 10 on *de facto* and shadow directors.

The concepts of *de facto* directors and shadow directors are recognized in a number Member States but the UK (Section 251 of Companies Act) and Ireland (Section 221(1) Companies Act 2014) have specific provisions in the on shadow directors. The Dutch Companies Act applies the same concept specifically in case of liability of directors in case of bankruptcy and unlawful distributions (Companies Act Sections 2:138/248 (7), 2:216 Companies Act (distributions, private companies)).

A question arises as to whether a parent company, who directs its subsidiaries, should be considered as a shadow director. The parent company might be a shadow director if it exercises real influence in the conduct of the subsidiary’s company’s affairs beyond a certain level, see further on this question below in Chapter 15 on groups.

Re 3) In the UK Companies Act Sections 170 and 172, directors’ duties are “owed to the company”. The importance of paragraph 3 arises mainly in relation to enforcement of director’s duties. It means that the duties are not owed to individual persons but to the company. Thus, it is the company which can enforce the duties. If the company does not want to do so, however, the EMCA includes a “derivative action”, see below in Chapter 11, Section 38. Paragraph 3 does not deal with the question as to whether the interests of stakeholders are recognized. However, it is broadly recognized in European company law that the interests of stakeholders should be taken into account, see further in the comments to Section 4. Thus, for example, directors may be liable to creditors for fraudulent and wrongful trading, see further below in Chapter 10. On this discussion, see also Chapter 1, comments to Section 6. Generally, the breach of duties included in this Chapter has consequences for the question of directors’ liability, see further below in Chapter 10, Section 1 and following.

*Section 9.02*  
**Duties of the Board**

(1) In companies which are run by a board of directors consisting of managing director(s) and a supervising body - real two-tier systems, the duties of the bodies are as follows:

(a) The supervisory board:

(i) supervises the administration of the company, which is the responsibility of the managing director(s);

(ii) shall regularly assess the company’s financial position, taking into account whether the company has adequate capital and liquidity;

(iii) shall ensure that the company’s governance arrangements are such as to ensure the proper monitoring of the company’s financial statements and positions;

(iv) shall ensure that sufficient procedures for risk management and internal control are established, and that the supervisory board receives all necessary information for the performance of duties from the management body.

(b) The management board:

(i) is responsible for the executive management of the company;

(ii) shall manage the company’s financial situation, taking into account whether the company has adequate capital and liquidity;

(iii) shall ensure that the company’s governance arrangements are such as to ensure the proper monitoring of the company’s financial statements and positions;

(iv) shall ensure that sufficient procedures for risk management and internal control are established and that the management body provides the supervisory body with all information needed for the performance of the duties of the supervisory body.

(2) In public companies with a one-tier system, the company shall ensure that there is a division of functions between supervisory and managing functions similar to the functions in the two-tier system. This can be done by separation between executive and non-executive directors, cf. Chapter 1, Section 4, or otherwise.

(3) In mixed systems, the articles of association may specify the division of duties between the management board and the supervisory board according to Chapter 8.

(4) In private companies which have only one director, the director undertakes the management of the company as described above under (1) a) and b).

*Comments*

Section 2(1)(a) and (b) applies to public companies as well as to private companies which have chosen a two-tier system. The EMCA Group especially wants to underline two elements of the duties of the board. Firstly, both the supervisory board and the management board have a duty to take care of, or consider, the company’s financial position. This is a general duty which supplements, for example, the duties regarding dividend and capital reduction in Chapter 7, Section X, according to which, the directors must agree on paying out dividends or decisions on capital reduction. Also, this duty should be taken into account when deciding questions of directors’ liability towards creditors, see Chapter 10. Secondly, the Group intends to underline that the company should have a comprehensive risk profile. This is in line with the Commission’s Action Plan 2012 (COM (2012)740 final), no. 2(1).

Risk management may be supervised by a risk management committee. The EMCA does not include a provision on a mandatory risk committee. As a rule, board committees are not mandatory, see above in Chapter 8, Section 23.

Risk management committees have risk management responsibilities that are often defined by corporate governance codes, which set out best practices and guidelines. If the company chooses to have a risk management committee, the company should define the task of the committee. The Risk Committee should assist the boards in assessing the different types of risk to which the organization is exposed. The management board is responsible for executing the organization’s risk management policy. The risk committee should exercise oversight. The members of the committee should have direct access to, and receive regular reports from management.

#### *Section 9.03*

#### **Duty of Care**

A director of a company must exercise reasonable care, skill and diligence.

This means the care, skill and diligence that would be exercised by a reasonably diligent person with—

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
- (b) the general knowledge, skill and experience that the director has.

#### *Comments*

In most EU Member States, the Companies Acts (e.g. Article 20a of the Greek Companies Act, Article 64 (1) (a) of the Portuguese Companies Act, Article 225 of the Spanish Companies Act and section 228 of the Irish Companies Act) or general principles of company law (Austria, Denmark, Germany, Greece, the Netherlands, Poland and Sweden) contain general rules on the duty to demonstrate reasonable care with regard to running the company’s affairs. Section 31(1) of the proposal for the SPE Statute describes the duty in a way, which would probably apply in most countries. The proposal states that: “*A director shall have a duty to act... with the care and skill that can reasonably be required in the conduct of business*”. The Finnish Companies Act Chapter 1, Section 8 states concisely that “*the management of the company shall act with care...*”. According to the Spanish Companies Act, Section 225, the directors shall perform their duties with “*the diligence of an orderly business person, taking into account the nature of the role and the duties inherent in each one*”. The duty of care principle in Section 3 is inspired by the UK principle in Section 174 of the Companies Act on the “duty to exercise reasonable care, skill and diligence.” Even if there are slight differences in the manner in which the duty is expressed, the core meaning is that the rule includes a normative standard, which may be developed by the courts.

#### *Section 9.04*

#### **Duty of Loyalty**

Directors must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so the director should have regard to a range of factors such as the long-term interests of the company, the interests of the company’s employees, the interest of company’s creditors and the impact of the company’s operations on the community and the environment.

#### *Comments*

The duty of loyalty is often expressed in a way that the directors have a duty to act in the interest of the company. The requirement that directors act in the interest of the company is an underlying tenet of much EU company legislation, although it often remains unspoken. An exception is Section 3(1)(c) of the Directive on Takeover Bids (2004/25/EC) which obliges Member States to ensure that the board of a target company “*acts in the interests of the company as a whole*” during the course of a takeover. The duty to promote the interest of the company is a part of the directors’ duty of loyalty to the company.

National law, for example the Finnish Companies Act Chapter 1, Section 8, expresses the duty of loyalty as the management’s duty “*to promote the interest of the company*”. Similarly, the UK common law duty of loyalty was typically formulated as one, which required the directors to act in good faith in what they believed to be “*the best interest of the company*”. This principle is also expressly laid down in Sections 2:129/239, 140/250 Dutch Companies Act. In other cases, this duty is more extensively formulated: this is the case of Portugal, where the law requires managers to observe “*duties of loyalty, in the interest of the company, taking into account the long-term interests of shareholders and concerning the interests of other stakeholders relevant to the sustainability of the company, such as their employees, clients and creditors*” (CA Article 64 (1) (b)).

The duty of loyalty expressed as “*in the interest of the company*” leaves open to discussion as to what “*the interest of the company*” is. A rather open interpretation of “*the interest of the company*” has been adopted in many Member States. It generally includes the interests of shareholders, employees and other stakeholders. A more detailed description can now be found in Section 172 of the UK Companies Act 2006 which replaces the common law duty of a director to act “*in the best interests of the company*” with a duty to act in the way the director considers, in good faith, would be most likely to “*promote the success of the company for the benefit of its members as a whole*”. This reference to members is to the collective body and not just to the majority shareholders or to any particular section of shareholders. However, equally significantly it is ‘for the benefit of the members’ alone and not any other class of stakeholders. This is the case despite the fact that the Section continues by providing that, in so acting, the director must have regard (amongst other matters) to six specified factors: the likely consequences of any decision in the long term; the interests of the company’s employees; the need to foster the company’s business relationships with suppliers, customers, creditors and others; the impact of the company’s operations on the community and the environment; the desirability of the company maintaining a reputation for high standards of business conduct and the need to act fairly.

It is now widely accepted that claims of other stakeholders – creditors, customers, suppliers, and even the general society – may deserve recognition in Companies Acts. The UK Companies Act Section 172 has been described as an “*enlightened shareholder value*” approach by adding that “*in doing so (the directors also) have regard to employees, suppliers, environment, etc.*” The enlightened shareholder approach is based on the idea that maximizing shareholder value is in principle the best means of securing overall prosperity.<sup>65</sup> Thus, the UK Company Law Review (CLR) rejected the so-called “*pluralist approach*”, which is based on the idea that a company should serve a wider range of interests, not subordinate to, or as a means of achieving, shareholder value, but as valid in their own right. This would mean that the interest of a number of groups should be advanced without the interest of a single group such as shareholders prevailing.<sup>66</sup> Using the words “*have regard to*” indicates that the mentioned requirement is subordinate to the overriding duty to promote the success of the company. The pluralist approach would enable, and indeed require, the directors to overwrite shareholders’ interests in circumstances where this would be in the interest of the company, as widely defined by these stakeholders. This approach however is firmly established in other countries like the Netherlands. The Dutch Companies Act explicitly provides that both the management and the supervisory board should take into account the interest of all stakeholders (2:129/239 and 2:140/250 CA). In Germany, the law is ambiguous and legal scholars are divided on the issue, but the Corporate Governance Code acknowledges a stakeholder approach. France has a similar approach to Germany. Also in Italy the issue is controversial.

The EMCA Group agrees that the term “*success of the company*” should be understood in line with UK CLR’s understanding and Section 172 of the UK Companies Act.

Section 4 uses the wording “*promote the success of the company*”. The word “*success*” is a more general word than for example “*value*”. However, the word “*success*” is used because not all companies are aimed at maximizing the financial interests of their members. In such cases, maximizing the value of the company is not the primary objective of its members and perhaps not even an objective at all. Section 172(2) of the UK Companies Act makes this clear but the EMCA Group considered that it was not necessary to have specific provision on this.

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<sup>65</sup> UK Company Law Review, *Modern Company Law for a Competitive Economy: The Strategic Framework* (1999), para. 5.1.11.

<sup>66</sup> *Ibid.*, para. 5.1.12 – 5.1.13.

In terms of timing, the EMCA Group shared the view of the Reflection Group on the Future of EU Company Law of 2011, the view of the Green Paper on Corporate Governance and the Commission’s Action Plan (2012) that the interests of the company in the medium to long term should be the focus of the directors’ attention.

Section 4 clearly does not specify all the duties and rules to which directors are subject. Specific duties, such as the duty to prepare accounts, the duty to avoid conflicts of interest or the duty to creditors on insolvency are set out in Chapters 9, 10 and 12 of the EMCA. Furthermore, directors are subject to a duty to act in accordance with a company’s instrument of incorporation and articles of association and to use powers for a proper purpose.

PART 2  
CONFLICTS OF INTEREST

GENERAL PROVISIONS

*Section 9.05*

**Duty to Disclose Conflicts of Interest**

(1) Directors shall inform the board of directors or, in the absence thereof, the other directors or, in the event of a sole director, the general meeting, of any situation that may involve a conflict of interest between their own and the company’s interest. Directors in such a situation shall refrain from taking part in the agreements or decisions relative to the operation/transaction around which the conflict has arisen.

(2) This duty to inform in paragraph 1 is not breached if the matter has been authorized by the disinterested directors or the general meeting.

*Comments*

Section 5 contains the core general principle and it is supplemented by provisions on typical cases of conflicts of interests in the following sections. Further, it is supplemented by the Section 9 on limitation of voting.

The provision in Section 5 covers actual conflicts as well as potential conflicts.

Re 1) Directors have a general and ongoing duty to consider if there might be a conflict of interest. Typical examples are mentioned in the special provisions below. If the director considers that there is a possible conflict of interest, the next step is to disclose the possible conflict of interest to the other directors or to the shareholders.

There are different possible ways to avoid a conflict of interest. From Section 5 it follows that a director must always consider if he or she is in a situation where a conflict of interest may occur. In such cases, he or she must disclose the conflict and as a consequence may transfer the decision to the next “level”, meaning from management directors to supervisory board or from a director to the general meeting – depending on the board structure of the company.

Re 2) Having fulfilled his or her duties to consider if there is a conflict of interest and to disclose the conflict of interest to the other directors, the director’s duties are satisfied. If the matter has to be decided by the directors, the member of the board is disqualified from voting on the matter, see Section 9 below. Then, the decision on the matter may be taken by other directors or the general meeting, depending on the structure of the company’s governance system. Thus, for example, if a private company has only a director and a general meeting, the approval should be given by the general meeting.

SPECIAL PROVISIONS

*Section 9.06*

**Corporate Opportunities**

When a director is in a situation where there is a conflict of interest, the director may not personally or on behalf of third parties exploit a corporate opportunity unless he or she has received the approval of the disinterested directors or the general meeting.

*Comments*

A major example of the duty of loyalty problem is when directors take for themselves business opportunities which could be of use to their company.

Some Member States have specific rules on corporate opportunities, whilst other Member States seek to protect the company’s corporate opportunities through the director’s duty of loyalty, see above in the paragraph on national law.

Section 6 is inspired by Section 175(2) of the UK Companies Act. The latter does not define a corporate opportunity. Section 228 of the Spanish Companies Act also includes a prohibition on taking advantage of business opportunities stating that:

*“Directors may not invest, for their own benefit or the benefit of affiliates, in any operations relating to company assets of which they may become aware by reason of their position, when such investment or transaction/operation has been offered to the company or the company has an interest therein, unless the company has ruled out the investment or operation in a decision not influenced by the directors.”*

The corporate opportunity doctrine is developed in US case law. The ALI Principles of corporate governance § 5.05(b) sets out the following definition of such an opportunity:

*“(1) Any opportunity to engage in a business activity of which a director or senior executive becomes aware, either,*

*In connection with the performance of functions as a director or senior executive, or under circumstances that should reasonable lead the director or senior executive to believe that the person offering the opportunity expects it to be offered to the corporation; or*

*Through the use of corporate information or property, if the resulting opportunity is one that the director or senior executive should reasonably be expected to believe would be of interest to the corporation; or*

*(2) Any opportunity to engage in a business activity of which a senior executive becomes aware, and knows is closely related to a business in which the corporation is engaged or expects to engage.”*

The thinking behind the US law is that the company’s business opportunities – in the same way as the company’s “ordinary” capital – belongs to the company and therefore should not be appropriated by others or undermined by the management’s actions. The US courts use different tests to decide the specific contents of the corporate opportunity doctrine. Thus, many courts use a two folded test, firstly a “line of business test” and secondly a “fairness test”. The idea of the former is to decide how closely related the opportunity in question is to the type of business in which the company is engaged. The closer related they are, the more likely it is that a corporate opportunity exists. If this decision is positive, it is left to be considered whether it is fair that the management utilizes the opportunity.

The EMCA does not contain a specific definition of corporate opportunity. Neither does it set out the test to be applied. This should be decided by the national courts.

#### *Section 9.07*

### **Competition with the Company**

A director may not carry on a competing activity or be a manager or director of a competing company without prior approval of the disinterested directors or the general meeting.

#### *Comments*

The duty of loyalty limits the manner in which, or the extent to which, a director may compete with the company. This problem arises both while the director is a director and after the director ceases to be a director. Regarding executive directors, it is common to have provisions on non-competition in the director’s contract with the company. Regarding non-executive directors and members of supervisory boards, it is up to company law to decide on the matter.

The EMCA Group considered whether it should be left to national courts to set the boundaries in order to deal with the variety of specific situations which occur. The “*case law solution*” is preferred in many Member States such as the UK, the Netherlands, and the Nordic countries. Special provision on competition is for example found in Germany (§ 88 AktG) and Greece (Companies Act Section 23).

Section 7 is inspired by Section 23 of the Greek Companies Act., see further in Chapter 8, Section 2 on the appointment of directors. This requires the directors to disclose their positions in other companies, in which case the general meeting has the opportunity to consider whether there should be a possible conflicts of interest in the future.

Section 7 does not deal with the problem whether a director, who is going to resign, prepares for a competing activity after resigning.

*Section 9.08*

**Benefits from Third Parties**

(1) A director of a company may not without consent of the disinterested directors or the shareholders accept a benefit from a third party conferred by reason of his or her being a director, or his or her doing, or not doing, anything as a director.

(2) This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

*Comments*

Section 8 is inspired by the UK Companies Act Sections 176.

Re 1) A prohibition on the acceptance of benefits from third parties may be considered as a part of the general duty of loyalty. The risk of such benefits distorting the proper performance of a director’s duties is so high that it is right to require authorization from the general meeting.

Accepting benefits is - under further conditions – also a criminal offence in some Member States. In Denmark this is characterized as a “*breach of trust*” according to the Danish Criminal Code Section 280e. Similarly German Criminal Law contains further provisions for this aspect of the acceptance of benefits from third parties, including the acceptance of bribes.

Re 2) Paragraph 2 is a general exception meaning that benefits of minor significance, which could not influence the director, should not be prohibited. The limit for minor benefits should be decided by national custom.

Section 8 uses the word “*benefit*”. Benefits could be “*bribes*” but could also include something else. Thus, there is no need to show that the giver of a benefit acts with a corrupt motive or that the director’s mind was actually affected by the benefit. The issue of bribery is generally a matter of criminal law, but, as noted, it is also covered by Section 8 as part of the breach of duty of loyalty.

*Section 9.09*

**Limitation of Voting**

A director shall be disqualified from voting at a board meeting on a matter pertaining to an agreement between the director and the company. A director shall likewise be disqualified from voting on a matter pertaining to a contract between the company and a third party, if the director is to derive an essential benefit in the matter and that benefit is contrary to the interests of the company. The limitation of voting applies correspondingly to court proceedings.

*Comments*

According to Chapter 8 Section 20, the board makes decisions on the basis of a simple majority of the members participating in the resolution. Section 9 provides that if a director has a conflict of interest as described in this Section, he or she is not allowed to vote on the matter.

The consequence of limitation of voting of a member of the board of directors is that other members of the board may decide. If all members of the board are disqualified, the decision must be taken by the next level meaning either a supervisory board or general meeting depending on the management structure of the company.

According to Section 9, not all conflicts of interest exclude the director from voting. The key word in Section 9 is “*contract*” and “*court proceedings*”.

Section 9 is inspired by the Nordic Companies Acts, especially Section 131 of the Danish Companies Act.

Court proceedings include any kinds of court proceeding such as a petition for bankruptcy or proceedings before any kind of court.

The EMCA Group considered whether Section 9 should also limit the directors’ right to attend board meetings and to take part in discussions, or if only the right to vote should be limited. The Group decided that only the right to vote should be limited because there might be a need for the board to ask the conflicted directors questions etc.

## **CHAPTER 10 DIRECTORS’ LIABILITY**

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## General Comments

### 1. EU law

The proposed, but never passed, 5<sup>th</sup> Directive was concerned with directors’ liability but the draft was eventually withdrawn by the Commission. However, Article 6 of the Prospectus Directive (2003/71/EC)<sup>67</sup>, which is in the process of being turned into a regulation, is relevant as it refers to some extent to the issue of directors’ liability. The Directive states that any Member State should have rules on liability that apply to those persons responsible for the information given in a prospectus.

### 2. National Law

On a general level, the rules on the duties and liabilities of directors are very similar in the different Member States. However, taking a closer look reveals some differences, as shown for instance by a 2013 study of the London School of Economics (LSE) for the Commission.<sup>68</sup> There are many explanations for the great similarity between the Member States. One explanation is that the influence of American corporate law, such as the design of the Business Judgment Rule and the duty of loyalty of directors, is fairly significant.

Common to all Member States is the liability of directors based on the principle of fault, which is derived from civil law. Further, directors have different tasks and responsibilities in the company, which must be reflected in the diligence assessment.

In order to make an assessment of diligence, objective standards are used, in particular based on rules that can be found in the Companies Act and in the articles of association. The assessment must also consider the circumstances relating to the party causing the damage.

### 3. Considerations

When assessing liability, insufficient personal qualifications do not disqualify or reduce the responsibility of directors. Because Chapter 10 applies to companies of different sizes and different industries, it is difficult to find an acceptable minimum standard for such an assessment. However, national corporate governance codes demand that directors should have appropriate qualifications and commitment. Such demands may be taken into consideration. Since a person has taken up the position as a director voluntarily, it is reasonable to require that he or she leaves the business when it becomes clear that the personal qualifications are not sufficient.

US law includes the term “*an ordinary prudent person*”. It means that a person need not have expertise or specific knowledge to sit on the Board but they must be a person “who has the capacity to perform a given corporate assignment”. A similar standard may be used in the EMCA as a basis for assessing liability.

A rule that seems to apply, explicitly or implicitly, in most legal systems is the “*Business Judgment Rule*”. This requirement is also reflected in Section 1(2). The “*Business Judgment Rule*” should be formulated in such a way, that a director or managing director will not be deemed liable for their actions in cases where it is clear that they had a justifiable basis for making a decision and that they had an overview of the company’s financial position.

U.S. law has influenced the content of the “*Business Judgment Rule*” in most legal systems in Europe. For example, in German law, liability may apply in cases where a harmful action is carried out which is not based on a sufficiently comprehensive, accurate and fundament decision, cf. Chapter 9, Section 2, according to which the supervisory board must receive all necessary information for the performance of their duties.

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<sup>67</sup> 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.

<sup>68</sup> See *Study on Directors’ Duties and Liability*, prepared for the European Commission DG Markt by: C. Gerner-Beuerle, P. Paech and E. P. Schuster (Department of Law, London School of Economics), London, April 2013. The study is available at [http://ec.europa.eu/internal\\_market/company/docs/board/2013-study-analysis\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf).

A principle that applies in most European legal systems is that the burden of proof lies with the injured party to show that an injury has resulted from negligence. One of the few exceptions to this principle can be found in German law under AktG § 93 (2) where the burden of proof for alleged negligence lies with the member of the management board or supervisory board. However, this position is not taken in the GmbH-Gesetz. In this regard, Spanish Companies Act (sect. 236.1) also provides that “*When the act is contrary to the law or the company-bylaws, guilt shall be presumed, until proven otherwise*” (i.e. proven by directors).

In those legal systems where the Companies Act provides for a hierarchical organization and where the general meeting may give binding instructions to the board, it is held that liability does not apply if the director has followed such an instruction or gathered the general meeting’s consent to perform the action. The exemption from liability should not be effective if the instructions of the general meeting are not in conformity with applicable rules or regulations in the statutes.

In Poland and Spain, however, the exemption from liability applies regardless of whether the instructions are in conformity with law or the statutes or not. Contrary to the exemption based on consent from the general meeting, an approval from the supervisory board will not exclude liability.

On the contrary, in France and in Italy a vote of the general meeting cannot exempt the directors from their liability.

The company’s claims for damages against directors must be passed by the general meeting according to EMCA Chapter 11, Section 38. Section 38 contains a rule on discharge regulating situations where the shareholders have not been provided with correct or complete information. Further, Chapter 11, Section 39 contains a rule on shareholders’ derivative suits regarding liability for directors as well as shareholders.

*Section 10.01*  
**Directors’ Liability**

- (1) A director has a duty to the company to perform the functions, according to his or her duties and according to this Act and the articles of association.
- (2) A director, managing director or a member of the supervisory board, who in the performance of his or her duties according to this Act, the applicable annual reports legislation or the articles of association, intentionally or negligently causes damage to a shareholder or other person, shall compensate such damage.
- (3) A director who makes a business judgement in good faith fulfils the duty under this Section if he or she:
  - (a) is not interested in the subject of the business judgement;
  - (b) is informed with respect to the subject of the business judgement to the extent that the director or managing director reasonably believes to be appropriate under the circumstances;
  - (c) rationally believes that the business judgement is in the best interests of the company
- (4) A person challenging the conduct of a director under this Section has, in a damage action, the burden of proving a breach of the duty of care, including the inapplicability of the business judgement rule as it is explained under Subsection (2), and that the breach was the legal cause of damage suffered by the company.
- (5) A director shall not be liable for damages against the company if the action was taken on the basis of a lawful resolution of the general meeting. The fact that a supervisory board has approved the action shall not exclude liability.

*Comments*

Section 1(1) decides that directors are liable to the company as well as other persons affected by their activities in the company. Such persons may be individual shareholders, creditors or other parties.

Liability towards the company may for example occur if minority interests are violated, for example if the directors act outside their competence and the company suffers losses from such actions.

Liability towards individual shareholders might arise in situations where shareholders have acted on the basis of information from the company’s annual accounts or information given in a prospectus.

Liability towards creditors may occur where creditors have been motivated to extend credit to the company based on incorrect facts as to the company’s financial situation for example showing misleading financial reports, or if the directors have ignored their duty to realize the financial situation was dire and not taken the appropriate actions. Thus the legal basis for liability towards creditors is the provisions in the Companies Act (EMCA) which protect the interest of creditors.

The principle of fault applies in the same way to the members of the supervisory board as to managing directors. The extent of liability depends on the specific duties that apply to members of a supervisory board depending on the different role of supervisory boards in the various systems, cf. EMCA Chapter 9 above.

According to UK law, the interest of creditors are mainly protected through the Insolvency Act, especially Section 214 on wrongful trading. As mentioned below, a similar rule is recognized in the laws of other Member States and in the EMCA (See Section 4 and EMCA Chapter 15, Section 17 on Parent liability). The German AktG § 93 only provides for liability towards the company. However, liability towards third parties may be based on BGB § 823(2).

In the case of liability against creditors, legal provisions differ quite considerably within the EU. In the UK, for example, a liability rule on wrongful trading is set out in Section 214 of the Insolvency Act to the effect that the director may be held liable to the creditor if the company continues in business at a time when there is no reasonable prospect that the company could avoid going into insolvent liquidation, unless the director has taken any steps with a view to minimizing the potential loss to the company’s creditors. A similar approach is taken by the EMCA. Danish and Swedish laws, in turn, also include other rules with a creditor perspective, namely that a director has a responsibility to ensure that the company has an adequate capital base in order to carry on business.

Section 1 builds on the premise that the EMCA include rules designed to protect creditors interests by ensuring that the company has an adequate capital base or, as in the case of wrongful trading, by imposing a duty on the directors to act to satisfy the creditors’ interests.

Several Member States instruct directors of limited liability companies to file for bankruptcy. This is particularly the case under French and German company law. This duty applies if a company is unable to pay its debts or if its assets in the balance sheet do not cover its debt. In other Member States such as the Nordic Countries no such duty exists. It is up to the creditors to file for bankruptcy, but as mentioned above, the directors may be liable if they continue to do business when they could have foreseen that the company would not be able to pay the creditors. A duty to file for bankruptcy might hinder an attempt to reconstruct a company. Therefore, the EMCA does not include a provision containing a mandatory rule on bankruptcy.

#### *Section 10.02*

#### **Joint and Several Liability**

(1) Where several directors are liable for the same damage, they shall be jointly and severally liable. Reimbursement of damages paid by any of them may be sought through recourse to the other parties in accordance with what is reasonable in the circumstances.

(2) Members of the management board or the supervisory board shall not be liable to the company for damages if their acts were based on a lawful resolution adopted by the general meeting. The fact that the supervisory board has approved the action shall not mean that liability for damages is excluded.

#### *Comments*

In the majority of Member States, the directors are held to be jointly liable for the damage caused because of breaches of their duties. In some Member States, the principle of joint and several liability also applies to a director who has not breached his or her duties to a company. According to Section 4 – and consistent with most Member States – such as Denmark, Finland, France, Italy, Poland, Britain and Sweden - joint and several liability is only imposed on those who neglected their duties. Whether a director is considered to be liable is dependent on an individual assessment. However, a director who claims not to be liable will need to prove that he or she has acted diligently for example by ensuring that any objections they made to the decisions taken by the board are documented in the minutes.

#### *Section 10.03*

#### **Adjustment of Damages**

Where any person is liable in damages pursuant to Sections 1-3, the damages may be adjusted in accordance with what is reasonable taking into consideration the nature of the act, the extent of the damage and the circumstances in general.

#### *Comments*

This Section is a manifestation of general tort law. However, the possibility of adjustment in terms of responsibility for the director and managing director is larger than in general tort law. The reason is that damages in these circumstances may be very large.

*Section 10.04*  
**Wrongful Trading**

Directors may be liable if the company continues its business at a time when the directors knew or ought to have concluded that there was no reasonable prospect of the company being able to pay its creditors.

*Comments*

Section 4 is inspired by Section 214 of the UK Insolvency Act and by Nordic company case law. In the UK, wrongful trading may be viewed as a breach of duty to take care of the creditor’s interests. In some Member States, provisions on wrongful trading may appear in tort law. Section 4 does not exclude any national tort law provisions on wrongful trading.

A special Section on parent liability, which is close to the concept of wrongful trading, in regards to Groups is found in Chapter 15, Section 17.

*Section 10.05*  
**Time for Announcement of Proceedings**

Claims regarding damages to the company shall become time-barred after three years.

*Comments*

If a claim regarding damages to the company is time-barred, then it is stopped on the basis that it has been filed too late according to Section 5. The time period available to claim liability to the company varies in general between three and five years between the various Member States. A five-year limitation period is common. In France and Ireland, a period of three years applies.

*Section 10.06*  
**Insurance**

A company may purchase and maintain insurance on behalf of an individual director or managing director of the company or a person who, while a director or managing director of the company, serves at the company’s request as a director or managing director of another domestic or foreign company, against liability asserted against him or her in that capacity.

*Comments*

One possibility for the company to obtain compensation for an injury that a director or managing director has caused is to sign liability insurance. Such insurance is permitted in all Member States, although it is not always stated in the Companies Act. The premium is generally paid by the Company.



## CHAPTER 11 GENERAL MEETING AND MINORITY PROTECTION

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## General Comments

### 1. EU law

There is an on-going international debate on the role of shareholders in companies. One of the main aims of the European Commission's 2003 Action Plan (COM (2003) 284 final) was to strengthen the position of shareholders in the company.<sup>69</sup> Following this aim, Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies (i.e. companies whose shares are admitted to trading on a regulated market), the 'Shareholder Rights Directive', has been adopted and implemented in Member States. In addition, in 2012 the Commission published a new Action Plan (COM (2012) 740 final) on the EU Corporate Governance Framework which stipulates that shareholders should be encouraged to be more active on corporate governance issues. Among others, shareholders should be offered more possibilities to oversee remuneration policy and related party transactions, and shareholder cooperation to this end should be made easier. The Directives highlight a number of measures in order to ensure that shareholders are able to play an active role in the company's decision-process as well as being able to hold the management accountable for running the company.

Generally, Chapter 11 of the EMCA is in line with the Shareholder Rights Directive and the thoughts of the Commission's 2012 Action Plan.

The Shareholder Rights Directive of 2007 takes the view that there is a need to enhance shareholder rights in listed companies. It follows an international trend to foster *active shareholders*. Generally, the preamble stresses "*effective shareholder control is a pre-requisite to sound corporate governance and should therefore be facilitated and encouraged.*" Thus, the Directive includes provisions on shareholder voting rights, including proxy voting rights and cross-border voting rights, on shareholders' rights to put items on the agenda of the general meeting, to ask questions and, for companies, the right to use electronic means to communicate with the shareholders and to enable electronic voting at the general meeting. As mentioned before, certain provisions are also applicable to non-listed companies, but other provisions should only apply to listed companies because of the special need to inform and protect shareholders in companies with shares admitted to trading on the market.

In 2014, the Commission published a proposal for a new Directive amending the Shareholder Rights Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EC as regards certain elements of the Corporate Government Statement (COM (2014) 213 final). The amending directive has been adopted in 2017 (but not yet published in the EU Official Journal at the time of publication of the EMCA).

The 2017 directive for the amended Shareholder Rights Directive encourages shareholders to engage more in the companies in which they invest, and to take a longer perspective of their investment.

The proposal identifies five specific objectives:

- Increase the level and quality of engagement of asset owners and asset managers with their investee companies
- Create a better link between pay and performance of company directors
- Enhance transparency and shareholder oversight of related party transactions
- Ensure reliability and quality of advice of proxy advisors
- Facilitate transmission of cross-border information (including voting) across the investment chain in particular through shareholder identification.

From a company law perspective, it should be noted that not all of the mentioned objectives require company law regulation. Thus the directive (Article 3 f-3 h) increases the transparency of institutional investors and asset managers. The articles mention that 'Member States shall ensure that institutional investors develop an "engagement policy" (Article 3 f), "Investment Strategy" (Article 3 q) etc.'

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<sup>69</sup> K. Hopt, *European Company Law and Corporate Governance: Where Does the Action Plan of the European Commission Lead?*, ECGI Working Paper- No. 52/2005, p.3

The relevant regulation is not company law, but the (different) national law regulating institutional investors and asset managers.

The directive's Article 9 a and 9 b require listed companies to publish detailed and user-friendly information on the remuneration policy and on the individual remuneration of directors. The articles give shareholders the right to approve the remuneration policy and to vote on the remuneration report. Therefore, the report facilitates the exercise of shareholders rights and ensures the accountability of directors. This is clearly a matter for company law regulation, see further below.

The directive's Article 9 c requires listed companies to submit material transactions with related parties' transactions to the approval of the general meeting or the administrative or supervisory body. This is also a matter for company law regulation, see further below.

The directive's Article 3 i requires proxy advisors to adopt and implement adequate measures to guarantee that their voting recommendations are accurate and reliable. The relevant regulation is not company law but national regulation concerning proxy advisors.

The directive's Article 3 a-3 e include rules on identification of shareholders, transmission of information and facilitation of exercise of shareholders rights.

Article 3 a-3 e affect a number of company law issues as well as regulations regarding institutional investors and proxy advisors, see further below.

The Commission has put forward in 2014 a proposal for a Directive on single-member private limited liability companies, creating the *Societas Unius Personae* or SUP (see EMCA Introduction, Point 7). The proposal aims to make it easier and less costly to set up companies across the EU. In particular, it aims to encourage SMEs including individual entrepreneurs to carry out their activities in other Member States. It should also benefit groups by allowing them to set up single-member subsidiaries according to the same main requirements across the EU. The proposal aims to address some of the obstacles that SMEs face by facilitating the setting up of companies with a single shareholder across the EU (in light of the Commission's withdrawal of the SPE proposal in its REFIT exercise (IP/13/891)). The Juri Committee of the European Parliament has been split over the proposal despite amendments to take into account concerns. Thus an agreement on the proposal seems far in the future, but not impossible.

The formal requirements applying to the holding of general meetings and especially the rules on minority protection are based on the assumption that a majority of shareholders is present at the general meeting.

There is no EU regulation on the shareholders position and general meetings in private companies or non-listed public companies. However, most of the fundamental principles regarding shareholders' rights in listed companies are also applicable in non-listed companies.

## 2. National law

Chapter 11 is divided into three parts.

*Part I* comprises the rules on general meetings, including the competence of the general meeting, how general meetings are conducted, and the rules on shareholders' rights at general meetings.

There are different positions in the Member States as to the competence to take business decisions. The situation is also different in public and private companies. Generally, there are two opposite positions regarding *public companies*: In Czech, German and Polish law the management board has the exclusive competencies with respect to the administration of the company and neither the general meeting nor the supervisory board may pass resolutions regarding the management of the company. In Germany, the general meeting may only take business decisions at the request of the management board (*Vorstand*) (cf. German Stock Corporation Act §§ 11 and 119). According to the Polish Commercial Companies Code, the general meeting is prohibited from giving instructions to the board (cf. Section 375). In the Nordic countries the opposite is the case: Neither the supervisory board nor the management board has exclusive competence. This is a consequence of the conception of the company as being a strong shareholders' democracy and also belonging to shareholders which should therefore be able to exercise direct power. The balance struck in the UK in all companies is that all powers of management are vested in the board, subject to the statute and the articles which can reserve matters to the general meeting, and subject to any directions given by the general meeting to the directors but that requires a 75 % vote. Overall then, most powers reside with the board, some are withheld by statute or the articles to the shareholders, and the option is there for the shareholders, on an ad hoc basis, if they can reach a 75 % vote, to instruct the board as to how to proceed. Equally, since a simple majority can dismiss the directors without cause, in practice, the board will not seek to exercise a power contrary to the wishes of a majority of the shareholders, so it is rare for a 75 % direction to be given.

The situation in *private companies* is different in the Member States, as there is usually a controlling shareholder. Therefore, the distinction between shareholders and management is reduced and this affects the legal organisation. Generally, there is a freedom to organize the competence between the general meeting and the board. The competence of the general meeting is unrestricted and the general meeting may take business decisions.

A modified model between the two positions can be found in Dutch Law. The Dutch rule regarding instructions reads as follows (cf. Section 2:239(4) of the Dutch Civil Code (Book 2)):

*“The articles of association may stipulate that the management board has to follow the instructions of another body of the company. The management board has to follow these instructions, unless these are in conflict with the interests of the company or the enterprise connected with it.”*

Section 9 of EMCA Chapter 15 on Groups also recognises the right of the shareholders, subject to certain conditions and limitations, to give binding instructions, to the management body of a company.

Following this approach, article 23 (Shareholder's instructions) of the 2014 proposal of directive on the single-member private limited liability company, creating the SUP, established a right of the single shareholder to issue instructions :

- « 1. The single-member shall have the right to give instructions to the management body.*
- 2. Instructions given by the single-member shall not be binding for any director insofar as they violate the articles of association or the applicable national law. »*

*Part II* includes the different minority rights which are divided into five areas;

Firstly, there are provisions which demand that a super majority is reached in order to make different decisions. Provisions on super majority, or even unanimity, of course secure the interests of the minority or even a single shareholder (minority protection/individual rights). Provisions on super majority are found in various chapters of the EMCA, for example the chapters on capital increase and decrease, merger and divisions and liquidation. In this Chapter on general meetings, the EMCA includes the very important provision on alteration of the articles of association. All Member States have provisions on alteration of the articles of associations demanding super majority. The majority requirement in public companies, however, is different with the main distinction being between a 75 % or a 2/3 majority. For example, in Germany (AktG § 179) and the UK (Companies Act 2006 Section 21(1), cf. 283(1)) the majority must not be less than 75 %, in Denmark (Section 106), France (Article L. 225-96 of the Commercial Code), Finland (Companies Act, Chapter 5, Section 30) and Sweden (Chapter 7, Section 42) a 2/3 majority of both the votes cast and represented at the meeting is required. Unanimity is sometimes required in exceptional circumstances (e.g. change of nationality, increasing the obligations of shareholders, etc...).

Secondly, Part II contains provisions on shareholder exit. In traded companies minority shareholders or individual shareholders are, in principle, always able to leave the company by selling their shares if they feel oppressed by the majority. Even the threat of leaving the company (“vote with one’s feet”) may force the majority not to misuse their position. Thus, in traded companies, exit is a powerful means to protect shareholders against misconduct by majorities. In non-traded companies and even more significantly in private companies (and closed companies which are public) exit rights are also effective regarding protection of minorities. Exit rights may oblige the company to redeem the shareholders’ shares or require other shareholders (the majority) to redeem the shareholders’ shares.

Provisions which force the majority shareholders to redeem shares of the minority in case of abuse are found, for example, in Denmark (Companies Act Section 362 (2)), Finland (Chapter 18) and Sweden (Chapter 29, Section 4). On the other hand, there are also provisions which force an abusive shareholder to sell his shares to the other shareholders or to the company. Such a provision is found, for example, in the Danish Companies Act Section 362(3).

A number of Member States’ Companies Acts also include general provisions on squeeze-out/sell-out rights which are not conditional on abusive conduct. Thus, for example, the Danish Companies Act Section 69-73 contain provisions according to which shareholders who own more than 90 % of the capital and the votes may demand the other shareholders to let their shares be purchased/sold by that shareholder. The minority has a corresponding right. Similar provisions are found in Finland (Chapter 18) and in Sweden (Chapter 22, Section 1 and the following Sections). Even if the purpose of squeeze-out/sell out rights also goes further than minority protection - for example to facilitate restructuring of companies – squeeze-out/sell-out rights may also be seen as a part of minority protection. Other Member States, such as France and Italy, do not recognize such right and allow only damages or nullification of a decision to protect minority shareholders. The EMCA Group considers that sell-out right is a modern and powerful protection tool for minority shareholders in closed companies. Therefore, in the EMCA, a minority may use the sell-out right for protection without having to prove actual misuse by the majority. Therefore, the provisions on squeeze-out/sell-out rights are included in Chapter 11. The sell-out right is also part of the regulation of groups (See Chapter 15).

The rules on squeeze-out/sell-out rights regarding takeovers, which are found in Article 15 and 16 of the Takeover Directive are in most Member States implemented by securities regulation. However, a number of Member States have also implemented rules on squeeze out/sell out in the Companies Acts in connection with traded companies, e.g. the Danish Companies Act Section 70 and following sections. Several Member States apply the squeeze-out/sell-out right to public as well as private companies. Thus, squeeze-out can be performed by a shareholder, who holds securities representing at least 90 % of the capital carrying voting rights of a company and 90 % of the voting rights in the offeree company. This is the case in a number of Member States, among them Denmark, Finland, Sweden and the UK. In other Member States like Belgium, France, Germany, Italy and the Netherlands, the required majority is 95 % of the capital carrying voting rights of a company. In Belgium, France and Italy, the rules on squeeze out apply only to listed companies. In most Member States, also the minority has a right to sell out. However, this is not possible in Germany and the Netherlands. To sum up, the national rules on squeeze out/sell out rights vary substantially.

Thirdly, there are in the EMCA provisions on shareholders' derivative suits. It is up to the general meeting to decide on a director's possible liability towards the company. Often, the general meeting decides on discharge, meaning that the general meeting considers that there is no reason for director's liability. However, the minority may disagree. A number of Member States' Companies Acts contain provisions on derivative suits which allow a minority of shareholders to sue the directors on behalf of the company. Derivative suits are thus included in the Companies Act, for example in Denmark, France, Germany, Italy, Luxembourg (since 2016), Sweden and in the UK. Also the US Model Business Corporation Act (MBCA) has provisions on derivative suits in Chapter 7, Subchapter D.

Fourthly, provisions on special examiners, which are a powerful protection tool for minority shareholders, are found in a number of Member States' Companies Acts, such as the Danish Companies Act Section 150, the Finnish Companies Act Chapter 7, Section 7 and the Swedish Companies Act Chapter 10, Sections 21-23.

Finally, provisions on dissolution in connection with misuse of majority power are found in Part II. Dissolution is an ultimate sanction in case of majority misconduct. The provision on dissolution is however included in Chapter 14 on liquidation.

Part III contains provisions on shareholder liability.

### 3. Considerations

1. Generally the EMCA Group shares the view that company law, including the Chapter on general meetings, should encourage the shareholders to be active and improve their possibilities to act as the company's highest decision-making body. This is also stated in the EMCA in the general principle of shareholder democracy, in Chapter 1, Section 12. The approach of the EMCA is that the general meeting must take important decisions which concern the company. This is expressed by mandatory provisions in the Chapter on general meeting as well as in other chapters of the EMCA. Further, the articles of association may decide that certain decisions may only be taken by the general meeting. Shareholders should have the right to set any other issues on the agenda of extraordinary meetings.

The EMCA does not intend to challenge the governance system of those Member States which follow the German-oriented system whereby the competence of the general meeting is limited in that the general meeting cannot give instructions to the management board in public companies or deal with management decisions not required by the management board; see further below.

In order for shareholders to play an active role in the company, they must have the opportunity to participate in the general meeting. Older Companies Acts assumed that shareholders would be physically present. By means of an increased internationalization of ownership, this precondition is almost non-existent any more in large companies. Incentives are needed to ensure and facilitate that shareholders participate actively at the general meetings. Improvements should be made by the EMCA to ensure that shareholders have and take the opportunity to attend and vote at the meetings by allowing for electronic general meetings, use of proxies, etc.

Especially in large companies with many shareholders there is the risk of opportunistic behaviors from the board, such as undeserved golden-parachutes. The 2008 financial crisis has demonstrated that shareholders have not been able to hinder opportunistic behavior, especially related to directors' pay (remuneration). This situation demonstrates that there is a need to provide shareholders with the opportunity to comment or approve on directors' pay. The amended Shareholder Rights Directive, Article 9a-9b, introduces "say on pay" rules. A "say on pay" rule is already found in the EMCA, Chapter 8, Section 25.

In recent years there has been a big discussion about the role of institutional investors. Institutional investors are often the most powerful group of shareholders. They exercise their power at the general meeting. It has been discussed if the institutional investors should be obliged to use their votes and if the institutional investors' voting policy should be transparent. New editions of a number of national corporate governance codes, among them the UK Stewardship Code and the Dutch Eumedion best practices, recommend institutional investors to be transparent about the way they exercise their ownership/stewardship responsibilities, which in particular includes information about voting and engagement.

The Group has considered which way should be the most appropriate to enhance investors' role as active shareholders. According to the proposed amendments to the Shareholder Rights Directive there is clear evidence that the current level of monitoring of investee companies and engagement by institutional investors is sub-optimal. Therefore, the proposal encourages the institutional investors to be more active and long-term investors.

In that respect the EMCA Group has considered whether Chapter 11 on general meetings should include provisions especially on the role of institutional investors. Among other things, mandatory rules necessitate a precise definition of "institutional investors". On a European level this is extremely difficult. A way forward might be provisions in the legislation (law or other regulation) which applies to the institutional investors demanding them to disclose their voting policy etc. on comply or explain basis. According to the EU proposal above amending the Shareholder Rights Directive, articles 3 f(1) and 3 g(1) Member States shall ensure that institutional investors develop an engagement policy and disclose their investment strategy. The EMCA Group considers that these duties should be implemented in national law by special regulation regarding institutional investors. The impact on company law is, however, that the duties to be active shareholders presuppose that the shareholder's position at the general meeting makes it possible.

2. Typically, there are substantial differences between the governance systems in private, public and traded companies. In private companies and public companies where the shareholders are engaged in running the company, the general meeting (shareholders) is much more involved in the company's business than shareholders typically are in traded companies. There is a need for private companies (and some public companies) for shareholders to be able to act in the daily business, and also to be able to take decisions without a large formal and bureaucratic system. In traded companies there is a need for more formal regulation which secures the interests of shareholders, at least allowing them to take decisions of great importance for the company and be informed of the company's affairs. The rules in Chapter 11 on general meeting comprise private, public as well as traded companies but the rules should be adjusted to the need in each of the mentioned categories of companies. Especially, it should be mentioned that the Shareholder Rights Directive only applies to companies whose shares are traded on a regulated market. However, the EMCA Group considers that the special provisions on traded companies should also apply to companies with shares admitted to trading on alternative markets (e.g. AIM London, Nasdaq OMX...).

3. In some Member States the Companies Acts include special provisions on public companies with only one shareholder. This is for example the case in Poland. There are a number of special issues regarding general meeting in such companies. The formal requirements on general meetings including notice, agenda, conduct of the meeting etc. are obviously of no importance. The Group has considered whether the EMCA should contain special provisions regarding companies with only shareholder? The Group is of the opinion that such provisions are not needed in general. Most of the provisions in the EMCA Chapter on general meetings do not apply to companies with only one shareholder. Especially regarding the proposal on the SUP company the EMCA Group is of the opinion that time has not come to implement special provisions on single-member companies in the EMCA.

4. As mentioned under national law there are different positions in the Member States regarding the competence of the general meeting in private, public and traded companies. En brief, according to the Companies Acts in some Member States, the position in public companies is that the general meeting may take any decisions and may also give instructions to the board. The opposite position is that the general meeting may not interfere with the boards' business decisions and may not give instructions to the board. Further, in some Member States (for example in the German AktG § 122(2)) there are restrictions regarding the shareholders' access to set issues on the agenda of the general meeting. In practice, however, the difference between the two positions has minimized in so far as the shareholders may dismiss the board at any time. The latter is the position of the EMCA; see above, Chapter 8, Sections 6 and 14.

In private companies, however, there is no similar distinction regarding the competence of the general meeting. Thus, for example, the German GmbHG § 46 includes a catalogue of decisions which should be taken by the general meeting unless the articles decide otherwise. However, the catalogue is not exhaustive. The general meeting has a fundamental competence to decide on all company matters.

Generally, the EMCA Group is of the opinion that for more reasons in public companies there should be a *division of work* between the general meeting and the company organs running the company's business. This is especially important in large (traded) companies. However, in the light of the recent developments, including the considerations in the Commission's Action Plan of 2012 and the amended Shareholder Rights Directive, there is a need to improve the shareholders' position versus the board – without eliminating the board's duties to run the company. However, the two positions – if pushed to extremes – are quite incommensurable. Therefore, Section 1 below contains alternative provisions.

Since the EMCA Chapter 11 comprises general meetings in all companies, i.e. private, public as well as traded companies, the rules are made flexible in order to secure shareholders' interest in formal general meetings and at the same time allow shareholders to decide on company matters without unnecessary bureaucracy. One of the most important means is to allow general meetings to take place without complying with the requirements of form and notice, see below in Section 2.

5. General meetings are a forum for shareholders' decisions but also for the company's (the board's) dialogue with the shareholders. Many companies with a large number of shareholders regularly invite their shareholders to attend "shareholder meetings" for information purposes only. Such meetings may be useful for the necessary dialogue with the shareholders, but the meetings are not a forum where decisions are taken. There may also be other types of shareholder meetings. For example, the German AktG § 127a contains a provision on "shareholder's forum" which is a forum where shareholders or shareholders' associations invite other shareholders for the purpose of exercising their voting rights at a shareholders' meeting.

The need for dialogue with the shareholders is stressed in many Corporate Governance Codes. The EMCA Group agrees that shareholder meetings or shareholder meetings called by the company or the shareholders are useful means for dialogue. However, the Group is of the opinion that recommendations on such meetings should be left to the national Corporate Governance Codes. Besides, it is up to the company to decide, if a shareholder meeting – which is not a general meeting – should be established or the company for example prefers to communicate with the shareholders on the company's website; see below in Section 22.

6. The Group has considered which means for minority protection should be included in the EMCA. Chapter 11 part II should include provisions on decisions which should be taken with a super majority or even unanimously, see below in sections 27-29. A special problem in this regard arises because of the difference between systems. In one system the shareholders may demand that any item should be included on the agenda of the general meeting, and the general meeting may take any decision on company matters. This is the case, for example, in Nordic company law. In other systems, individual shareholders have no right to add items to the agenda and the general meeting is limited regarding which decisions the general meeting may take. See for example the German AktG §§ 122(2) and 119(2). An example of the consequences of this difference is the discussion whether there should be a provision defining certain important decisions which always should be made by the general meeting. This problem is illustrated by the well-known German *Holz Müller*-case, according to which, a decision on transferring business to a subsidiary should be taken by the general meeting. In some Member States the *Holz Müller*-case has initiated a discussion as to whether there should be a principle stating that extraordinary decisions, e.i. decisions which are not mentioned in the company law as situations where a decision by the general meeting is mandatory, must be made by the general meeting. The Group considers that it is important to secure the shareholders' influence, as mentioned. However, the Group is of the opinion that it should be as clear as possible when it is mandatory for the general meeting to make the decision. The balance may be obtained by a provision defining the meaning of very important decisions, see Section 29 below.

Further, the Group considers that the EMCA should include squeeze-out/sell-out rights, not only related to securities regulation but also to general provisions, see below in sections 35 and 36. The EMCA Group considers that squeeze out/sell out rights which are not contingent on proved misuse of the power of the majority represent useful tools to protect the minority.

A number of Member States have provisions on derivative suits. This is for example the case for Italy, for public companies in France (Article L. 225-252 of the Commercial Code), Germany (AktG § 148), Lithuania (Companies Act Article 16 Part 1 Item 5), the Nordic countries (Danish Companies Act § 364(3) and Sweden (Chapter 29, Section 9), Poland (CA Article 295), and the UK (CA Sections 260 and the following). The experiences in Member States, whose Companies Acts have provisions on derivative suits, vary. There are different explanations for this. The Group is of the opinion that an assessment of the rules should consider both the more and less complicated structure of the rules on derivative suits and the number of court cases. The Group has chosen to include simple rules on derivative suits – also taking into account that such rules should not only be judged upon the number of court cases but also upon the preventive effect of the rules.

The EMCA Group also stresses the protective effects of a rule which allow minority shareholders to ask for special examiners and in extreme situations a right of dissolution or liquidation. Therefore, the EMCA includes such provisions; see below Section 32.

PART 1  
GENERAL MEETING

*Section 11.01*

**Competences of the General Meeting**

- (1) The shareholders shall exercise their rights with respect to the company at the general meeting unless this Act provides otherwise.
- (2) National Law may provide that the general meeting in public companies may decide on matters concerning the management of the company only when required to do so by the management board or the board of directors.
- (3) It may be provided in the articles of association of public companies that the general meeting decides matters that fall within the general competence of the managing director/ the board of directors.
- (4) In private companies the general meeting has competence in all company matters, except where the articles of association otherwise provide. The general meeting may give direct instructions to the managing director/the board of directors.

*Comments*

The wording of Section 1(1) is similar to the German AktG § 118. Similar provisions are also found in the Danish Companies Act Section 76(1), the Finish CA Section 5(2) and the Swedish Companies Act Chapter 7 Section 1.

The provision states that the general meeting is the forum where the shareholders decide on company matters, but the provision does not decide in detail which decisions *may* or *must* be taken by the shareholders.

There are two problems regarding the competence of the general meeting which, however, also are closely connected. The *First problem* is the general meeting's competence vis-à-vis the directors (board of management). This is only a problem regarding public companies. In Denmark for example, the general meeting is in principle regarded as *omnipotent* (in public as well as in private companies). The opposite is the case in Germany (in public companies). The German AktG § 119 (2) thus decides that "The shareholders meeting may decide on matters concerning the management of the company only if required by the management board." The corresponding AktG § 76 (1) states that "*The management board shall have direct responsibility for the management of the company.*" Some Member States have provisions with a compromise, thus for example the Finish CA Section 5 (2), which states that "It may be provided in the articles of association that the general meeting decides matters that fall within the general competence of the managing director and the board of directors." Other Member States deal with this in public companies through case law and take a general restrictive view on modifications to the organisation of power established by the legislator. This is the case for instance in France (Cour de cassation (civ.), *Sté de teinturerie c/ Motte*, S 1947, 1, p. 153, note Barbry; JCP 1947, II, n° 3518, note Bastian) except for the simplified public limited liability company (*Société par actions simplifiée* or SAS) where large freedom is granted to the articles of associations.

As decided in the EMCA, Chapter 8 on management, the EMCA recognizes that there are different governance systems in the Member States. As a consequence, the provisions in Chapter 11 should also recognize that there are different positions regarding the question whether the general meeting may give binding instructions regarding the competence of the general meeting.

In practice the difference between the systems is diminished because of the possibility of dismissing the directors, see the EMCA Chapter 8 Sections 6 and 14.

Given a wish to allow a flexible governance system, Section 1 (2) and 1 (3) includes two alternatives regarding the question of the competence in public companies.

If none of the alternatives are used in national law, Section 1 (1) such be interpreted in such a way that the general meeting is omnipotent.

*The second problem* is to which extent it should be decided by mandatory provisions that certain decisions should be taken by the general meeting. Generally, the general meeting may not decide on management issues given the exclusive management competence of the board of directors. Technically, there are two ways to go.

One is to provide examples of decisions which are considered so important that they need to be decided by the shareholders. Further the company may choose to give more examples in the articles of association.

Another is to try to make a complete list of matters, which should be decided on or approved by the general meeting. Thus, for example, the German AktG § 119 (1) states that “The shareholder meeting shall resolve on all matters expressly stated in this act, in particular with respect to... (1-8).” The list in § 119 (1) is supplemented by some specific provisions in the AktG. Further, the articles of association may decide that certain decisions should be taken by the general meeting.

Similarly, in the UK there must be a positive decision via the articles to subject a power to shareholder control, otherwise the power vests in the directors. However, some matters are reserved for the shareholders by statute for example to alter the Articles (UK Companies Act Section 21) or to increase or reduce the share capital.

The shareholders are the ultimate decision takers in companies. However, the principle does not decide in detail the balance between the general meeting and the board of directors which has to take business decisions.

Especially, in large companies there must be a practical division of the work between shareholders and the management. Generally, shareholders take decisions at the general meeting and the directors implements the decisions taken at the general meeting.

It should be kept in mind that the size and shareholder structure of public companies, both in each Member State and between Member States, vary. There are small public companies which are comparable to typical private companies, but also large (listed) companies with thousands of shareholders. In listed companies there are Member States with dispersed ownership and Member States with concentrated ownership. It is more likely that large shareholders – for example large family owners, foundations or institutional investors – wish to, and are able to, decide on company matters than small private shareholders. Conversely, the shareholders in companies with dispersed ownership cannot run the company. This fact has led to a stronger position of the board, for example in Germany and the UK.

In Member States where the competence of the general meeting is not restricted it is possible for the shareholders to be active – if they wish. However, following the experience from the financial crisis and the intentions behind the amended Shareholder Rights Directive, it seems necessary to decide by law that more decisions should be made by the general meeting and, in general, make it possible for the individual companies, by means of provisions in the articles of association, to enhance the competence of the general meeting.

It may be useful, or necessary, to decide by law that more decisions should be made by the general meeting. An example is the “say on pay” discussion. Article 9a in the amended Shareholder Rights Directive introduces a European “say on pay” provision. Such a provision seems necessary in Member States where the competence of the general meeting is limited according to Section 1(2), but is also appropriate even if the competence of the general meeting in principle is unlimited.

The EMCA Chapter 8 imposes upon the directors a right as well as a duty to run the company’s business. A number of provisions in the EMCA, however, demand the approval of shareholders regarding important issues, such as capital changes, changes of a company’s structure by mergers and divisions, the purchase of own shares etc. Further, the articles of associations always may demand shareholder approval for specific decisions. Moreover, the directors prepare the agenda of the general meeting and directors may call extraordinary general meetings. Therefore, the directors always have the possibility to ask for the shareholders’ consent regarding any decisions. Since the directors may be dismissed without cause – see EMCA Chapter 8, Sections 6 and 14 – the board will not seek to exercise a power contrary to the wishes of the majority of shareholders.

There is a wide acceptance in Europe that the company has other stakeholders than shareholders. The EMCA does not take the view that the interests of other stakeholders should not be considered by the company, quite to the contrary (See Chapter 9, Section 9.04 *Duty of loyalty*). However, it is (only) for the general meeting to decide on the company's fundamental business profile – including the balance between a stakeholder or a shareholder value orientation.

*Section 11.02*

**Taking Shareholders' Resolution**

- (1) Shareholders may decide matters, without complying with the rules governing the conduct of general meetings, provided all shareholders agree.
- (2) This rule does not apply to companies whose shares are traded on regulated or alternative markets.

*Comments*

Section 2(1) allows “general meetings” without being physically present, e.g. in the way that the company's lawyer sends out a written paper about the decisions which is signed by all shareholders. If all shareholders are present they may also decide to deviate from the rules on form and notice regarding decisions at the general meeting.

Section 2(1) also permits general meetings, where all shareholders are present or agree, to take decisions on matters which are not on the agenda of the general meeting. Under same condition a “written general meeting” or a meeting by use of conference call is allowed.

The need to depart from formal general meetings or other formal requirements is especially acute in private companies. In the UK Companies Act 2006 Section 336 the default rule is that private companies are not required to hold an annual general meeting unless such requirement is included in the articles. The EMCA acknowledges the need for simplification of the decision process in private companies but considers that it should also be possible for public companies (which could have an owner structure similar to private companies) to deviate from the mandatory rules on form and notice regarding general meetings.

Section 2(1) applies also to one-shareholder companies. In such companies the shareholders exercise the powers otherwise preserved to the general meeting, cf. Article 4(1) of the 12<sup>th</sup> Company Law Directive. According to Article 4(2) of the Directive the decisions which are made by the sole shareholder must be recorded in minutes or drawn up in writing; see below in Section 22.

Section 2(1) is in line with the thinking behind the Companies Acts of a number of Member States; for example, Section 76 of the Danish Companies Act and Section 121(6) of the German AktG and the UK COMPANIES ACT2006 Section 336.

Section 2(1) applies to private as well as to public companies, however not to companies whose shares are admitted for trading at a regulated or alternative market. For the latter it is important for the shareholders as well as for the market that formal general meetings are conducted. The reason for the provision in Section 2(2) is, among other things, that the rules concerning public companies which have shares traded on a regulated market are based on absolute Directive requirements, for example in Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies. A similar rule is found in the UK Companies Act 2006 Section 336. In some Member States (e.g. Denmark) it is also stated that deviation from the requirements to hold general meetings are not allowed for companies where the press has access. In Denmark this is the case for traded companies.

*Section 11.03*

**Provision on Single Member Companies**

- (1) A sole member shall exercise the powers of the general meeting of the company.
- (2) Decisions taken by the sole member in the field referred to in Section 3(1) shall be recorded in minutes or in drawn up in writing.

*Comments*

Section 3 implements Directive 2009/102/EC (the former 12<sup>th</sup> Council Company Law Directive 89/667/EEC) Article 4.

*Section 11.04*

**The Place of General Meeting**

Unless otherwise provided in the articles of association, the general meeting shall take place at the company's registered office.

*Comments*

The general meeting must be held in the locality in which the company has its registered office, which is specified in the articles of association.

The articles of association may, however, provide that the general meetings may or must be held elsewhere in the Member State than where the company has its registered office. The articles may also stipulate that the general meeting may be held abroad. Certain requirements apply regarding how the place of the general meeting should be specified. It is for example not enough to state in "country X", whereas a statement of the country and a particular municipality meets the requirement.

The general meeting must be held at such a place that interested shareholders are able to attend in person or through proxy without any great difficulty.

It is also possible to arrange the general meeting so that certain shareholders participate from a distance, e.g. via a TV link from premises designated by the company or via the Internet, see also Section 5.

It follows from Section 1 above that the general meeting can take place at any location, if all shareholders agree.

In some Member States the Companies Acts include a provision according to which the general meeting under certain circumstances in isolated cases may be held elsewhere, see for example the Danish Companies Act Section 87 and the Swedish Companies Act Chapter 7, Section 15. Such circumstances refer to traditional force majeure situations, such as natural disasters, outbreak of war etc. The Group is of the opinion that an exception from the mentioned extraordinary circumstances follows from ordinary principles in civil law and therefore a special exception is not needed to be specified in Section 3. However, if the board decides to move the general meeting to another place, the courts may examine whether this decision is justified.

Some Member States are even more flexible. For instance, in the Netherlands, the articles of association in a Flex BV may explicitly state a place outside the Netherlands.

*Section 11.05*

**Electronic Participation**

(1) The management board or the board of directors may decide that the shareholders, in addition to or instead of the right to attend a general meeting physically, may exercise all or some rights in the general meeting using electronic means of communication. The notice of the general meeting shall explain in sufficient detail the manner of exercising shareholders rights in the meeting and the conduct thereof.

(2) The articles of association may provide for general meetings to be held by electronic means only.

(3) The articles of association must specify the conditions for taking part in the general meeting by electronic means.

*Comments*

The chairman of the general meeting shall assure effective exercise of the shareholders rights and the possibility of verification of the shareholders exercising their rights, as well as the results of the votes cast.

Section 5 allows “general meetings” without being physical present. Section 5 is in line with Article 8 of the Shareholder Rights Directive, allowing Member States to permit companies to offer to their shareholders any form of participation in the general meeting by electronic means, and generally the efforts engage shareholders in the general meeting’s decision process. This is especially important regarding the growing number of international investors. The provision of the Directive is compelling. However, Section 5 goes further, allowing completely electronic meetings, see below. The articles of association may provide for a right for minority shareholders to request a physical meeting.

Electronic participation is especially useful in large companies, mostly traded companies, but the Group considers that all companies should be allowed to make use of electronic general meetings.

Especially in (small) companies with few shareholders “written general meetings” (*résolutions circulaires*) is often used. Written general meetings are allowed in the EMCA according to Section 2 above.

Most Member States allow electronic participation general meetings, see for example Germany (Section 118 AktG), the UK (Companies Act 2006 Section 360a and Model Articles for private companies Article 37 and for public companies art 29, respectively), Spain (Companies Act Section 182) and Denmark (Companies Act Section 77). The Danish Companies Act goes further, allowing completely electronic general meetings.

According to Section 5(1) any or all of the following forms of participation should be available:

- real-time transmission of the general meeting.
- real-time two-way communication from another place.
- a mechanism for casting votes without appointing a proxy holder who is physically present at the meeting.
- a general meeting without any physical presence (completely electronic general meeting).

Section 5 solely dispenses with the way whereupon general meetings are being held. The remaining provisions regarding the shareholders’ right to participate in, vote and ask questions at the general meeting also apply in case of electronic general meetings with the deviations which are necessary given the use of electronic means.

#### *Section 11.06*

### **Rights of Shareholders at General Meeting**

(1) All shareholders may participate at the general meeting and make use of their rights according to the provisions of this Chapter.

(2) The articles of association may provide that holders of designated security interests in the shares may be entitled to exercise all or some shareholder rights at the general meeting.

(3) A shareholder may vote all of his shares, unless otherwise specified in this Act or the articles of association.

#### *Comments*

Chapter 11 of the EMCA gives shareholders some fundamental rights.

Section 6(1) secures that all shareholders may participate in general meetings. This includes the right to speak, to vote, to make proposals, and to ask questions etc.

*Section 11.07*

**Proxies**

- (1) A shareholder may exercise his rights at general meeting by proxy.
- (2) The proxy document shall be executed in writing and dated under the sanction of nullity. Proxy appointments may be revoked at any time.
- (3) The articles of association may limit the number of proxies appointed by a shareholder.
- (4) The articles of association of a public company may not prescribe that the management board may collect proxies, except pursuant to the requirements of Subsection (8). Members of the board may not be appointed as proxies.
- (5) Where a proxy holder holds proxies from several shareholders, the proxy holder may cast votes for a certain shareholder differently from votes cast for another shareholder.
- (6) Proxies providing that a shareholder shall vote in accordance with instructions of the management board or supervisory board of a company shall be null and void.
- (7) In public companies whose shares are admitted to trading at the regulated or multilateral trading facilities the management board may, in connection with a notice to attend the general meeting, provide the shareholders with a proxy form. The form shall contain instructions as to the exercise of the shareholder's right to vote, and as to how to revoke the proxy, as well as the alternative answers "Yes", "No" and "Abstention from voting". The form shall state that the shareholder may not instruct the proxy in any manner other than by marking one of the stated answer alternatives and that the answer may not be conditional.
- (8) A public company whose shares are admitted to trading on a regulated market or on an alternative market shall make hard copy or electronic proxy forms available to all shareholders entitled to vote at a general meeting and shall offer the shareholders at least one method of notifying the company of electronic proxy appointments. The appointment of a proxy, the notice of the appointment to the public company, and the issue of the voting instructions to the proxy may only be made subject to such formal requirements as are necessary and reasonable for the purpose of identifying the shareholder and the proxy, as well as verifying the contents of the voting instructions. This also applies to the revocation of proxy appointments.

*Comments*

Article 10 of the Shareholder Rights Directive states in Subparagraph 1 that every shareholder shall have the right to appoint any natural or legal person as a proxy holder to attend and vote at a general meeting in his name. The proxy holder shall enjoy the same rights to speak and ask questions in the general meeting, as those to which the shareholder thus represented would be entitled. Article 11 of the Directive includes formalities applying to proxy holder's appointment and notification. The Shareholder Rights Directive only applies to companies with shares traded on a regulated market.

The Transparency Directive (2004/109/EC) contains rules on proxies regarding companies with shares traded on a regulated market.

Most of the rules of the Shareholder Rights Directive should also apply in private companies and non-listed public companies. However, Section 7 contains provisions which only apply to publicly traded companies.

Most Member States' Companies Acts have provisions on proxies or at least acknowledge the use of proxies at general meetings. Supplementary rules on proxies are common in the national corporate governance codes for traded companies. The practical use of proxies and the need for special regulation is most obvious in traded companies.

Proxy may be given to other shareholders or other persons, without specific requirements. Special problems arise when large financial shareholders (institutional investors) make use of so-called proxy advisors – banks, credit institutions or other professionals to vote for them. The German AktG § 135 has a comprehensive provision which regulate the exercise of voting by credit institutions and professional agents. The Greek Companies Act Article 30b has a short provision allowing banks to vote shares not owned by them if they are authorized to do so in writing. The authorization is freely revocable and may not be given for a period exceeding 15 months. Most Member States have no provisions on this issue in their Companies Acts.

The Commission's Action Plan (2012) point 3.3. mentions the problems regarding proxy advisors. The amended Shareholder Rights Directive, Article 3i contains a provision on transparency of proxy advisors according to which Member States shall ensure that proxy advisors adapt and guarantee that their voting recommendations are accurate and reliable.

The EMCA Group has decided not to formulate provisions on proxy advisors – at least not for the moment.

The chairman of the general meeting, according to Section 21, has the duty and right to examine the proxy document and to decide whether the proxy document is void. The chairman's decisions can be challenged before court.

A time limit for proxies may be included in the articles of association. The EMCA Group considers that there should not be a mandatory time limit because there are a number of situations where non-limited proxies (e.g. for shareholder associations) are needed.

Section 7(4) shall ensure that the use of proxy is not misused by the management, especially in large companies with many shareholders. Section 7(3) and other sub-paragraphs of this Section shall ensure that the proxy is used in the interests of the represented shareholder. There is an international debate about misuse of proxies. Especially, there is critique on a widespread practice where directors collect proxies in order to establish the necessary majority for resolutions which may be in the interest of the board members. The preliminary guarantee against such misuse is the possibility to revoke the proxy at any time, cf. paragraph 2. However, in some Member States there are further restrictions regarding proxies to the board. Thus, for example, according to the Swedish Companies Act Chapter 7, Section 4, the company may not collect proxies. In the former Danish Companies Act § 80(4) proxies to the board had a time limit of 12 months and only for the purpose of a specific general meeting for which the agenda is known in advance. The latter entails that the management could not be authorized to vote on proposals which are unknown for the shareholder and which can go against the interests of the shareholder. The Danish rule implemented the article 10 (2) 1. sentence of the Shareholder Rights Directive. The provision of the Directive is optional. The provision did not work well in practice and was repealed in 2013.

Section 7(4) is inspired by the Swedish Companies Act 7 Chapter 4 §. The Polish COMMERCIAL COMPANIES CODE Article 412 § 3 forbids a member of the management board to serve as proxies. Also the Czech Commercial Code Section 184 forbids the management board or the supervisory board to represent a shareholder.

Re Section 7(5): A proxy may represent more shareholders. Section 7(5) ensures that the proxy may vote in the interests and according to the instructions of different shareholders. Section 7(5) implements the Shareholder Rights Directive, Article 10(5).

Section 7(6) is inspired by the UK Companies Act Section 324A.

Section 7(7) and 7(8) follow from the Transparency Directive Article 17(2)(b) and the Shareholder Rights Directive, Articles 10 and 11. The Shareholder Rights Directive, as mentioned, only applies to companies with shares traded on a regulated market. However, the EMCA Group considers that there is a similar need for providing the shareholders of companies with shares on an alternative market with a proxy form. It is important to be able to establish the result of the voting. Thus, in many situations it is useful for the shareholders to know if a resolution has been passed with a large or small majority. As indicated by the UK listing rules, the EMCA Group considers it best practice that the three alternatives “yes”, “no” and “abstention from voting” are included in the proxy form.

*Section 11.08*

**Advisors**

A shareholder and proxy may attend the general meeting together with one or two advisors. The advisor(s) may speak on behalf of the shareholder on the general meeting.

*Comments*

There are no EU rules on advisors. A number of Member States' Companies Acts allow shareholders to attend the general meeting together with advisor(s). This is for example the case in the Danish Companies Act Section 81 and the Swedish Companies Act Chapter 7, Section 5. In other Member States, such as France, this is accepted practice subject to the discretion of the secretarial board of the meeting, which includes usually the chair of the board of directors.

Probably the use of advisors is most needed in public companies but the Group considers that the use of advisors should also be allowed in private companies. This is the case according to the Nordic Companies Acts.

The advisor(s) may speak on behalf of the shareholder at the general meeting. The Group considers that a shareholder should only be allowed to attend the meeting with one or two advisors. The Swedish Companies Act, for example, allows two advisors, the Danish Companies Act only one.

The presence of many advisors should be avoided. One financial and one legal advisor should be sufficient.

*Section 11.09*

**Formalities of Attendance at General Meeting**

(1) Shareholders, who are registered in the company's registry of shareholders or who can prove their rights as shareholders, may attend the general meeting.

The title of the shareholder shall be determined on the basis of the company register of shares or any notice of ownership received by the company for the purpose of registration of a shareholder for the meeting.

(2) In public companies the articles of association may provide that attendance at the general meeting or the exercise of voting rights shall require shareholders giving notice to the company of their attendance or voting not later than six days before the meeting.

If a notice of attendance is required, the company shall prepare and make available to the shareholders a list of shareholders entitled to participate in the meeting.

(3) In public companies whose shares are admitted to trading on a regulated or a multilateral trading facility, a shareholder's right to participate at general meeting applies to the shares held by that shareholder on the seventh day before the meeting (the record date).

*Comments*

Section 9(2) corresponds to the Danish Companies Act Section 84 (three days), the German AktG § 123(2) (maximum 6 days), the Lithuanian Companies Act Article 21 Part 1 (five days), the Polish COMMERCIAL COMPANIES CODE Article 406 (one week), and the Swedish Companies Act Chapter 7, Section 2 (no later than the day stated in the notice to the general meeting). The UK Companies Act Section 307(1) and (2) demands a notice between 14 and 21 days. The German AktG § 123 demands 30 days. The purpose of the rule is to give the company sufficient time to organize the general meeting. Therefore, the company may shorten the time limit.

The Group considers that the requirements for notifying the company are for practical reasons, thus making it possible for the company to take care of the practical organizing of the general meeting. Therefore, the time limit should be short, however, it should not deny shareholders the possibility of attending the general meeting. Paragraph 2 applies to all companies, including traded companies, cf. paragraph 3.

The purpose of Section 9(2) is to avoid coups giving the board information on the shareholders who will attend the general meeting. If a shareholder does not notify the company of his attendance, the chairman of the general meeting should not allow him to attend and vote.

Section 9(3) is based on Article 7(3) of the Shareholder Rights Directive. The Directive introduces a special provision on “a single record date”, which is pivotal for the shareholder’s right to attend and vote on the general meeting. Article 7(3) applies only to companies with share traded on a regulated market, but the Group is of the opinion that a similar rule should apply to companies with shares traded on multilateral trading facilities. According to the Directive, the record date shall not lie more than 30 days before the date of the general meeting to which it applies. The Group considers that the time limit should be less than 30 days before the general meeting. Thus, for example, the Greek Companies Act states a time limit of 5 days, the Swedish Companies Act also 5 days, the German AktG has a time limit of 21 days and the Danish Companies Act Section 84 contains a time limit of 7 days.

The Group is of the opinion that record date should be close to the date of the general meeting, in order that the meeting reflects as much as possible the actual shareholder structures, and hence the Group has chosen 7 days.

#### *Section 11.10*

### **Company’s Own Shares**

- (1) The company is not allowed to vote its own shares or shares in a parent company held by a subsidiary.
- (2) Own shares are excluded for the purpose of determining the quorum or a majority of votes.

#### *Comments*

Re 1) The Shareholder Rights Directive contains no provisions on whether the company can vote on its own shares. Following the Companies Acts in most Member States, Section 10 does not allow the company to vote on its own shares, for example the Danish Companies Act Section 85, the French Commercial Code Article L. 233-31, the German AktG § 71b, the Lithuanian Companies Act Article 54 Part 7 and the Swedish Companies Act Chapter 7, Section 7.

According to Article 22 (1) (a) of the Second Company Directive, the voting rights for own shares must be suspended. In line with the general provisions on own shares in the EMCA Chapter 7, Section 10 (1) also applies regarding the shares in the parent company owned by the subsidiary.

Re 2) The company’s own shares cause problems in proportion to other provisions concerning general meeting decisions. For example, this applies to decisions regarding amendments to the articles of association, the exercise of minority rights, mergers and divisions, appointment of liquidators, auditors and scrutinizers, and derivative suits. Section 9 (2) supplements the provision in Section 10(1) by providing that own shares are not included in the mentioned situations.

Section 10(2) corresponds with the provisions in the Danish Companies Act Section 85 and the Swedish Companies Act Chapter 7, Section 7.

#### *Section 11.11*

### **Conflicts of Interest**

- (1) The shareholder or proxy must not take part in a vote relating to his liability to the company, including a resolution on the discharge of his duties.
- (2) Paragraph (1) applies also to a situation when the vote relates to the liability of another person if the shareholder has a material interest in the matter which may conflict with the interest of the company.

*Comments*

Section 11 is not based on EU regulation, as there are no EU rules on shareholders' conflicts of interest. Provisions on shareholders' conflict of interest are found in most Member States, for example Denmark, Finland, Germany, Poland and Sweden. Other Member States, for example the Czech Republic, have no special provisions on shareholders' conflicts of interest.

A shareholder does not have the same duty of care and loyalty to the company as members of the management. Moreover, shareholders are not obliged to act positively in the company's interest or to concern themselves at all with the company's affairs. If a shareholder participates at a general meeting, he or she is able to advance his or her own interests without thereby becoming liable to the company or any third party. However, this does not imply that a shareholder has absolute freedom with regard to satisfying personal interests at the expense of the company or other third parties. Especially Section 31 (the general clause) of this Chapter provides a basis for making a claim in tort against shareholders for losses which they have inflicted upon the company, other shareholders or creditors through intentional or grossly negligent acts.

Shareholders have no duty of loyalty when they vote at the general meeting. In certain situations such as when parent companies vote on the subsidiary's general meeting or when parent companies just decide on the subsidiary's affairs, it is assumed that the parent company may have a duty of loyalty, see further below in Chapter 15 on groups. According to case law in some Member States, especially Germany, a duty of loyalty may also exist regarding major shareholders' voting. Apart from that, shareholders are generally able to vote in their own interest. The only exception from this is when the general meeting has to decide on whether the company should discharge or sue a shareholder. If board members are also shareholders, they may not, in their position as shareholders, vote regarding discharge or liability of the board members. Similar rules are for example found in the Danish Companies Act Section 86 and the German AktG Section 136.

Section 11 reflects that there is a difference between the duties of the board and the duties of the shareholders. Board members have a duty of loyalty which is reflected in the provisions on conflict of interests in Chapter 9 of the EMCA.

Chapter 9, Part 2, on board members' conflicts of interest exclude board members from taking decisions, also with respect to agreements in which the board members have an interest. If, in such cases, the decision is moved to the general meeting, a board member who is also a shareholder may vote. Misuse of the board members' votes may however be a violation of the provisions on minority protection, especially Section 31.

*Section 11.12*

**Ordinary and Extraordinary General Meetings**

- (1) The ordinary general meeting shall be held once a year not later than six months after the end of each financial year.
- (2) The agenda of the ordinary meeting shall include at least the following resolutions:
  - (a) approval of the annual statement of accounts, as required by the national regulations,
  - (b) allocation of profit and/or losses,
  - (c) discharge of duties by members of the board of directors/management board and supervisory board,
  - (d) any other matter prescribed by the articles of association or proposed by the shareholders in accordance with Section 13.
- (3) The annual general meeting must be held in time for the adopted annual report to reach the Registrar within the time limit specified in the Financial Statements Act. The annual report must be submitted to the general meeting.

(4) In public companies, an extraordinary general meeting shall be convened upon decision of the board of directors/management board, supervisory board, or upon request of the auditor of the company or shareholders representing at least 5 % of the share capital or any smaller fraction of the capital as prescribed by the articles of association.

(5) For private companies, any shareholder can request an extraordinary general meeting. Extraordinary general meetings to consider specific issues must be convened within two weeks of receipt of a request to such effect.

(6) The articles of association may deviate from Section 12(4).

*Comments:*

Regarding 12(3), the general meeting shall be convened and organized by the board of directors/management board. If an extraordinary general meeting according to Section 12(3) is not convened, a general meeting may be convened according to Section 15(3).

Regarding 12(4), the articles may decide that shareholders representing less than 5 % of the share capital may call for an extraordinary meeting or that any particular shareholder may request an extraordinary general meeting.

Section 12(4) is inspired by the Danish Companies Act and the Shareholder Rights Directive, Articles 6(1) and 6(2). It should be noted that the percentage varies very much in Member States, e.g. Germany and Poland 10 %, France 5 % and the Netherlands 3 %.

Section 12(5), which deals with private companies, is also inspired by the Danish Companies Act. According to the Danish Companies Act, Section 89(2), any shareholder in private companies may request an extraordinary general meeting. France follows the same approach. Some Member States have a threshold.

If national law sets a threshold of for example 10 % in private companies, Section 12(6) should also refer to Section 12(5). A threshold of 10 % is for example found in Germany, Poland and Sweden. It should be noted that some Member States Companies Acts contain rules which allow private companies to circulate written resolutions and accompanying statements to all shareholders which, using e-mail, is a swift and almost cost-free mechanism which allows the small shareholder to raise issues of concern to him. See for example the UK Companies Act Section 290 and following. See also the Czech Commercial Code, Section 130. According to the EMCA, Section 2 of Chapter 11 above, it is also possible to circulate written resolutions.

Regarding Section 12(6), the articles in public companies may set a threshold lower than 5 % but may not increase the percentage.

*Section 11.13*

**Agenda**

(1) A shareholder shall be entitled to propose specific issues for inclusion on the agenda of the general meeting.

(2) The shareholder request specified in Subsection (1) shall be presented to the board of directors/management board at least six weeks before the date of the pertinent general meeting, unless the articles of association provide otherwise.

(3) Not later than eight weeks before the scheduled date for an annual general meeting, public companies whose shares are admitted to trading on a regulated or alternative market must announce the date of the meeting as well as the deadline for any shareholder request to include specific issues on the agenda, unless both dates are specified in the articles of association.

(4) Any matter which is not on the agenda must not be decided unless all shareholders are present and approve the proposal.

(5) In public companies, the articles of association may provide that the right in subsection 13(1) is conditional on the relevant shareholder or shareholders holding a minimum stake in the company which does not exceed 5 % of the share capital.

#### *Comments*

According to Article 6 of the Shareholder Rights Directive, the shareholders have the right to add items on the agenda of the general meeting and to table resolutions. Article 6 expresses a general principle regarding the shareholder's right. The right to add items to the agenda and to table draft resolutions enables shareholders to decisively influence general meetings.

According to the Shareholder Rights Directive Article 6(4), companies shall ensure that, where the exercise of the right referred to in Section 13(1) entails a modification of the agenda for the general meeting already communicated to shareholders, the company shall make available a revised agenda in the same manner as the previous agenda in advance of the applicable record date.

Section 13(2) entails a deadline, with reference to a specified number of weeks, i.e. at least 6 weeks, prior to the general meeting or the convocation, by which shareholders may exercise the right referred to in Section 13(1). A time limit is necessary so that the board of directors/management board can include the matter in the notice convening the general meeting. The amended agenda and the new resolutions should be circulated to shareholders. This requires that items be added to the agenda and draft resolutions be tabled sufficiently in advance of the general meeting, i.e. at least 6 weeks in advance of the meeting. If the request is received less than six weeks before the date of the general meeting, the board of directors/management board decides whether the request has been made with enough time for the issue to be included in the agenda.

Section 13(4): Matters not on the agenda may not be dealt with. That is an important shareholder protection rule. See for example the similar rule in the the Danish Companies Act § 91(1) ), the Lithuanian Companies Act Article 27 Part 9 and the Polish COMMERCIAL COMPANIES CODE, Articles 239 and 240. However, there can be flexibility. For instance in France, directors can be dismissed during the meeting, even if this resolution was not put on the agenda, for reasons which occur during the meeting (e.g discovery of abuses, of mismanagement..). Case law is very flexible on those reasons.

Section 13(5) states that where any of the rights specified in Section 13(1) is subject to the condition that the relevant shareholder or shareholders hold a minimum stake in the company, such minimum stake shall not exceed 5 % of the share capital. In some Member States there is a minimum threshold for putting items on the agenda; see for example the German AktG § 122(2) (5%). The Shareholder Rights Directive, Article 6(2), allows Member States to have a threshold of 5 % of the capital in listed companies. Other Member States, such as the Nordic countries, have no threshold.

There might be different experience regarding the need to have a threshold. An unlimited right for all shareholders might be abused, for example for political reasons. However, in the Nordic countries there is no negative experience regarding allowing the shareholders to add items to the agenda.

Section 13(5) allows companies to evaluate if there is a need for a threshold.

#### *Section 11.14*

#### **Recessed (Continued) General Meeting**

(1) General meetings may pass a resolution providing for a recess and continuation of its proceedings. The recess shall last no longer than 3 months.

(2) Where a continued general meeting is to be held after more than two weeks, a separate notice to attend the meeting shall be sent pursuant to Section 15.

(3) A minority of shareholders representing at least one tenth of all shares has the right to request a continued general meeting regarding resolutions mentioned in Section 12(2) (a)-(c).

*Comments*

Some national Companies Acts include rules that allow general meetings to postpone issues on the agenda to be discussed at a continued general meeting, e.g. Swedish Companies Act Chapter 7, 14 §. The decision should be made with simple majority.

The continued general meeting is treated as a separate general meeting compared to the original general meeting.

The right for a minority according to Section 14(3) is limited to issues mentioned in Section 12(2) (a)-(c).

*Section 11.15*

**Convocation of a General Meeting**

(1) A general meeting shall be convened and organized by the board of directors/management board. The general meeting must be held at the time indicated in the notice to attend the general meeting.

(2) The articles of association of a company having a two-tier board may provide that the general meeting may be also convened by the supervisory board.

(3) If the board of directors/management board fails to call an extraordinary general meeting within two weeks following a submission of the request made by a shareholder or another person or body authorized under Section 12(3) and 12(4), such person may petition the court or to the national Company Registrar to obtain authorization to convene the general meeting at the company's cost.

*Comments*

Section 15 includes convocations of ordinary and extraordinary general meetings. The provision deals with the practical convocation of a meeting.

It is the duty of the board of directors/management board to convene general meetings, cf. Section 15(1). The duty to organize the general meeting also includes the duty to actually hold the general meeting according to the notice after Section 18.

If national CA allows for two-tier boards, the competence to convene may also be placed with the supervisory body, cf. Section 15(2).

Section 15(3) refers to all costs associated with the planning of the general meeting, convening and organizing the meeting, and including the costs associated with the application to the national company Registrar or the court.

*Section 11.16*

**Time of Notification**

(1) In private companies, notice of a general meeting shall be sent out no later than 4 weeks before the meeting and no earlier than 6 weeks before the meeting. In public companies, notice of a general meeting shall be sent out no later than 3 weeks and no earlier than 6 weeks before the meeting date.

(2) The articles of association of a private company may provide that, at the latest, the notice shall be sent out 2 weeks before the meeting date.

*Comments*

It is important that shareholders receive information about the time of the general meeting. Article 5 of the Shareholder Rights Directive only decides on the latest day of the notification (21 days). The EMCA Group recommends that there should also be a limit on the earliest notification and suggests no earlier than 6 weeks before the meeting and no later than 4 weeks.

Section 16(1) is in line with Article 5(1) of the Shareholders Rights Directive which, however, only applies to companies traded on a regulated market. According to Section 16(2) of the EMCA it applies to all public companies.

The time of notification in private companies is not regulated by EU law. The time varies in national law. For example, in the UK Companies Act Section 207 it is 14 days. Also in the Polish COMMERCIAL COMPANIES CODE, Article 238, the time limit is 2 weeks. This is also the case according to the Danish Companies Act – 2 weeks at the latest and no earlier than 4 weeks before the meeting. In the Swedish Companies Act the time limit is no later than 4 weeks before the meeting (or according to the Articles 2 weeks) and no earlier than 6 weeks before the meeting.

*Section 11.17*

**The Mode of Giving Notice**

- (1) The articles of association may specify the mode of giving notice, except as provided in paragraph 3.
- (2) A shareholder registered in the register of shares shall receive a notice in writing by registered mail or courier, regardless of whether notice is also given by other means, unless the articles of association provide otherwise.
- (3) Regardless of whether notice is given by other means of communication, notice of general meeting for a public company whose shares are admitted on a regulated or an alternative market shall be published on the company's website.

*Comments*

As a starting point, companies may decide how notification shall occur.

The provision on this issue states that this should be specified in the articles of association, cf. Section 16(2). The articles may, for example, specify that notification should be given in different daily newspaper, via IT systems operated by the national companies register, or by notification on the company's homepage. If shareholders are registered in a shareholder registry including their name, notification shall be directly sent out to them, cf. Section 16(2).

Notification on the company's homepage is mandatory for companies whose shares are admitted to trading on a regulated or alternative market, cf. Section 16(3). The articles of association may provide for a similar provision in public non-listed companies as well as in private companies.

If shareholders do not receive a notice according to Section 17 – or to Sections 16, 18 and 19 - the general meeting may be void; see below in Section 27.

*Section 11.18*

**The Content of Notice**

- (1) A notice to attend the general meeting shall specify the following information:
  - (a) The time and place of the meeting;
  - (b) the agenda; a proposal to amend the articles of association shall specify the text of the proposed alteration;
  - (c) description of the procedures of attendance at the meeting, in particular, the record date and the date of registration pursuant to Section 9(3);
  - (d) where and how documents specified in Section 19 can be obtained or are available;
  - (e) the procedure of voting by proxy, particularly the voting by proxy;
  - (f) the procedures for voting by post or electronically, if applicable.
- (2) The articles of association of a private company may waive or modify the requirements set forth in Subsection (1), other than items (a)-(b).

*Comments*

Section 18 is in line with Article 5(3) of the Shareholders Rights Directive. In the EMCA, however, Section 18 applies as a starting point to all companies but it is possible to opt out of these requirements, cf. Section 18(2)

The notice must state the time and place for the meeting and must contain the basic information relating to the meeting. The notice must also contain a proposed agenda which states the business to be addressed at the meeting.

If amendments to the articles of association are proposed the new wording must be stated in the notice. However, a reproduction of the full proposed wording is not to be given, which would be both expensive and cumbersome. In that case the proposed wording must be accessible to the shareholders from the time of convening and to be sent, free of charge, to any shareholder on simple request to such effect, cf. Section 19(1) and 19(3).

*Section 11.19*

**Provision of Documents prior to the General Meeting**

(1) In public companies, the agenda, the full text of any proposal and all documents to be submitted to the general meeting, shall be available for shareholders inspection at least three weeks prior to the date of the meeting. In companies with shares traded on a regulated market or an alternative market, all documents shall be available on the company's website.

(2) In companies with shares traded on a regulated market or an alternative market, the company shall make available to its shareholders the total number of shares and voting rights at the date of convocation.

(3) Public companies shall make available to its shareholders the draft resolution, or when no resolution is proposed to be adopted, a comment from the competent body of the company, for each item on the proposed agenda of the general meeting.

*Comments*

Section 19 is inspired by the Shareholder Rights Directive Article 5(4), but to some extent the provisions should also apply to public companies which are not traded on a regulated market.

The company shall indicate where and how the documents and information in Section 19 may be obtained. If information is made available on the company's website, the internet address must be indicated.

*Section 11.20*

**Language**

The language of the proceedings of the general meeting and of documents should be specified by the articles of association.

*Comments*

In large companies there are a growing number of international shareholders. Therefore there is a need to allow such companies to use another language than the official language of the Member State in question.

Some Member States have already provisions regarding the choice of language at the general meeting and of documents which have to be presented at the general meeting, see for example the Danish Companies Act §§ 100 (general meeting) and 100 a (annual accounts). There are not EU provisions on language.

The articles of association may include conditions for using other languages than the national language, for example that the company offers all shareholders simultaneous interpretations to and from the national language or that it is only allowed to change to certain other languages, cf. the Danish Companies Act § 100.

The possibility to change language may be misused by the majority of shareholders. However, changes in the articles of association require supermajority according to Section 29 below. In case of severe misuse, the general clause in Section 32 may apply.

*Section 11.21*

**Opening of the General Meeting and Election of Chairman**

- (1) The general meeting shall be opened by the chairman of the board of directors and, in a two-tier board company, by the chairman of the supervisory board. In the absence of the chairman, the general meeting shall be opened by a member of the board of directors/management board. The person opening the meeting shall preside over the election of the chairman of the general meeting.
- (2) A chairman of the general meeting shall be elected by a simple majority of votes cast, unless otherwise provided by the articles of association.
- (3) The chairman of the meeting shall ensure that it is conducted fairly and efficiently. The chairman shall have powers for that purpose, including the right to manage discussions, to order voting and announce their results, to bring speeches to an end and, if necessary, to expel a participant from the meeting. He may not change the agenda or adjourn the meeting, except for a short recess.
- (4) A shareholder may challenge a decision of the chairman by requesting an immediate vote by the general meeting.

*Comments*

There are no EU provisions on election of the chairman or the chairman's role. However, such provisions are found in the Companies Acts of almost all Member States.

The chairman plays an important role. He conducts the general meeting and takes all necessary decisions, legally as well as practically.

The chairman may be a shareholder or another person (see for example the Danish Companies Act § 101 and the Swedish Companies Act Chapter 30 Section 7, but contrast the Polish COMMERCIAL COMPANIES CODE Act 409 § 1). The articles of association may decide who should be the chairman, for example that the chairman should be appointed by the board or is a member of the board. However, the chairman must act in a neutral and fair way. Therefore, it may be inappropriate to choose the company's lawyer as a chairman. It should also be taken into consideration that members of the management board or supervisory board may have conflicts of interest chairing the general meeting.

If the articles decide who should be the chairman, he may be dismissed by supermajority according to Section 28 below. Otherwise he can be dismissed by simple majority.

*Section 11.22*

**Minutes of the General Meeting**

- (1) The minutes of the general meeting shall record the date and place of the meeting, as well as any resolutions adopted during the meeting. The minutes shall specify all votes "for" and "against" the resolution, as well as abstentions, if any.
- (2) The articles of association may provide that the minutes shall also include a summary of the discussion.
- (3) The minutes shall be signed by the keeper of the minutes and the chairman.
- (4) The company shall keep the book of general meeting minutes. The minutes shall be available to the shareholders not later than a week after the meeting.

(5) Companies whose shares are admitted to trading on a regulated market must, for every resolution passed, specify at least:

- (a) the number of shares for which valid votes have been cast
- (b) the proportion of the share capital represented by such votes
- (c) the total number of valid votes.

(6) The company must announce the results of all votes not later than one week after the general meeting.

#### *Comments*

It is urgent that all resolutions adopted during the meeting are kept and are available to the shareholders via the minutes.

According to Section 22(3) the minutes must be signed by the chairman. In some Member States, however, the minute must be signed by a notary, see for example the Polish COMMERCIAL COMPANIES CODE Act 421 and the German AktG § 130.

Section 22 applies also to one-man companies, see for example the German GmbHG § 48.

Section 22(5) implements the Shareholder Rights Directive Article 14 regarding companies with shares on a regulated market.

Contrast, for example, the Danish Companies Act § 101(6) and the German AktG § 130(2) Section 22 does not implement the exception in the Directive Article 14(1).

#### *Section 11.23*

#### **Shareholders' Right to Information**

(1) Upon request from a shareholder and when deemed by the board of directors/the management board not to cause material damage to the company or, be contrary to law, the company's board shall disclose to the general meeting the pertinent information at the meeting in respect of any circumstances which may affect the evaluation of a matter on the agenda.

(2) If the answer to a request requires information that is not at hand at the general meeting, such information shall be made available to the shareholders no later than two weeks after the meeting. A public company, whose shares are admitted to trading on a regulated market or an alternative market, shall publish such information on its website. Questions will be deemed to be answered if the relevant information is made available on the company's website in the form of a 'Question and Answer' feature.

(3) For public companies whose shares are admitted to trading on a regulated market or an alternative market, the disclosure requirements under Subsections (1) and (2) also apply to questions regarding any circumstances which may affect the assessment of the company's financial situation. Such questions shall be submitted to the company at least two weeks before the date of the general meeting.

(4) If the company refuses to provide information pursuant to Subsections (1)-(3), the shareholder has the right to petition the court. If the court establishes that there are no reasonable grounds to refuse information, it shall order the company to provide the requested information.

(5) In a company which belongs to a group, the duty to provide information shall also apply to the company's relationship to other group companies. Where the company is a parent company or controls other company/ies directly or indirectly, the duty to provide information shall also apply to the group accounts and such circumstance regarding subsidiaries as specified in Subsection (1).

#### *Comments*

Article 9 of the Shareholder Rights Directive provides every shareholder with the right to ask questions related to items on the agenda of the general meeting. The Directive does not contain any limitations regarding the right to ask questions.

Shareholders can hardly exercise their rights to vote and bring derivative suits in a proper way unless they have adequate information about their company. It is thus important that shareholders have effective means to actively exercise influence over the company. Shareholders focus on wealth creation and are also qualified to oversee the management not only on their own behalf, but even on behalf of other stakeholders. However, shareholders incentives to be active depend on the costs and difficulties attached to exercising influence. The more costly and burdensome it is to act, the less likely shareholders are to exercise influence.

Section 23(1) provides that the board of directors/management board must provide the requested information if this can take place without material harm to the company. However, the board needs not to disclose information which results in the company's trade secrets being revealed to outside parties, in competing interests being promoted, or in the company otherwise being materially harmed. This is in line with Article 9(2) of the Shareholder Rights Directive which gives the board of directors/management board a (high) degree of discretion if they do not want to answer by referring to the very broad terms "protection of confidentiality or business interests".

If the board of directors/management board believes that the requested information cannot be disclosed without material harm to the company, the shareholder who requested the information must be notified immediately.

Section 23(2) is in line with the initiatives taken on EU level, which include the improvement of access to information. The Transparency Directive (2004/109/EC) enhances that information to be made available about issuers whose shares are admitted to trading on a regulated market. The directive requires that shareholders of listed companies should be provided with electronic facilities to access the relevant information in advance of general meetings (Article 13). This includes also the shareholders' right to receive timely access to information when securities are listed in another Member State than the home Member State (Article 17).

Shareholders are supposed to be fully informed before they participate at the general meeting, and should also be allowed to ask questions at the general meeting or even before.

The requirements to make use of the right to ask questions differ between Member States. There is generally a danger that shareholders may misuse the right to ask questions and receive information on company matters. Therefore, most national Companies Acts include certain limitations on the right to ask questions and impose conditions on the exercise of this right. Whereas some states require that questions must be submitted in writing in advance of the meeting, other states provide that questions can only be asked orally at the meeting itself.

Section 23(4) provides for a mean for the shareholders to enforce their rights. On a European level it is questioned whether the right to ask questions is in principle unlimited because it is argued that it can be misused by shareholders to harm the company. At least in the Nordic countries the unlimited right to ask questions has worked well so far, but national law may consider that there is a risk that shareholders misuse this right. The issue is often dealt with by case law. For instance, French case law considers that this right cannot be used as a bargaining tool in an attempt to force the company or another shareholder to buy out the requesting shareholder. In Germany, the Supreme Court held that a large list of precise questions asked by a shareholder in relation with the discharge to the management and supervisory board had to be justified by a need to provide valuable information for the vote.

Section 33 on special investigation may also be used as a tool to force the company to answer questions.

The remedies available to a shareholder who does not receive the information requested are very much dependent upon the judicial system of each country (court order to provide information – fine – damages etc.). Therefore, EMCA abstains from prescribing other sanctions.

*Section 11.24*

**Shareholders' Right of Access to Company Documents**

(1) In addition to the provisions set forth in Section 23, each shareholder in a private company shall be afforded an opportunity to review accounts and company documents and ask questions to the extent necessary for the shareholder to be able to assess the company's financial position or a particular matter. The shareholder may act through a proxy or an assistant.

(2) The board directors/management board may refuse to disclose a document, or provide information where it would result in violation of law or material damage to the company.

*Comments*

Section 24 supplements the right to information according to Section 23. Section 24 is inspired by the Swedish Companies Act Chapter 7 Section 36, which, however is limited to companies with less than ten shareholders. Section 24 applies to all private companies.

*Section 11.25*

**Voting at the General Meeting**

(1) Each shareholder must vote on his/her share in aggregate, unless otherwise provided by the articles of association.

(2) For public companies, where a shareholder acts in a professional capacity on behalf of other national or legal persons (clients), that shareholder will be entitled to distinguish between the different shares and exercise the voting rights attached to different shares in different ways.

(3) Shareholders may vote by post casting their votes in writing. Written votes can only be subject to requirements and restrictions that are reasonable necessary to ensure identification of the shareholders. For companies, which do not have shares admitted to trading on a regulated market, this option of postal voting may be excluded by the articles of association.

*Comments*

Section 25(2) is a special rule on proxies. It may cause problems in practice if shareholders are able to cast different votes, using some of their shares to vote one way, and other shares to vote in the opposite way. However, companies need to consider if such problems are likely to arise. Section 25(2) applies for example on banks which may vote on behalf of a number of shareholders. Section 25(2) corresponds with Section 7(5) on proxies. Section 25(2) does not include private companies. In private companies, it is up to the shareholders to decide whether such a rule is necessary.

Section 25(3) implements the Shareholder Right Directive Article 12, but applies also to companies whose shares are not traded on a regulated market, unless otherwise provided in the articles of association.

If the articles of association so provide, shareholders may also vote by electronic means, cf. Section 4.

*Section 11.26*

**Decisions Taken by Simple Majority**

Unless otherwise provided by this Act or the articles of association, all decisions taken at the General Meeting must be decided by a simple majority of the votes cast. Where votes involve the electing of people or the casting of only one vote against several options, these votes must be decided by a relative simple majority of votes. If a vote involving the election of people, results in a tie, the tie must be decided by lot, unless otherwise provided by the articles of association.

*Comments*

The EMCA follows the “majority principle“, i.e. majority of the votes cast. The simple majority is calculated on shareholders present and represented. There is no need for a quorum. If the number of votes for and against is the same the proposed resolution will not be passed. Simple majority means that there are more votes for than against a proposed resolution.

In cases where the vote concerns a resolution with more than two options, the vote must be decided by relative simple majority, i.e. the option with the most votes is passed. In case of a tie between the options, the resolution will be defeated. However, when the vote is on electing people, e.g. for the board of directors, a decision must be taken. Therefore, Section 26 prescribes that the tie must be decided by lot, unless otherwise provided by the articles of association.

Normally votes are open, but the EMCA Group agree that a secret vote shall be ordered when it is requested by a shareholder present or represented at the general meeting. This is explicitly said in the Polish Commercial Companies Code, Article 430

*Section 11.27*

**Provision on Very Important Decisions**

(1) Resolutions of the board of directors or management board leading to major changes in the identity or the character of the company or its enterprise, requires the approval of the general meeting, including but not limited to:

(a) a transfer of the enterprise to a third party,

(b) the start or termination by the company or its subsidiary of a long-lasting alliance with another legal person or of a commercial partnership, if such start or termination is of fundamental importance to the company.

(c) the acquisition or disposal of a participating interest in the capital of another legal person equalling at least one third of the assets according to the company’s balance sheet with explanatory notes or, in case of its consolidated balance sheet, according to its consolidated balance sheet with explanatory notes, on the basis of the last adopted annual accounts of the company.

(2) The absence of the general meeting’s approval on a resolution as referred to in paragraph (1), does not affect the authority of the board of directors/the directors to represent the company.

*Comments*

Special resolutions must be passed by a qualified majority of the votes cast at the shareholders’ meeting according to a number of provisions in the various Chapters of the EMCA.

A special majority is only required if it is stated in statute or it is in the company’s articles. If there is no specific demand of a qualified majority, the presumption is that an ordinary majority is sufficient.

Examples of resolutions which must be approved by qualified majority are:

- Alteration to the Memorandum or Articles of Association.
- Reduction of capital.
- Variations of shareholders’ rights.
- Disposal of the undertaking or major assets of the company.
- Amalgamation and reconstructions.
- Voluntary winding up of the company. The question is if there is a need for a supplementary provision regarding shareholders’ consent to very important decisions e.g. sale of substantial parts of the company or on formation of Groups.

The EMCA Group has discussed the need for this supplementary rule. Some Member States rely on a very formalistic approach : a vote of the general meeting is needed only if there is an alteration of the articles of association, even if the resolution. This is the case in France (except for listed companies). This approach was deemed not satisfactory by the EMCA Group as it leaves minority shareholders with insufficient protection. Therefore, in line with the scope of Chapter 11 – to enhance shareholder democracy – there is a need to secure shareholder approval on the most important decisions regarding the company. The EMCA and the national Companies Acts include and identify a number of such issues as mentioned above. However, this list does not cover all decisions which might be of substantial interest for the shareholders. The need for such a rule might be different in the various Member States.

This supplementary rule also seems to be of specific importance in Member States where there are limitations on the competence of the general meeting, such as Germany. This is demonstrated by the well-known German *Holz Müller* and *Gelatine* cases. A supplementary rule would be of less importance in Member States such as the Nordic countries where the general meeting is considered omnipotent. It should also be considered if it is possible to draft a rule that is precise enough to provide legal certainty. On the other hand, the German alternative rule – based on case law –, which requires shareholder approval, also leads to legal uncertainty. Section 27 is inspired by Dutch law, cf. Article 107 A Companies Act (Book 2, Dutch Civil Code).

#### *Section 11.28*

#### **Void Resolutions at the General Meeting**

- (1) Legal proceedings can be instituted by a shareholder or member of management if a resolution passed by the general meeting has not been lawfully passed or is contrary to this Act or to the company's articles of association.
- (2) Legal proceedings must be instituted no later than three months after the date of the resolution, or the resolution will be deemed to be valid.
- (3) Subsection (2) does not apply where
  - (a) the resolution could not be passed lawfully even with the consent of all shareholders;
  - (b) this Act or the limited liability company's articles of association require the consent of all or certain shareholders and such consent has not been obtained;
  - (c) there has been a serious failure to comply with the rules governing notice of general meetings.
- (4) A shareholder who institutes proceedings after expiry of the time limit specified in Subsection (2), but within 24 months of the date of the resolution, and who can demonstrate reasonable grounds for the delay, may at the discretion of the court be permitted to apply, despite the non-compliance with the requirements of Subsection (2).
- (5) Where the court finds that the resolution is not lawfully passed, the court may order that it be amended or it may be declared invalid. The resolution may only be amended if a claim is made to such effect and the court is able to establish the proper contents of the resolution. The ruling of the court also applies to shareholders who have not instituted proceedings.

*Comments*

There are no EU-provisions on void resolutions at the general meeting. Member States have different approaches. German law has an extensive regulation in AktG §§ 241 and following (but no provision in the GmbHG). Less extensive regulation is found in the Greek Companies Act Articles 35a and 35b and in the Polish Commercial Companies Code, Articles 425-427. Even less regulation is found in the Czech Commercial Code Section 183. The main provision in the UK is contained in Companies Act Section 994 regarding the protection of members against “unfair prejudice” but it is rarely if ever used to challenge resolutions. In France, in public and private companies, any shareholder can bring a derivative action against the directors, the managing director or the members of the executive and supervisory boards in the company’s name. In Italy, each shareholder may bring a derivative action against the directors. In the Danish Companies Act there is only a single Section, Companies Act § 109. Similar provisions to Danish law are found in the Swedish Companies Act Chapter 7, Sections 50-52.

Section 28(1) is in line with the basic wording in most Companies Act. Together with the general clause below in Section 31 it enables shareholders to get a court decision on the validity of a resolution passed by the general meeting.

Like the German and the Danish/Swedish law, Section 28 provides for a distinction between a void resolution and voidable resolutions. This distinction is found in Section 28(2) and (3). The principle that legal proceedings regarding voidable resolutions must be instituted with a short time limit are found in most Companies Act, see e.g. the Lithuanian Companies Act Article 19 Part 10, the Polish Commercial Companies Code Article 425. A provision like Section 28(4) after which the court may amend or (just) declare a resolution invalid is also found in most Member States.

The court may decide that minor violations, for example, regarding the notice of holding the general meeting or the shareholders right to vote, will not nullify the general meeting or a resolution passed at the meeting. This principle seems to be generally accepted but may also be included in the Companies Act, see e.g. the Czech CC, Section 183(2). Also the principle that shareholders may ratify a voidable resolution of the shareholders meeting seems generally accepted and is also found in law, see e.g. the German AktG § 244.

PART 2  
MINORITY PROTECTION

*Section 11.29*

**Change of Articles of Association**

Any proposed resolution to amend the articles of association must be passed by at least two-thirds of the votes cast as well as at least two-thirds of the share capital represented at the general meeting. Resolutions to amend the articles of association must also fulfil any other requirements stipulated in the articles of association.

*Comments*

All Member States' companies' Acts include provisions on changing of the articles of association. Generally the companies' Acts demand a qualified majority to change the articles of association, but the size of the majority vary. In Germany the majority is 75 % (AktG § 179, GmbHG § 53). Likewise in Poland and in the UK, a 75 % majority requirement is applicable, cf. COMMERCIAL COMPANIES CODE Article 415 and CA Sections 21 and 283, respectively. In the Czech law, in France, and in the Nordic countries, the majority is two-thirds, cf. the Czech Commercial Code Sections 127 and 186, the French Commercial Code Article L. 225-96, the Danish Companies Act § 106, the Finnish Companies Act Section 27 § and the Swedish Companies Act Chapter 7, 42 §. In Greece the 75 % requires absolute majority or in some cases two-thirds of shares represented, cf. 75 % Section 31.

Like most Member States the EMCA distinguish between general changes of the articles of association in Section 29 and specific changes which demand a higher majority, in Section 30.

Section 29 demands a qualified majority of both the votes cast and the shares represented. The dual requirement is chosen to protect the interest of shareholders with limited voting rights.

The articles may provide for further requirements, e.g. a quorum.

*Section 11.30*

**Specific Changes of Articles**

(1) Any proposed resolution to amend the articles of association and increase shareholder obligations to the limited liability company requires the unanimous agreement of all shareholders.

(2) The following proposed resolutions to amend the articles of association must be passed by at least nine-tenths of the votes cast as well as at least nine-tenths of the share capital represented at the general meeting:

- (a) Resolutions to reduce shareholder rights to receive dividends or distribution of the company's assets, including subscriptions for shares at a favorable price, to the benefit of parties other than the shareholders and the employees of the limited liability company or its subsidiary.
- (b) Resolutions to restrict the transferability of the shares or increase existing restrictions, including the adoption of provisions that make share transfers subject to the consent of the limited liability company or prevent any shareholder from holding shares that exceed a specific amount of the share capital.
- (c) Resolutions to require shareholders to redeem their shares on equal terms, except on dissolution of the company or in circumstances governed by Part 5 of this Act.
- (d) Resolutions whereby shareholder rights to exercise voting rights in respect of their own or other shareholders' shares is restricted to a specific part of the votes or the voting share capital.
- (e) Resolutions that the shareholders, in connection with a division of the company, will not receive votes or shares in each of the transferee companies in the same proportion as in the transferor company.

(3) Shareholders who have opposed the amendments to the articles of association in Section 30(2) at the general meeting may demand that their shares be redeemed by making a written request no later than four weeks after the date of the general meeting. On redemption the company must buy the shareholders shares at a price corresponding to the value of the shares.

(4) If the company has more than one class of shares, any proposed amendments to the articles of association that alter the respective rights attaching to each of the share classes, either by changing existing distinctions or creating new distinctions between such rights, must be adopted by shareholders attending the general meeting who hold at least two-thirds of the shares in the share class whose rights will be prejudiced.

#### *Comments*

Most Member States require a higher majority for a number of specific changes of the articles or even demand unanimous decisions. Section 30(1) corresponds with the principle of limited liability. The general meeting cannot oblige the shareholders to commit more capital or e.g. sell products from or to the company. A similar provision is found in the German AktG § 180.

Section 30(2) specifies a number of resolutions which may require a majority of nine-tenths. The majority of nine-tenths is inspired by Danish law and partly Swedish law, but it is debatable whether the resolutions mentioned in Section 30(2) should instead be decided by a unanimous decision. Compare for example the Finnish Companies Act Section 29. However, to compensate for the majority rule in Section 30(2), EMCA Section 30(3) gives shareholders who oppose the amendments in Section 30(2) a right to redemption.

Section 30(2) applies only to changes which are deemed necessary or advantageous for the company as a whole – as an example in connection with reconstructions – and should therefore not be hindered by a small minority. Section 30(2) is inspired by the Danish Companies Act § 107(3) and the German AktG § 179(3).

#### *Section 11.31*

### **General Provisions on Minority Protection**

The General Meeting may not pass a resolution which obviously is likely to give certain shareholders or others an undue advantage over other shareholders of the company.

#### *Comments:*

The principle of shareholders equal rights is included in the general provision in Section 31. It is a fundamental company law principle that all shares in same position enjoy equal rights in the company. Thus, the principle of equality is expressed in Article 42 of the 2<sup>nd</sup> Company Law Directive, in Article 4 of the Directive on shareholder rights (2007/36/EEC) as well as in Article 17 of the Transparency Directive (2004/109/EC) and Article 3 of the Takeover Bid Directive (2004/25/EC).

Member States have essentially two different approaches which are based on the principle of equality, a fiduciary duty and/or the concept of abuse of majority.

Some Member States require, with some variations, a damage to both the company's social interest and to the minority shareholders. This is the case for instance of France (*abus de majorité*), Belgium (*abus de majorité*), Italy (*abuso della maggioranza*), and Portugal. In Spain, since a 2014 legislative reform, the requirement that the decision had to damage the social interest of the company was removed and it is enough that the decision was approved by the majority without there being a reasonable company need and for its own benefit to the unjustifiable detriment of remaining shareholders. These requirements make it usually difficult for minority shareholders

Other Member States only require a damage to the minority shareholders. This approach is more protective and is expressed in several Member States' Companies Acts, for example German AktG § 53 a. The Nordic Companies Acts all contain a similar provision to Section 31 in the Chapter on general meeting as well as in the Chapter on the management of the company. The UK Companies Act Section 172(1)(f) requires the directors to have regard to the need to act fairly as between members of the company.

Section 31 includes the requirement that the decision in question gives some shareholders a benefit that must be “obvious” and that this advantage can be characterized as unfair.

The word “obvious” indicates that there must be a clearly unreasonable exercise of influence which “is likely to give”, i.e. it requires an objective assessment of the situation. By “undue advantage” it is meant that there certainly must be unfairness. The requirement that an “advantage” must be present also implies that this leads to a pecuniary advantage.

If a resolution is passed violating the general clause, the resolution may be void according to Section 28 above. The shareholders may also be liable according to Section 37 below.

*Section 11.32*  
**Special Examiner**

(1) A shareholder or shareholders of a company may submit a proposal for a special examiner to assess specific company’s operations with a view to prepare a report on their effects for the company and its shareholders, as well as their consistency with law and good business practices. The motion to appoint the special examiner shall contain at least the following information:

- (a) The scope of the examinations;
- (b) the reasons for the appointment of the examiner,

(2) Persons that provided services for the company or a member of the same group to which the company belongs shall not qualify for performing the task set forth under this Section.

(3) If the general meeting refuses to appoint the special examiner in accordance with the demand of the petitioner(s), owners of at least one tenth of the shares may request the court to order the company to appoint the special examiner in accordance with the shareholder(s) demand. Upon the request of the company, the court may modify the examiner’s mandate taking into account the need to avoid serious damage to the company and third parties.

(4) The special examiner shall submit a report regarding the result of the examination. The report shall be available to the shareholders and shall be presented at a general meeting.

(5) The remuneration of the special examiner shall be met by the company. The articles of association may provide that the shareholder(s) shall meet the remuneration of the examiner where his report does not establish any material violation of law and corporate governance standards by the company.

*Comments*

Special examinations may be carried out in order to clarify whether there are reasons to make the directors liable. The possibility to ask for a special examiner may also be seen as a supplement to the shareholders’ right to information.

Provisions on special examiners are found for instance in France and the Nordic countries. The Danish Companies Act gives a minority of 25 % the right to ask for a special examiner. The Finnish and Swedish Companies Act gives a minority of 10 % the same right. In France the minority has to reach a 5 % threshold. Especially in large companies, a too high threshold makes the right rather worthless. Therefore, the EMCA Group prefers a threshold of 10 %.

*Section 11.33*  
**Liquidation due to Fraud on the Minority**

Where any shareholders in a company have wilfully contributed to passing a resolution of the general meeting that is in contravention of Section 31, or have otherwise abused the influence that they have over the company or contributed to a contravention of the EMCA or the company’s articles of association, the court may, upon request from shareholders representing not less than one-tenth of the share capital, order that the company be dissolved whether because of the duration of the abuse or other circumstances.

*Comments*

In the case of a severe majority abuse, Section 33 provides a minority representing one-tenth of the share capital with the opportunity to request the company to be dissolved. The provision is the ultimate minority protection rule in cases where the abuse by the majority continues after the use of the redemption and buy-out provision in Section 37 below.

Section 33 is inspired by Nordic law (Danish Companies Act § 230, the Finnish Companies Act, Chapter 23, Section 2 and the Swedish Companies Act Chapter 25, 21 §§). Many Member States Companies Acts or judges are rather reluctant to allow the liquidation of a company on the basis of an breach of equality among shareholders, except in extreme circumstances. Therefore, section 33 increases the protection of minority shareholders.

*Section 11.34*

**Squeeze-Out by Request of a Shareholder Holding Nine Tenth of the Shares**

(1) Any shareholder holding more than nine-tenths of the shares in a limited liability company and a corresponding share of the votes may demand that the other shareholders have their shares redeemed by that shareholder. In this case, the other shareholders must be requested, under the rules governing notice for general meetings, to transfer their shares to the shareholder within four weeks.

(2) The terms of redemption and the basis used for determining the redemption price must be set out in the request. It must also be stated in connection with the redemption that in the event that no agreement can be reached on the redemption price, such price will be fixed by an expert appointed by the court with jurisdiction over the place where the registered office of the company is situated. If the redemption is carried out for the purpose of a takeover bid under the rules in the national Securities Trading Act, the rules in that Act on price determination apply to the redemption, unless a minority shareholder requests that the price be fixed by an expert. The request must also include the information referred to in Subsection (3), first sentence. Finally, the request must include a statement by the central governing body of the company on the general terms of redemption.

(3) Where the expert opinion or a decision made leads to a redemption price that is higher than that offered by the shareholder, the higher price will also be valid for the holders of shares of the same class who have not requested an opinion. The costs pertaining to the price determination are payable by the shareholder who has requested such determination. Where an opinion or decision leads to a redemption price that is higher than that offered by the redeeming shareholder, the court that appointed the expert may order the redeeming shareholder to pay the costs in whole or in part.

*Comments*

Conflicts between the majority and the minority occur regularly. The majority may oppress the minority so that the general clause or other minority protection rules may be used. However, misuse may be hard to prove. In other situations, there are simply different opinions regarding the company's business strategy. This can be the case in private companies as well as in public companies. An example could be a change of the majority shareholder. In listed companies the takeover regulation contains *the mandatory bid rule*, which is seen as a minority protection rule.

The squeeze-out/sell-out rule protects on one side the minority but, on the other side, makes it possible for large shareholders to run the company or change business strategy. Thus, a majority shareholder with 90 % of the votes may delist a company in connection with a takeover.

Sections 34 and 35 are inspired by Nordic law (Danish Companies Act §§ 70 and following, the Finnish Companies Act Chapter 18, Section 1, and the Swedish Companies Act Chapter 22, 1 §§ and following).

This provision is also part of the regime of groups of companies. See EMCA Chapter 15 of groups.

*Section 11.35*

**Sell Out by Request of a Minority Shareholder**

If a shareholder holds more than nine-tenths of the shares in a company and a corresponding share of the votes, each minority shareholder of the company may demand redemption by that shareholder.

*Comments*

See comments for Section 34.

This provision is also part of the regime of groups of companies. See EMCA Chapter 15 of groups.



PART 3  
SHAREHOLDER LIABILITY

*Section 11.36*

**General Provision on Liability**

- (1) (1) Shareholders must provide compensation for any losses that they cause to the company, individual or third parties through intentional acts or omissions, or gross negligence.
- (2) Damages and under Section 36(1) may be reduced if it is considered reasonable having regard to the degree of fault, the amount of loss and other circumstances of the case.
- (3) If multiple persons are liable, they will be jointly and severally liable in damages. However, any person whose liability is reduced under Section 36(2) is only liable for the reduced amount. If any persons have paid the damages amount, they have a right to receive contribution from each of the other liable persons with regard to the degree of fault attributable to each individual and the circumstances of the case.

*Comments*

See comments for Section 13.37.

*Section 11.37*

**Redemption and Buy-out**

If any shareholder has, intentionally or by gross negligence, caused a loss to the company, individual shareholders, the company's creditors or other third parties, and there is a risk of continued abuse, the court may order that shareholder to redeem the shares belonging to the shareholder who suffers a loss or to sell his shares to the other shareholders. The redemption or sale shall be made at a reasonable price, which is to be fixed in respect of the company's financial position and the circumstances of the case.

*Comments*

Section 37 is inspired by Nordic law (Danish Companies Act §§ 362 and 363, Finnish Companies Act Chapter 23, Section 2 and Swedish Companies Act Chapter 29, 3 § and following).

*Section 11.38*

**Discharge**

- (1) Any resolution that the company should take legal action against directors and shareholders must be passed by the general meeting.
- (2) Proceedings may be commenced notwithstanding any previous resolution by the general meeting granting exemption from liability or waiving the right to take legal action if the information about the legal action information about the subject matter of the proceedings which was provided to the general meeting before the resolution was passed was not essentially correct or complete.

*Comments*

Directors and shareholders may be liable towards the company according to Section 36 above. A resolution on liability towards the company must be passed by the general meeting i.e. the majority of shareholders according to Section 26 above. However, a resolution on discharge is not binding for subsequent general meeting if the resolution is based on incorrect or incomplete information.

Section 38 does not prevent a claimant from taking action to recover personal losses according to Section 36 and 37 above. Further, Section 40 below contains a rule on derivative suits.

Section 38 is inspired by Nordic law, cf. Danish Companies Act § 364(2), Finnish Companies Act Chapter 22, Section 6(2) and Swedish Companies Act Chapter 29, 11 §§.

*Section 11.39*

**Derivative Suits**

(1) If shareholders that represent not less than one-tenth of the share capital oppose any resolution to grant exemption from liability or waive the right to take legal action, any shareholders can commence legal proceedings to recover damages from the person(s) liable for the loss suffered. Shareholders who commence such proceedings must pay the legal cost involved, but may have such cost reimbursed by the company to the extent that they do not exceed the amount recovered by the company as a result of the proceedings.

(2) Legal action pursuant to Section 39(1) must be taken no later than six month after the resolution of the general meeting that granted exemption from liability or waived the right to take legal action.

*Comments*

Section 39 is inspired by Nordic law, cf. Danish Companies Act § 364(3), Finnish Companies Act Chapter 22, Section 7 and Swedish Companies Act Chapter 29.

The UK Companies Act Part 11, Section 260 and following has provisions on derivative claims. In contrast to Nordic law, a member of a company who brings a derivative claim must apply to the court for permission to continue it. Sections 263 and 264 decide whether permission may be given. Also the Polish COMMERCIAL COMPANIES CODE Article 486 and following has rules on derivative claims. According to Article 486 § 2 the court may order that the claimant pay a sum by way of security for the possible damage incurred by the defendant should the plaintiff's case be found to have been brought in bad faith or negligently. This rule is close to the Nordic Rules.

## CHAPTER 12 ANNUAL ACCOUNTING AND AUDITING

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## General Comments

### 1. EU law

#### 1.1. Accounting

The most important Directives containing provisions on financial reporting requirements for limited liability companies were the following:

- the 4<sup>th</sup> Directive (78/660/EEC) on the annual accounts of certain types of companies, and
- the 7<sup>th</sup> Directive (83/349/EEC) on consolidated accounts.

The 4<sup>th</sup> and 7<sup>th</sup> Directives are replaced by the Accounting Directive (2013/34/EU), which entered into force 20 July 2013 and had to be implemented into national law by 20 July 2015. It has further been amended by Directive 2014/95/EU.

According to the IAS Regulation 1606/2002, application of International Accounting Standard (IAS) have been adopted. Further, each IAS and International Financial Reporting Standard (IFRS) as well as related interpretations (SIC/IFRIC) are adopted by the EU in the form of regulations.

Special accounting requirements for listed companies are found in the Transparency Directive (2004/109/EC) as amended by Directive 2013/50/EU.

#### 1.2. Auditing

Directive 2006/43/EC contains regulations on statutory audit of annual accounts and consolidated accounts. The Directive has been amended by Directive 2014/56/EU. The Directive is supplemented by Regulation (537/2014). The Directive had to be implemented in national law by 17 June 2016. The Regulation also entered into force on the same date.

The Directive aims at high-level, though not full-harmonization, of statutory audit requirements.

Member States should organize an effective system of public oversight for statutory auditors and audit firms on the basis of home country control.

The statutory auditors or audit firms should be appointed by the general meeting of shareholders or members of the audited entity, cf. Article 37 of the Directive. Dismissal should be possible only if there are proper grounds and if such grounds are communicated to the authority or authorities responsible for public oversight, cf. Article 38.

Article 2 of the Directive contains definitions. According to the Directive “*statutory audit*” means an audit of annual accounts and consolidated accounts insofar as required by EU law, national law as regards to small undertakings, or voluntarily carried out at the request of small undertakings.

Each public-interest entity shall have an *audit committee*, cf. Article 37. Public interest entities are companies whose transferable securities are admitted to trading on a regulated market, certain credit institutions and insurance undertakings and entities designated by Member States as public entities, cf. Article 2(f).

The EU Commission has issued a number of Recommendations and Communications. Among those are Recommendation 2008/473/EC concerning the limitation of the civil liability of statutory auditors and audit firms and the Green Paper (COM(2010) 561 Final) on Audit Policy. Among other issues, the Green Paper emphasises 7 considerations on “Simplification for Small and Medium Sized Enterprises (SMEs)”.

## 2. National law

### 2.1. Annual accounts

The EU Regulation gives the Member State freedom to decide on the technical manner in which the Accounting Directive is implemented. Member States have chosen different methods for implementing accounting rules. There is a tendency that Member States implement the material rules of the Directive outside the Companies Act or in separate accounting laws - for example, in Germany in the HGB and in Greece, the Czech Republic, the Nordic countries and Poland in the Annual Accounting Act. Certain countries, such as France, Italy and the UK still include accounting rules in their Companies Acts.

The different national company law rules include a number of special rules which require that companies prepare annual accounts and/or use annual accounts as a basis for company law rules, such as the duty to present annual accounts which in most Member States must be approved at the general meeting. Further, a number of provisions in company law refer to or make use of items from the annual accounts; see further below.

### 2.2. Auditing

It is also left to the Member States how to implement the Directive on auditing. Contrary to accounting law, most of the Member States have included rules on auditing in their Companies Acts. However, the contents of auditing rules vary considerably. Separate Chapters on auditing are for example found in Denmark (Companies Act, Chapter 9), Spain (Companies Act, Chapter IV), Sweden (Companies Act Chapter 9, Sections 1-48) and the UK (Companies Act Part 16, Chapter 1-7).

## 3. Considerations

As mentioned, Member States may implement the accounting rules in the Companies Acts or in separate Accounting Acts. Generally, the EMCA Group has chosen not to implement material accounting regulation in the EMCA; see further below.

Similar to the Accounting Directive, it is up to the Member States to choose the implementation of the Directive on auditing. The EMCA Group has chosen not to implement the Auditing Directive in the EMCA; see further below. However, regarding auditing the EMCA should contain some basic rules regarding the general meeting's choice of auditors, the auditors' position on the general meeting etc.; see further below.

The various chapters in the EMCA contain a large number of provisions in which the annual accounts and the auditors' work are described and used. Paragraph 3) below therefore refers to such provisions which belong to other chapters of the EMCA. The aim is to decide which provisions on accounting and auditing should be included in Chapter 12; see below in Section paragraph 4).

The following contains the Group's considerations regarding how to implement in the EMCA the EU regulation on annual accounts and auditing.

The following choices should be made:

The EU regulation is implemented differently in the Member States. Regarding the accounting rules, there is a choice between implementation in the separate Financial Statement Acts and partly in Member States' securities regulation regarding listed companies, and/or in the Companies Act.

Regarding auditors there is a choice between implementation in a separate Auditor Act/Financial Statement Act or in the Companies Act.

### ***3.1. Which accounting provisions should be included in the EMCA?***

Regarding accounting rules, the Group considers that the EMCA should not try to include a complete regulation of accounting. The fundamental accounting rules should be found in a separate Financial Statement Act which includes the accounting rules not only for public and private companies, which the EMCA is about, but also for other types of companies or businesses. To make a complete regulation of accounting rules would, as a start, demand a comprehensive comparative study. The EMCA Group is not of the opinion that it would be possible to succeed in developing a European model for accounting rules within the framework of a model Companies Act. Instead, the EMCA should contain a few fundamental rules on the company's duty to make annual accounts and the general meeting's approval of the annual account as well as regarding the duty to file the annual account with the Registrar.

### ***3.2. Which auditing provisions/duties should be included in the EMCA?***

Regarding auditing provisions the Group considers that the fundamental rules on auditors should be found in a separate Auditor's Act, but again, the EMCA should include a few provisions on auditors which are closely linked to company law.

### ***3.3. EMCA rules on accounting and auditing***

A number of provisions regarding accounting and auditing are included in other Chapters of the EMCA, such as:

#### *Accounting:*

- In connection with contribution in kind regarding capital increases, a balance sheet must be drawn up, cf. Chapter 6.
- The issuance of bonus shares is dependent on the contents of the latest annual report.
- In the case of mergers and divisions, a merger plan and division plan, respectively, must be drawn up. The plan must among others include an interim balance sheet regarding the period after the latest annual report and an assessment report regarding contributions in kind.
- At the company's general meeting, decisions regarding the approval of the company's annual accounts and the use of a possible profit must be made, cf. Chapter 11.
- The company's accounting profit is, among other things, decisive for the extent to which dividends can be paid out, cf. Chapter 7, and the extent to which own shares can be purchased, cf. Chapter 7.
- The company's annual accounts are also decisive in terms of the calculation of capital loss, cf. Chapter 7.
- The access to financial assistance is limited to the amount which can be paid out as dividend, cf. Chapter 7.
- In connection with the company's conversion from a public company to a private company or vice versa, among other things, an interim balance sheet and an assessment report regarding contributions in kind must be drawn up, cf. Chapter 4.
- In connection with the approval of a winding-up, decisions regarding this matter must be made on the basis of accounts. Likewise, winding up must be completed by drawing up a winding up account, cf. Chapter 14.
- Directors are liable for bookkeeping and financial reporting procedures, cf. Chapter 9.

#### *Auditors:*

- Regarding formation of companies: Contributions in kind should be valued (EMCA Chapter 2, Chapter 6 and Chapter 13). This valuation report in relation to formation of companies, capital increase and mergers and divisions may be executed by an auditor.
- Extraordinary general meetings may be held upon request from the auditor, cf. Chapter 11).
- The auditor is entitled to attend general meetings, cf. Chapter 11.

### 3.4. Provisions on accounting and auditing in Chapter 12

#### *Accounting:*

- Companies have a duty to make and submit annual accounts to the Registrar; see Sections 1 and 2 below.
- If the company fails to submit annual accounts to the Registrar, the Registrar can apply various sanctions in order to force the company to produce the accounts (such as default fines, sanctions or even compulsory winding up). See Sections 2 and 11 below.

#### *Auditors:*

- Within groups, the companies should as far as possible have the same auditor; see Section 5 below.
- The auditor is elected/appointed by the general meeting. The EU rules have exemptions for auditors in small companies. For example in Denmark, those rules are implemented in the Financial Statement Act. Therefore, the Danish Companies Act just refers to appointment of auditors “if auditors are needed according to the Danish Financial Statement Act”. See similarly Section 3 below.
- Right of a minority to elect/appoint a minority auditor; see Section 4 below.
- Dismissal and change of the auditor; see Sections 7 and 10 below.
- The auditor’s duties; see Section 8 below.
- Audit records; see Section 9 below.
- The management’s duty to provide the auditor with information; see Section 11 below.
- A provision on audit committees; see Section 6 below.
- Sanctions and liability; see Sections 11 and 12 below.

#### *Special investigation (special examiner/auditor):*

A number of Member States Companies Acts include provisions on shareholders’ right to ask for a special investigation of the annual accounts and/or matters related to the administration of the company. As an example, the Chapter on accounting and auditors in the Danish Companies Act, Sections 150 and the following, includes some provisions on special investigation. Similar rules are found in the Swedish Companies Act Chapter 10, 21 §. Another example is found in the German AktG § 258 which have rules on appointment of special auditors (Sonderprüfung). In the EMCA rules on special investigation are found in Chapter 11 on General Meeting and Minority Protection.

*Section 12.01*

**Duty to Make Annual Accounts**

- (1) All companies must draw up an annual report in accordance with the provisions in the national Accounting Act and the EMCA.
- (2) The annual accounts should be signed by all directors.

*Comments*

The annual accounts should be presented to and be approved by the annual general meeting; see EMCA Chapter 11, Section 11. The Directors have the duty to prepare the annual accounts and may be liable towards the company, individual shareholders or creditors for losses caused by defective annual accounts. See Section 12 below.

*Section 12.02*

**Submitting to the Registrar**

- (1) The annual accounts shall be submitted to the Registrar according to the national Accounting Act.
- (2) If member of the board fail to comply with the requirement to submit the annual accounts to the Registrar in accordance with paragraph (1), the Registrar may impose sanctions and fines on them that accrue on a daily and weekly basis.

*Comments*

The approved annual accounts shall be published according to the Accounting Directive, Chapter 7 within a reasonable time limit, no longer than 12 months after the balance sheet date.

For investors as well as creditors, it is important to have access to the company's current accounts. It is often a sign that a company has financial difficulties, if the annual accounts are not submitted and published. It is therefore important that the Registrar may impose sanctions in order to motivate companies to submit the annual accounts on time. Detailed rules on sanctions and fines should be implemented in the accounting act and/or an executive order according to the Accounting Directive, Article 33.

*Section 12.03*

**Appointment of Auditor(s)**

- (1) If a company is subject to audit obligations under the national Financial Statements Act or any other statute, or if the general meeting otherwise resolves that the company's financial statements must be audited, the general meeting must elect one or more approved auditors, and alternate auditors if applicable. Such resolution may be passed by a simple majority of votes. The articles of association may also grant other parties the right to appoint one or more additional auditors.
- (2) The Registrar may appoint an auditor if a company which is subject to audit obligations has no statutory auditor and a member of management or a shareholder so requests. The appointment remains in force until a new auditor has been elected by the general meeting.

*Comments*

Re 1) As a result of Directive 2014/56/EU on statutory audits (and the former Directive 2006/43/EC), Member States have modified the duty to have a statutory auditor. Based on criteria such as company size, smaller companies are exempted from this duty. Therefore, Section 3 only applies to companies which are subject to statutory auditing requirements or where the general meeting decides to elect an auditor.

Re 2) The provision applies to the situation where an auditor, elected at the general meeting, retires before his term expires. In such a situation, the company's management cannot just elect another auditor to continue with the predecessor's work until the general meeting appoints a new auditor. Section 3(2) provides the Registrar with the possibility to appoint an auditor temporarily at the request of a member of the management or a shareholder.

*Section 12.04*  
**Minority Auditor(s)**

Any shareholder may request the Registrar to appoint an additional approved auditor to participate in the audit together with the other auditor(s) until the next general meeting where

- (a) shareholders holding not less than one-tenth of the capital have voted in favor of an additional auditor at a general meeting whose agenda included the election of an auditor; and
- (b) the request is made no later than two weeks after the date of the general meeting.

*Comments*

Section 4 is a rule on minority protection where the company has a duty to appoint an auditor according to Section 3.

A provision on minority auditor is for example adopted by the Danish Companies Act (Section 144(2)), the Finnish Companies Act (Chapter 8, Section 5) and the Swedish Companies Act (Chapter 9). This provision is not based on EU rules.

The appointment of a minority auditor requires that the company has an auditor who is elected at the general meeting. The minority auditor shall thus participate in the audit together with the auditor appointed by the general meeting. The minority auditor thus has the same rights and responsibilities as the auditor appointed by the general meeting.

The Registrar is not obliged to appoint the auditor suggested by the shareholder(s). The Registrar thus can consider objections against a proposed auditor.

*Section 12.05*  
**Auditors in Groups**

- (1) Any subsidiary in a group as defined by the national Financial Statements Act must, where possible, elect the same auditor as the auditor elected by the parent company in general meeting.
- (2) Where this is not possible, the subsidiary must elect an auditor who is a partner of the auditor elected by the parent company in general meeting, unless this is not possible.
- (3) If it is not possible to elect the same auditor, the group auditor should evaluate and review the work of the subsidiary's auditor.

*Comments*

The provision is not based on EU law. However, Section 5 is in line with Directive 2014/56/EU on auditing, article 27, which states that the group auditor bears the full responsibility for the audit report in relation to the consolidated financial statement and further that the group auditor must evaluate and review the audit work performed by third country auditors. Provisions similar to Section 5 can be found in the Danish Companies Act (Section 145) and the Swedish Companies Act (Chapter 9:20).

The Danish provision is limited to groups where the parent company is admitted to trading on a regulated market. However, the EMCA Group does not consider that Section 5 should be limited to companies on a regulated market.

The aim of this provision is to ensure that the auditor elected by the parent company gets insights into the subsidiary's financial situation with respect to assess the group's financial situation as a whole.

If the subsidiary is a foreign company, national law cannot oblige the subsidiary to elect the parent company's auditor. As stated in Section 5(3) – and in line with the Directive, Article 27 as mentioned – the group auditor should then evaluate and review the work of the subsidiary's auditor.

The provisions must be seen in line with Section 11 regarding the duty to inform the auditor.

*Section 12.06*  
**Audit Committees**

*Alternative 1*

(1) Companies of public interest shall have an audit committee. The audit committee shall be either a stand-alone committee of the management or supervisory board of the audited company. It shall be composed of non-executive members of the management or supervisory board and/or members appointed by the general meeting of the audited company. At least one member of the audit committee shall have competence in accounting and/or auditing. The committee members as a whole shall have competence relevant to the sector in which the audited company is operating.

A majority of the members of the audit committee shall be independent of the audited company. The chairman of the audit committee shall be appointed by its members or by the supervisory board of the audited company and shall be independent of the audited company.

If national law so requires, the chairman of the audit committee shall be elected annually by the general meeting of the audited company.

(2) In public-interest companies which meet the criteria set out in points (f) and (t) of Article 2(1) of Directive 2003/71/EC the functions assigned to the audit committee may be performed by the management or supervisory board as a whole, provided that where the chairman of such a body is an executive member, he or she shall not act as chairman whilst such body is performing the functions of the audit committee.

(3) The audit committee shall, inter alia:

(a) inform the management or supervisory board of the audited company of the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process;

(b) monitor the financial reporting process and submit recommendations or proposals to assure its integrity;

(c) monitor the effectiveness of the company's internal quality control and risk management systems and, where applicable, its internal audit regarding the financial reporting of the audited company, without compromising its independence;

(d) monitor the statutory audit of the annual and consolidated financial statements, in particular its performance, taking into account any findings and conclusions by the competent authority pursuant to Article 26(6) of Regulation (EU) No. 537/2014;

(e) review and monitor the independence of the statutory auditors or the audit firms and, in particular, the appropriateness of the provision of non-audit services to the audited company;

(f) be responsible for the procedure for the selection of statutory auditor(s) or audit firm(s) and recommend the statutory auditor(s) or the audit firm(s) to be appointed in accordance with Regulation No. 537/2014.

*Alternative 2*

Companies of public interest shall have an audit committee. The audit committee shall be either a stand-alone committee of the management or supervisory board of the audited company. It shall be composed of non-executive members of the management or supervisory board and/or members appointed by the general meeting of the audited company.

National law may decide that the functions of the audit committee in public-interest companies which meet the criteria set out in points (f) and (t) of Article 2(1) of Directive 2003/71/EC may be performed by the management or supervisory board as a whole, provided that where the chairman of such a body is an executive member, he or she shall not act as chairman while such body is performing the functions of the audit committee.

National law on auditing shall include detailed rules on audit committees, including rules on composition and functions of the committee.

*Comments*

The amended Directive 2014/56/EU, Article 39, replaces the former Directive 2006/43/EC, Article 41. Still, in general the purpose of an audit committee is to minimize financial, operational and compliance risks and to enhance the quality of financial reporting as said in the preamble of the former Directive.

The tasks of the audit committee are more closely described in the Directive, Article 39(6)(a)- (f). Thus, the audit committee must work together with the board and enhance the board's financial control of the company. In that respect the committee should be seen in line with other board committees; see further on board committees in the EMCA Chapter 8, Section 23.

The duty to have audit committees rests on 'public-interest entities' as defined in the Directive, Article 1(f). According to Article 1(f) such entities include companies whose transferable securities are admitted to trading on a regulated market of any Member State, but could also include other (large) companies which are of significant public relevance according to national law. It is up to national law to decide which companies are of public interest.

In line with other provisions in the EMCA the Group is of the opinion that also companies on alternative markets should have audit committees as a starting point. The group considers that the burden of this duty may be minimized by the company because Section 6 – in line with the Directive, Article 39(2) – states that the functions of the audit committee may be performed by the management or supervisory board as a whole. It is assumed that small and medium-sized companies in the Member States will make use of this solution.

One may ask, if the Member States Companies Acts are the right place to include provisions on audit committees. Practice in Member States varies. Provisions on audit committees are for example found in Polish company law, but their tasks are limited; see the Polish COMMERCIAL COMPANIES CODE Article

221. In most Member States Corporate Governance Codes (such as the UK) include provisions or recommendations on audit committees. In other Member States provisions on audit committees are found in special Auditors Acts (for example in Denmark).

The Directive does not decide the way Article 39 should be implemented. Thus, the Group expects that Article 39 will be implemented differently in the various Member States. Therefore, the draft includes two alternatives.

Alternative 1 is a complete implementation of the Directive.

Alternative 2 is a shorter version which refers to a more comprehensive regulation outside the national Companies Act. Alternative 2(1) states that all public-interest companies shall have an audit committee.

However, in view of the size of boards in companies with reduced market capitalization and of small and medium-sized companies, the functions of the audit committee in alternative 2(2) allow national law to decide that the functions of the audit committee may be performed by the administrative or supervisory body as a whole. This modification is in line with the Directive, Article 39(2).

A similar modification was found in the previous Directive 2006/43/EC, Article 41.

As an example, the modification is used in the German AktG § 107(3) according to which public companies may choose to have audit committees. According to the wording of AktG § 107(3) it is up to the supervisory board (*Aufsichtsrat*) to create an audit committee if they wish. However, Germany relies on the exemption in the Directive that the supervisory board as such may act as an audit committee. In Germany there is no provision on audit committees in another Act.

The present Danish Act on auditors implements Article 41 of the previous Directive, also allowing the supervisory board to function as an audit committee.

The EMCA Group thinks that the modification in the Directive will be used in many Member States and should be expressed in the (company) act.

*Section 12.07*

**Dismissal and Change of Auditor(s)**

- (1) Auditors may be removed by the party that appointed them. An auditor elected to audit the company's financial statements under Section 3 may only be removed before his term of office expires if such removal is based on reasonable grounds.
- (2) If an auditor elected by the general meeting (see Section 3) resigns or is removed from office, or if an auditor's appointment is otherwise terminated before the auditor's term of office expires, the auditor must notify the Registrar to such effect as soon as possible. The notice must be accompanied by an adequate account of the reason for the termination if this took place before expiry of the auditor's term. In companies whose securities are admitted to trading on a regulated market, an auditor elected by the general meeting must also notify the market of his resignation or removal as soon as possible in accordance with the provisions of the national Securities Trading Act.
- (3) Shareholders representing 5 % or more of the voting rights of the share capital are permitted to bring a claim before a court for the dismissal of the statutory auditor(s) or the audit firm(s) where there are proper grounds for so doing.
- (4) If a company's auditor resigns and no alternate auditor has been elected to replace the auditor, the management must cause a new auditor to be elected as soon as possible in accordance with Section 3.

*Comments*

Section 7(1) and (2) implement Article 38(1) and (2) of Directive 2014/56/EU.

Section 7(3) implements the provision in the Directive, Article 38(3), which was added in the amended Directive.

No matter what the reason for resignation, it is the duty of the management to convene an extraordinary general meeting in order to elect a new auditor. If not, the company risks being wound up according to Section 12 below.

*Section 12.08*

**Auditors' Duties**

- (1) The auditor shall examine the company's annual reports in accordance with the national Auditor's Act.
- (2) The auditor elected to audit the company's financial statements as provided in Section 3 must comply with any audit requirements made by the general meeting in so far as such requirements are not contrary to statute, the company's articles of association or generally accepted auditing standards.
- (3) The auditor must ensure that the company's management complies with its obligations to draw up rules of procedure and prepare and keep books, records and minutes, and whether the rules on the submission and signing of audit records are complied with.
- (4) If the auditor finds that the requirements referred to in Subsection (2) are not fulfilled, the auditor must prepare a separate declaration to that effect to accompany the annual report at the general meeting, unless the company's annual report is to be approved at the general meeting and the matter is mentioned in the audit report.

*Comments*

Ad (1) The auditing Directive contains comprehensive rules on auditing, including the scope of the statutory audit, use of auditing standards, audit reporting, etc.

Detailed rules on auditing should be implemented in national auditing law.

Ad (2) It is a central principle in auditing that an auditor chooses by himself how to prepare and conduct the audit. It is not for the general meeting to decide on its scope and manner of execution.

Ad (3) and (4) These provisions are partly inspired by the rules of the Danish Companies Act (Section 147) and the Swedish Companies Act (Chapter 9:3 – 9:6).

*Section 12.09*  
**Audit Records**

The members of the board must sign the records prepared by the auditor if the auditor is required by the national law, or if the auditor has kept such records in accordance with an agreement with the company.

*Comments*

This Section does not implement EU law. The provision is inspired by the Danish Companies Act, Section 129. A minute book containing the auditor's communications to the board regarding the auditing shall be submitted at every board meeting according to the national Accountants Act or according to agreement with the company. The purpose of the provision is to secure that all members of the board are aware of possible shortcomings or uncertainties which the auditor has pointed out.

*Section 12.10*  
**Duty to Inform Auditors**

The auditor may demand that members of the company's board provide relevant audit information that is deemed to be of importance for the assessment of the company and, if the company is a parent company, its group. This also applies to members of the management of a national company which is a subsidiary in a group as defined by the EMCA.

*Comments*

This Section does not implement EU law. The provision is necessary in order to provide the auditor with the information needed to draw up the annual accounts. The provision is inspired by the Danish Companies Act Section 133, the Swedish Companies Act 9 Chapter 7 §, and the UK Companies Act Section 499.

*Section 12.11*  
**Compulsory Dissolution**

(1) The Registrar may request the bankruptcy court to dissolve a company, if necessary under EMCA Chapter 14, Sections 4 and 5, where

- (a) the Registrar has not duly received the company's audited annual report prepared in accordance with the national Financial Statements Act;
- (b) the company has failed to register an auditor for the company despite having audit obligations under the national Financial Statements Act or any other statute;
- (c) the company has failed to register an auditor for the company despite the general meeting having resolved that the company's annual report must be audited; or

(2) The Registrar may prescribe a time limit within which the company must remedy a defect under subsection (1).

(3) If the defect is not remedied on or before expiry of the time limit prescribed by the Registrar, the Registrar may decide that the company must be compulsorily dissolved.

*Comments*

According to the 1<sup>st</sup> Company Law Directive 2004/101/EC Article 2 the auditors of the company must be registered with the Registrar. The duty of registration lies with the management of the company. Similarly, the annual accounts of the company must be submitted to the Registrar and be published. The Member States must lay down suitable sanctions to ensure that these duties are observed.

Section 2 above gives a right to the Registrar to impose fines on the members of the board for failure to comply with their duty to submit the annual accounts to the Registrar.

In most cases these sanctions would work. Ultimately, however, Section 11 authorizes the Registrar to request the bankruptcy court to dissolve the company, if the Registrar does not receive the annual report or register an auditor.

For solvent companies the threat of compulsory dissolution will work. Provisions on compulsory dissolution similar to Section 11 are for example found in the Danish Companies Act § 225 and the Swedish Companies Act 25, Chapter 11 §.

A useful sanction in the UK is that non-filing of their accounts will result in the company, eventually, being struck off the Register with the result that all its assets fall into the ownership of the Crown – i.e. the State – a very effective deterrent to non-filing without the need for any court winding up or anything of that nature; it is a purely administrative act of the Registrar with significant consequences for the company. They receive three warning letters before this happens.

*Section 12.12*  
**Civil Liability**

(1) Members of the management or supervisory board who, in the performance of their duties to make annual accounts and other reports, have intentionally or negligently caused damage to the company are liable to pay damages. The same applies where the damage is caused to shareholders or any third party.

(2) Similar liability for damages applies to auditors.

(3) If an auditing firm has been elected auditor, both the auditing firm and the auditor performing the audit are liable in damages.

*Comments*

According to the Accounting Directive 2013/34/1, Article 33(1), members of the management and supervisory boards should have collective responsibility for ensuring that (a) the annual financial statements, the management report and, when provided separately, the corporate governance statement and (b) the consolidated financial statements, consolidated management reports and, when provided separately, the consolidated corporate governance statement are drawn up according to the requirements of the Directive.

As a minimum, Article 33(2) states that the members of the boards are liable towards the company. This does not prevent Member States from going further and providing for direct responsibility to shareholders or even other stakeholders, especially creditors.

Ad (1) In line with provision on directors' liability in the EMCA Chapter 10, Section 12 states that members of the management or supervisory board, which according to national law are responsible for drawing up annual accounts etc., are liable towards the company, shareholders and third parties.

The legal basis for liability and the extent of liability is national tort law, which varies – and which the Directive does not try to harmonize.

Ad (2) and (3) Also auditors should be liable under national tort laws for not fulfilling their duties as auditors according to Directive 2014/56/EU and national law. According to national law in all Member States auditors may be liable towards the company. However, there are differences regarding auditors' responsibility to third parties. On one side, UK law is reluctant to make auditors liable to third parties. Contrary to the UK, the Danish Auditor Act designates the auditor as the public's representative, which according to both legal theory and case law indicates liability also towards third parties.

In line with the rules on liability in Chapter 10, Section 12(2) states that auditors may be liable to the company as well as to shareholders and third parties.

Directors' liability also involves liability for misleading annual reports or other financial statements according to EMCA Chapter 10.

The same liability standard (culpa-rule) applies to auditors, but of course the content of the auditors' duty is decided by professional standards regulating the work of the auditors.

Consideration should be given to a provision attaching civil liability to the directors where they negligently approve accounts which subsequently prove to be false / inaccurate.

Too often they paint a rosy picture which turns out to be entirely inaccurate without any real consequences attaching to their approval of those accounts – EMCA might give a lead on that.

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## General Comments<sup>70</sup>

### 1. EU Law

Chapter 13 contains the rules on restructurings. Restructurings comprise takeovers, mergers, divisions and also schemes of arrangement which can be used for a wide variety of restructurings. The EU company law Directives cover these different forms of restructurings to a certain extent. Takeovers are covered by the EU Takeover Directive 2004/25/EC. Directive 2011/35/EU, the former 3<sup>rd</sup> Company Law Directive, deals with domestic mergers. Domestic divisions are covered by the 6<sup>th</sup> Company Law Directive, which is addressed further below.

The Directives on mergers and divisions only apply to public companies. However, Member States can extend the Directive's rules to private companies as well.

(1) The Takeover Directive 2004/25/EC has been implemented into national law in all Member States since 2006. In many jurisdictions (e.g. Austria, Belgium, Czech Republic, Germany, Greece, Ireland Luxembourg and Sweden) an independent takeover act exists. In other jurisdictions, takeover regulation falls within the scope of a capital markets or a securities markets act (e.g. Estonia, Denmark, France, Hungary, Latvia, Lithuania, Portugal and Slovakia) or a general Companies Act (e.g. the Netherlands and the UK). In addition, primary legislation is often supported by a further set of takeover rules, with statutory effect, setting out more detailed provisions for the conduct of takeover bids.

(2) Restructurings may also take the form of mergers or divisions and, in some jurisdictions, such as the Ireland and the UK, provision is made for the inclusion of more broad ranging schemes of arrangement. Domestic mergers fall within the scope of the former 3<sup>rd</sup> Company Law Directive 78/855/EEC (as amended by Directive 2007/63/EC and Directive 2009/109/EC and recodified by Directive 2011/35/EU) which provides a framework for mergers by acquisition, or formation of public limited liability companies.

EU rules also apply to cross-border mergers and can be found in the 10<sup>th</sup> Company Law Directive (Cross-Border Mergers Directive - 2005/56/EC). Cross-border mergers are regulated similarly to domestic mergers. However, some special provisions deal with the entry into effect of the cross-border merger and the registration of the merger in the registries of the Member States involved. The effective application of the Directive's rules can only be achieved if similar rules apply in all involved jurisdictions. The 10<sup>th</sup> Directive applies to both private and public companies.

It seems clear from the *Sevic* Case, C-411/03, that participation in an international merger may be regarded as an exercise of the right of freedom of establishment. This is of relevance for “companies or firms” in the sense of Article 54 TFEU, which do not fall within the scope of existing secondary law. The full range of secondary law (3<sup>rd</sup> Directive in combination with 10<sup>th</sup> Directive) is only available to public companies, private companies are covered by the 10<sup>th</sup> Directive only insofar as the national law of the Member state allows for mergers of this company form (see Article 4 Directive 2005/56/EC). In all other cases private companies, cooperatives, partnerships and other legal entities need to refer directly to the freedom of establishment as determined in the *Sevic* judgement.

The 6<sup>th</sup> Company Law Directive 82/891/EEC provides a framework for divisions of public companies. The idea behind the Directive was that the rules concerning divisions should have the same approach and structure as the rules concerning mergers. The Directive primarily applies to “divisions by acquisition” (Article 2). This describes the operation whereby, after a company is wound-up without being liquidated, it transfers all assets and liabilities to more than one company in exchange for the allocation of the shareholders' shares of the divided company in the companies receiving contributions as a result of the division. The same rules apply to divisions by formation of new companies (Article 21).

Having regard to cross-border divisions, there is no EU Directive to regulate this area. However, the general perception is that the *Sevic* case, C-411/03, allows for cross-border divisions of any legal entity protected by the freedom of establishment.

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<sup>70</sup> The working group on Chapter 13 was chaired by Professor Blanaid Clarke (Trinity College Dublin, Ireland) and included Professor Christoph Teichmann (University of Würzburg, Germany).

(3) It is established case law of the European Court of Justice (Case C 378/10 – Vale) that companies being incorporated in the EU or EEA shall have the possibility to transfer their registered office from one Member State to another without having to be liquidated.

This procedure requires the cooperation of two legal systems. It is therefore also a precondition that the law of the state in the territory of which the company wants to reregister acknowledges a cross-border transfer of the registered office. In the Vale-judgment, the ECJ concluded in relation to a cross-border conversion, that the refusal of the authorities of a Member State to record the company in the national register of the original Member State as the ‘predecessor in law’ to the converted company is not compatible with EU law. According to the principle of effectiveness, also stressed by the ECJ in the Vale-case, Member States are required to take due account of documents obtained from the authorities of the Member State of origin certifying that a company has complied with the formalities laid down in that Member State.

(4) The 2011 report of the Reflection Group on the Future of European Company Law recommended that the Cross-border Mergers Directive should be reviewed and revised where appropriate. Such a revision was recommended in respect of time limits, suspension of the merger, creditors’ rights, exchange of shares and possibly other forms of restructuring such as cross-border contribution of assets or universal transfer of assets. The December 2012 Action Plan on European Company Law and Corporate Governance indicated an openness to amendments of the Directive. In its Action Plan, the European Commission also considers an initiative to provide a framework for cross-border divisions. Moreover, a study on the application of the Cross-border Mergers Directive has been delivered in September 2013 which suggests several amendments.

## 2. National Law

As mentioned above, the Directives (except for the 10<sup>th</sup> Company Law Directive) only apply to public companies. The national company legislation of the European Member States contains different opinions as to whether more simple rules should apply to private companies with regard to mergers and divisions. Hence, the Member States have different approaches. In some Member States, such as Finland, France, Italy and the Netherlands, the rules on mergers and divisions are the same for public and private companies. In Denmark, Germany, Spain and Sweden, some modifications have been made for private companies. In the UK and Ireland, restructurings of all types including mergers for private companies can be done via a scheme of arrangement. Although a decision involving a division can be made by the shareholders, in some cases the approval of a court is required.

All Member States should have rules on cross-border mergers in their Companies Acts or secondary legislation. For example, in the UK the legislation on cross-border mergers is found in a statutory instrument, SI 2007/2974. In Germany it has been incorporated in the existing Act on Transformations (*Umwandlungsgesetz*).

The operations governed by the 3<sup>rd</sup> and 6<sup>th</sup> Directives involve the winding up of at least one public company. The practical usage of such restructurings varies among the Member States. Whereas German companies frequently use such operations, they are seldom used in the UK and Ireland where typically the pre-existing public companies continue to exist. One of them will become a subsidiary of the other, and continue as a company on the register, possibly re-registered as a private company. Such a takeover will not be affected at all by these two Directives, as it is often effected by a straight takeover offer (Pt 26 UK Companies Act 2006, s.201 Irish Companies Act 1963). In the latter case the company goes into a voluntary liquidation before any property is transferred.

It seems that tax law is one of the main drivers for the choice amongst different restructuring methods. In Germany, for instance, the merger procedure is a tax privileged way of combining two companies, because the assets of the acquired company will be transferred at book value to the acquiring company. When the acquiring company, instead, decides to simply acquire the shares of the other company, those shares will have to be entered at their real value which leads to disclosure and eventual taxation of hidden reserves.

In the UK, a common method of acquiring control of a listed company is by way of a court sanctioned scheme of arrangement pursuant to the Companies Act 2006. Such a transaction does not fall within the scope of the Takeovers Directive. The scheme requires the consent of 75 % in value and a majority in number of the relevant class (shareholders, creditors) of those attending and voting in person or by proxy and thus generally only applies in case of a recommended offer. The transaction is effected by way of a single vesting order which delivers 100 % of the shares and binds all shareholders. There are two types of schemes available. The first is a transfer scheme which involves the shares being transferred by court order to an offeror in return for cash/shares to shareholders. The second and most common form of scheme is a cancellation scheme. Here the shares, which represent the subject of the scheme, are cancelled while the reserve is used to pay up new shares which are then issued to the offeror. The offerees' shareholders then receive, in exchange for their cancelled shares, cash or shares in the offeror. All schemes in the UK require the sanction of the court which acts as a protection for the shareholders and creditors who are otherwise bound by the consent of 75 % in value of the shareholders or creditors, as the case may be. Similar statutory provisions are used in Ireland and in the UK for all manner of compromises and arrangements between members or classes of members and creditors or classes of creditors.

Most Member States, such as Finland, France, Germany, Sweden and the UK, do not have rules on cross-border divisions. Only a few Member States, such as Denmark, have chosen to create rules on cross-border divisions based on their rules on domestic divisions. The Danish Companies Act incorporated the 10<sup>th</sup> Company Law Directive on Cross-border Mergers. The Act also recognizes the consequences of the Sevic case, C-411/03. This implies that the Act covers both cross-border mergers and divisions. The rules apply to companies established in at least two different EU/EAA Member States. The rules of the Member States in question must be respected during the merger/division process. Participating Danish companies must fulfil the requirements imposed by Danish legislation regarding mergers and divisions. In turn, a foreign company must fulfil the law of the country where it is registered. Denmark has allowed cross-border divisions because of the great similarities between a division and a merger from a company law perspective. As with cross-border mergers, cross-border divisions can simplify a company's access to the corporate environment of other Member States.

Article 13 of the Directive 2011/35/EU requires that the Member States in their national legislation provide a suitable mechanism to secure the participating companies' creditors, if the creditors' claims are established before the announcement of the merger plan and are due at the time of the announcement of the plan. Pursuant to the Directive, the Member States' legislation must at least provide that the creditors of the companies, which are involved in the merger, are entitled to adequate security. The requirement of security can be made if the financial situation of the dissolved companies and the continuing companies makes such protection necessary, and where those creditors do not already have such a security.

The Directive does not contain any further rules concerning how the creditors are to be secured. Therefore, in a study on the application of the Directive, commissioned by the European Commission, it has been noted that the different systems of creditor protection might be an obstacle to cross-border mergers which would require more detailed harmonization.

In Ireland and in the UK, in case of a scheme of arrangement, the court will take creditor protection into account. In Italy, the creditors can oppose a decision to merge/divide if they have not consented or waived the right to oppose. In the Netherlands, Finland and Sweden the creditors can submit a demurrer against the merger or division for the purpose of attaining security for their claims, whereas in Spain, the company has to advertise the merger/division three times before it can be concluded. In connection with a merger, creditors in Germany can make claims for security up until six months after the merger, whereas with a division, the acquiring company is jointly and severally liable for obligations entered into before the division. In Denmark an expert has to assess whether the creditors are sufficiently protected after the merger.

With regard to the cross-border transfer of the registered office, only a small number of Member States already provide such a procedure, amongst them Denmark and Spain. Under the EU freedom of establishment, however, even those Member States who do not explicitly provide for a cross-border transfer of the registered office are forced by EU law to enable companies from other Member States to reregister within their territory. According to the principle of effectiveness, which is mentioned by the ECJ in the *Vale*-case, Member States must not render impossible the exercise of rights conferred by the European Union legal order. Consequently, there are already cases, for instance in Germany, where courts have registered cross-border transfers of registered office even in the absence of a written legal text. There are, however, many uncertainties as to the applicable procedure in the absence of express legal provisions which the parties can rely on.

### 3. Considerations

It is not desirable to attempt to include all the necessary provisions required to establish a framework for the conduct of takeovers within the EMCA. Many of these provisions may be categorized as “market rules” or “bid procedures”. As part of a model Companies Act, this chapter restricts itself to setting out the board neutrality rule, a core company law issue which is an integral part of the takeover process. This rule applies only to the takeover of listed companies. However, certain other provisions of the EMCA such as squeeze out rights and the general duties of directors will also apply in the context of a takeover. These latter provisions would apply to public and private companies.

The EMCA Group discussed whether the scheme of arrangement which is widely used in Ireland and the UK could serve as a model for other countries. The attractiveness of such schemes to businesses is demonstrated by high profile seat transfers from other Member States to the UK in order to benefit from the flexible rules they offer. Some group members, however, had difficulties to accept the idea that the principle of a majority decision should not only apply within the group of shareholders – where it is well-established in national company laws all over Europe – but also within the creditors as a group, which means that individual creditors might lose their claim against their will. In English and Irish company law, however, this is balanced by the requirement that the scheme finally has to be approved by the court. The EMCA Group therefore, considered the scheme of arrangement a useful instrument also for other legal systems, provided that the judges are sufficiently qualified for a role as a quasi-arbitrator, responsible for reconciling potentially opposing interests amongst shareholders and creditors.

Generally, the EMCA should make use of the principle of Freedom of Movement within Europe mentioned in the EMCA Chapter 1, Section 13. It follows from this that the EMCA should contain rules on domestic mergers and domestic divisions as well as cross-border mergers and cross-border divisions. In the EMCA, the rules on mergers and divisions apply to both public and private companies. However, regarding private companies, the rules contain certain modifications. Hence, the EMCA provisions are consistent with the relevant Directives for public limited companies but provide a simplified set of rules for private companies and a more flexible approach to regulation.

The Commission has introduced simplified rules regarding the 3<sup>rd</sup> and 6<sup>th</sup> Company Law Directives. Among other things, the rules now allow the shareholders to agree on opting out of the directors’ explanatory report in both national mergers and divisions. Further, the shareholders can agree on opting out of the supplementary accounting statement in both national mergers and divisions. The EMCA makes use of the simplified rules, which the Directives make possible. The provisions on cross-border mergers are not limited to public or private companies from the EU or EEA Member States. In fact, the scope is opened to all private and public companies, as long as the applicable company law of all companies involved in the merger permits a cross-border merger.

Regarding the different types of protection, the EMCA Group decided that shareholders should be protected by the requirement that mergers and divisions have to be approved by a qualified majority in the general meeting. In connection with a merger, the EMCA Group has decided not to take up the option of derogating from the requirement of the general meeting, except for intra-group mergers.

Even if a general meeting takes place, however, minority shareholders representing less than one third of the shares will not be able to block a merger or division. Some Member States therefore provide for a right of dissenting minority shareholders to sell their shares to the acquiring company (e.g. § 29 German Act on Transformations). Other Member States, such as the UK, do not see any need for further protection, since the regular merger procedure already protects the interests of shareholders in general. They have a right to inspect the merger plan, the management report and the expert's report. Moreover, the expert's report must in particular ensure that the share exchange ratio is fair and reasonable. Minority shareholders therefore will not suffer any material damage if they are forced to become shareholders of the acquiring company. The group therefore considers that there is no need to suggest a mandatory sell-out right as a general rule in the model act. It should be left to the articles of association to provide for a sell-out right in such exceptional cases.

With regard to the creditors, the Member States have different models for protection. The common view is that the interests of the creditors should be protected. The creditors should therefore, not be forced into new companies without reasonable security that their claims can be honoured. According to Article 13 of Directive 2011/35/EU, the Member States must provide for an adequate system of protection of the interests of creditors of the merging companies whose claims antedate the publication of the draft terms of merger and have not fallen due at the time of such publication. The legislation of the Member States must at least provide that such creditors shall be entitled to obtain adequate safeguards where the financial situation of the merging companies makes such protection necessary and where those creditors do not already have such safeguards. In the EMCA the adequate system of protection is provided for in such a way that an expert must make a declaration stating that the creditors are adequately secured. This declaration can be subject to verification by the Registrar or the court. Thus, if the creditors are regarded as sufficiently secured, an automatic transfer of debts takes place (universal succession).

The EMCA Group has deliberated on the most appropriate form of regulation regarding cross-border mergers. One way could be to follow the Directive so that, to a large extent, the provisions simply refer to the rules on domestic mergers. However, the EMCA Group is of the opinion that it will bring more clarity, if the rules on cross-border mergers are to be found exclusively in a part of the Chapter.

Even though the cross-border transfer of the registered office is only regulated in a minority of Member States, a modern Companies Act should not abstain from regulating it. The cross-border transfer of registered office is part of the union-wide freedom of establishment. Practical cases where a transfer had been effected in the absence of a written legal text prove that there are too many uncertainties as to the applicable procedure where there is no express legal provisions for the parties to rely on. The EMCA Group therefore has opted for the implementation of a procedure on the cross-border transfer of the registered office thereby stressing the importance of regulating cross-border conversions.

The 6<sup>th</sup> Company Law Directive on divisions is conditionally mandatory. This means that if there are rules concerning divisions in a Member State, the Directive's rules on divisions must be complied with. The group decided to implement a dedicated part on divisions which mirrors the legislative approach of many Member States based on the functional interrelation between mergers and divisions. Economically and legally they are of a similar structure and require the same elements of regulation. The similarities which exist between mergers and divisions are also highlighted by the recitals of the 6<sup>th</sup> Directive.

The EMCA Group finds it desirable to construct separate rules on cross-border divisions. There are two different methods of introducing such rules. The most simplistic way is to refer to the domestic rules on mergers (with the necessary deviations). This was the way initially chosen by the Danish Companies Act but it was not satisfactory in practice. Therefore, the Danish Companies Act now contains a complete set of rules on cross-border divisions inspired by the domestic rules but adjusted to the needs of cross-border divisions. The EMCA Group decided to adopt this approach for the EMCA.

PART 1  
TAKEOVERS BY WAY OF GENERAL OFFER

*Section 13.01*

**Board Neutrality Rule**

(1) During the course of an offer, or before the date of the offer if the board of the offeree company has reason to believe that a bona fide offer might be imminent, the board must not, without the approval of the shareholders in the general meeting take any action, other than seeking alternative bids, which may result:

- (a) in the frustration of any offer or bona fide possible offer;
- (b) or in shareholders being denied the opportunity to decide on its merits.

(2) The term “offer” means any public offer made to the shareholders of a listed company, to acquire some or all of those securities; the term “securities” means transferable securities carrying voting rights in a company.

*Comments*

The Takeover Directive makes the Board Neutrality Rule, stated in Article 9 Directive 2004/25/EG, optional for Member States (Article 12 Directive 2004/25/EG). The EMCA Group has the opinion, in line with the principle of shareholder democracy, that the Board Neutrality Rule should be adopted as a general rule for the behavior of the management in the course of a public offer.

PART 2  
RESTRUCTURING BY WAY OF SCHEME OF ARRANGEMENT

*Section 13.02*

**Scheme of Arrangement**

- (1) A compromise or arrangement (a scheme of arrangement) may be proposed between a company and its creditors, or any class of them, or its shareholders or any class of shareholders and must be approved by a scheme meeting.
- (2) A “scheme meeting” is a meeting of creditors (or any class of creditors) or of shareholders (or any class of shareholders), as the case may be, for the purpose of considering, and voting on, a resolution proposing that a scheme of arrangement be agreed.

*Comments*

This Part introduces schemes of arrangement which are familiar in Ireland and the UK which are increasingly used by EU companies to restructure their businesses. The use of these provisions by other Member State companies has prompted interest in these types of arrangements. Schemes can be used by solvent or insolvent companies to reach a compromise or arrangement with shareholders or classes of shareholders or creditors or classes of creditors, including secured creditors. They are extensively used because when a scheme is approved, a majority in number and 75 % in value of the shareholders or creditors, as the case may be, can bind 100 % of the class, and this is so even if the scheme overrides existing contractual or proprietary rights.

The protection for the shareholders and the creditors is that all schemes require the sanction of the court which is only forthcoming if:

- the statutory provisions have been complied with – great attention is paid to the documentation which must be presented, especially the scheme document which sets out the scheme and its impact in great detail;
- the class was fairly represented by those who attended the meeting and that the statutory majority is acting bona fide and is not coercing the minority in order to promote interests averse to those of the class whom it purports to represent; and
- the arrangement is such that an intelligent and honest shareholder or creditor of the class concerned, acting in respect of his interest, might reasonably approve. Great attention is paid to ensuring that the class meetings are properly composed of those whose rights are not so dissimilar as to prevent them consulting with a view to their common interest. It is not necessary to seek the consent of shareholders or creditors with no economic interest in the scheme.

Schemes can be used to effect: a reorganization of capital; a takeover or merger or division; a restructuring in circumstances where creditors have contractual positions which require unanimity resulting in the significant hold-out power of minority creditors; the run-off of long term liabilities of an insurance company or a company with significant exposure to tort claimants (as in asbestos litigation). Insofar as the scheme is effecting a merger or a division in the sense of this Chapter, the provisions on mergers or divisions, as the case may be, apply. Other forms of restructuring, not covered by the provisions on mergers or divisions (and not subject to takeover rules) could be affected by scheme of arrangement.

*Section 13.03*

**Scheme Meeting**

- (1) Where an arrangement is proposed between a company and its creditors, or any class of them, or its shareholders or any class of them, the court may, on the application of the company or any creditor or shareholder or a liquidator or administrator, order a meeting of the shareholders or class of shareholders, or creditor or class of creditors, as the case may be, to be summoned in such a manner and subject to such disclosure requirements as the court directs.

(2) Without prejudice to Section 3(1), every notice summoning a meeting must include an explanatory statement as to the proposed scheme, its general effect, and the specific effect of the scheme on vested rights of those shareholders or creditors affected.

(3) If a majority in number representing 2/3rds in value of shareholders or class of shareholders or creditors or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting, agree to the scheme of arrangement, the scheme shall, if sanctioned by the court, be binding on all the shareholders, or class of shareholders, or creditors or class of creditors, as the case may be, and also on the company.

(4) An order made under Section 3(3) shall have no effect until a copy of the order is delivered to the public registry for registration.

#### *Comments*

In the interest of consistency with other Chapters where extraordinary decisions of the general meeting require a 2/3 majority, the group agreed to require the same majority for the scheme of arrangement, in awareness that in Ireland and in the UK, a majority of 75 % in value is required.

#### *Section 13.04* **Court Decision**

(1) Where an application is made to the court for the sanctioning of a proposed arrangement and it is shown to the court that the arrangement has been proposed for the purposes of or in connection with

- (i) a scheme for the reconstruction of any company or companies; or
- (ii) the amalgamation of any two or more companies;

and that under the scheme the whole or any part of the undertaking or the property of any company concerned in the scheme (“the acquired company”) is to be transferred to another company (“the acquiring company”), the court may, by the order sanctioning the arrangement, make provision for all or any of the following matters:

- (a) the transfer to the acquiring company of the whole or any part of the undertaking (including contractual rights and entitlements) and of the property or liabilities of any acquired company;
- (b) the allotting or appropriation by the acquiring company of any shares, debentures, policies or other like interests in that company which under the arrangement are to be allotted or appropriated by that company to or for any person;
- (c) the continuation by or against the acquiring company of any legal proceedings pending by or against any acquired company;
- (d) the dissolution, without winding up, of any acquired company;
- (e) the provision to be made for any persons who, within such time and in such manner as the court directs, dissent from the arrangement;
- (f) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

(2) Where an order under this Section provides for the transfer of property or liabilities, that property shall, by virtue of the order, be transferred to and vest in the acquiring company. Those liabilities shall, by virtue of the order, be transferred to and become the liabilities of the acquiring company, and in the case of any property, it shall, if the order so directs, be freed from any charge which, by virtue of the arrangement, ceases to have effect.

(3) The court may not sanction a compromise or arrangement between a limited-liability company and its creditors of shareholders or any class of them which falls within parts 3 (mergers), 4 (cross-border transfer of the registered office) or 5 (divisions) of this chapter unless the relevant requirements of these parts are complied with in the compromise or arrangement.

*Comments*

In the interest of consistency with other parts of this Chapter Section 4 (3) requires the court to take into account the provisions on mergers, cross-border transfer of the registered office and divisions. A comparable provision can be found in Section 903 UK Companies Act 2006.

PART 3  
MERGERS

GENERAL PROVISIONS

*Section 13.05*

**Definitions**

(1) A “merger by acquisition” is the operation whereby one or more companies are wound up without liquidation and transfer to another company all its assets and liabilities in exchange for the issue of shares in the acquiring company to the shareholders of the company or companies being acquired and, as the case may be, a cash payment.

(2) A “merger by the formation of a new company” is the operation whereby two or more companies are wound up without liquidation and transfer to a company incorporated by themselves, all their assets and liabilities in exchange for the issue to their shareholders of shares in the new company and, as the case may be, a cash payment.

(3) For the purpose of this Part on Mergers the “merging companies” shall mean all the companies participating in the merger. “The company being acquired” shall mean the company which is going to be wound up without liquidation and transferring all its assets to the “acquiring company”, the latter meaning the company to which the assets are transferred – be it an existing company (in the case of a merger by acquisition) or a new company (in the case of a merger by formation of a new company).

*Comments*

The definitions contained in Directive 2011/35/EU require that the shareholders of the acquiring company must receive, if applicable, a cash payment not exceeding 10 % of the nominal value of the shares. This part of the definition contained in the Directive can be derogated from (cf. Article 30 of the Directive). Thus, the 10 % limitation has not, for example, been implemented in the Danish Companies Act and in the German Act on Transformations. According to these national provisions, a merger may also take place where no consideration is made in form of shares or payment, or where a cash payment exceeds 10 % of the nominal value of the shares. The EMCA takes the same view meaning that the non-cash payment may be more than 10 %.

The definitions in Section 5(3) are based on the wording used in the official English version of Directive 2011/35/EU.

*Section 13.06*

**Companies in Liquidation**

A merger by acquisition or by formation of a new company may also be effected where one or more of the companies which are ceasing to exist are in liquidation, provided that this option is restricted to companies which have not yet begun to distribute their assets to their shareholders.

*Comments*

Section 6 makes use of the option contained in Article 3(2) and Article 4(2) of Directive 2011/35/EU. A comparable provision can be found in § 3(3) German Act on Transformations.

## DOMESTIC MERGERS

### *Section 13.07*

#### **Merger Plan**

- (1) Subject to Section 7(2) where a merger of either type specified in Section 5 is proposed to be entered into, the board of directors or the management board, as the case may be, of the merging companies must draw up and agree a joint merger plan.
- (2) If the merger only involves private limited companies, the shareholders may agree that no merger plan should be drawn up (but see Section 12(8)).
- (3) If the merger involves public limited companies, the merger plan must state, at least:
  - (a) the type, name and registered office of each of the merging companies, including, if applicable, of the newly formed company;
  - (b) the ratio applicable to the exchange of securities or shares representing the company capital and the amount of any cash payment;
  - (c) the terms relating to the allotment of shares in the acquiring company;
  - (d) the date from which the holding of such shares entitles the holders to participate in profits and any special conditions affecting that entitlement;
  - (e) the date from which the transactions of the company being acquired shall be treated for accounting purposes as being those of the acquiring company;
  - (f) any special conditions, including special rights or restrictions, whether in regard to voting, participation in profits, share capital or otherwise, which will apply to shares or other securities issued by the acquiring company in exchange for shares or other securities in the company or companies being acquired;
  - (g) any payment or benefit in cash or otherwise, paid or given or intended to be paid or given to any independent person referred to in Section 9 and/or to any director of any of the merging companies insofar as it differs from the payment or benefit paid or given to other persons in respect of the merger and the consideration, if any, for any such payment or benefit;
  - (h) a draft instrument of incorporation and articles of association if a new limited liability company is formed by the merger.
- (4) Save as provided in Section 7(5), the board of directors or the management board, as the case may be, of each of the merging companies must deliver a copy of the merger plan to the Registrar who must at least one month before the date of any meeting of that company summoned for the purpose of approving the merger (see Section 12), publish notice of receipt of the plan.
- (5) Section 7(4) does not apply in respect of a company if the merger plan is freely available on the company's website (and the Registrar has been notified of the website address) throughout the period beginning one month before, and ending on, the date of any meeting of the company summoned for the purpose of approving the merger. In the case of a public company, the merger plan must be made freely available on the company's website.

#### *Comments*

According to Article 5 Directive 2011/35/EU the administrative or management bodies – depending on whether the company applies a one-tier or a two-tier system (see Chapter 8) – of the merging companies shall draw up a merger plan in writing. The Directive is only applicable to public companies, therefore Section 7(2) allows for an exception in the case of a private company if all the shareholders agree.

The merger plan must be published in accordance with Article 3 of Directive 2009/101/EC. But a company shall be exempt from the publication requirement if it makes the merger plan available on its website (see Article 6 Directive 2011/35/EU).

*Section 13.08*

**Directors' Explanatory Report**

- (1) Subject to Section 14 (3) and Section 15(2), the board of directors or the management board, as the case may be, of each of the merging companies shall draw up a detailed written report explaining the merger plan and setting out the legal and economic grounds for them, in particular the share exchange ratio. That report shall also describe any special valuation difficulties which have arisen.
- (2) The board of directors or the management board, as the case may be, of each of the merging companies shall inform the general meeting of their company and the board of directors or the management board of the other merging companies so that the latter may inform their respective general meetings of any material change in the assets and liabilities between the date of preparation of the merger plan and the date of the general meetings which are to decide on the merger plan.
- (3) The report referred to in Section 8(1) and/or the information referred to in Section 8(2) shall not be required if all the shareholders and the holders of other securities conferring the right to vote of each of the merging companies have so agreed.

*Comments*

Section 8 is based on Article 9 Directive 2011/35/EU, making use of the option (Article 9(3) of the Directive) to waive the requirement of a directors' report by unanimous shareholder vote.

*Section 13.09*

**Expert's Examination and Report to Shareholders**

- (1) One or more independent experts, acting on behalf of each of the merging companies, shall examine the merger plan and draw up a written report to the shareholders. The experts shall be entitled to secure from each of the merging companies all information they consider necessary for the discharge of their duties.
- (2) That report must state in particular whether, in the expert's opinion, the share exchange ratio is fair and reasonable. The expert's statement must at least indicate the method or methods used to arrive at the share exchange ratio proposed; state whether such method or methods are adequate in the case in question; indicate the values arrived at using each such method and give an opinion on the relative importance attributed to such methods in arriving at the value decided on. The report shall also describe any special valuation difficulties which have arisen.
- (3) The expert's report has to make a declaration as to whether the creditors of each of the merging companies, whose claims antedate the publication of the merger plan and have not fallen due at the time of such publication, can be considered to be sufficiently protected after the merger or whether the financial situation of the merging companies requires particular safeguards.
- (4) The independent experts shall be appointed by the competent court at the request of each merging company. At the request of all the merging companies, one or more joint experts may be appointed to draw up a single report on all the merging companies. The appointed expert shall be a person eligible for appointment as a statutory auditor.
- (5) Neither an examination of the merger plan nor an expert report shall be required if all the shareholders and the holders of other securities conferring the right to vote of each of the companies involved in the merger have so agreed.

*Comments*

Section 9 is based on Article 10 Directive 2011/35/EU. Section 9(4) makes use of the option to appoint one or more independent experts for all the merging companies (see Article 10(1) Directive). Section 9(5) makes use of the option to waive the requirement of an expert's report by unanimous shareholder vote. Section 9(3) is part of the creditor protection regime and will be explained below (see Section 13).

*Section 13.10*

**Supplementary Balance Sheet**

- (1) This Section applies if the last annual accounts of any of the merging companies relate to a financial year ending more than 6 months before the board of directors or the management board, as the case may be, of the company adopts the merger plan.
- (2) Where one of the merging companies falls within Section 10(1) above, the board of directors or the management board, as the case may be, of the company must prepare a supplementary accounting statement, unless the shareholders and, where applicable, the holders of other securities conferring the right to vote, of each of the merging companies, unanimously agree that no such statement is required.
- (3) Where such statement is required, it must consist of a balance sheet, or a consolidated balance sheet, as the case may be, dealing with the state of affairs of the relevant company or group as at a date not more than three months before the merger plan (see above Section 7) was adopted, and the statement must be approved by the board of directors or the management board, as the case may be, of the relevant company.
- (4) The supplementary balance sheet shall not be required if the company publishes a half yearly financial report in accordance with Article 5 of Directive 2004/109/EC and makes it available to shareholders in accordance with Section 11.
- (5) The shareholders and all holders of other securities conferring the right to vote may agree that no interim balance sheet should be prepared, notwithstanding that the merger plan has been signed more than six months after the end of the financial year to which the company's most recent annual report relates.

*Comments*

The rules in Section 10 are based on Article 11 of Directive 2011/35/EU. Article 11(1)(c) states that “All shareholders shall be entitled to inspect at least the following documents at the registered office at least one month before the date fixed for the general meeting which is to decide on the draft terms of merger: [...] where applicable, an accounting statement drawn up as at a date which must not be earlier than the first day of the third month preceding the date of the draft terms of merger, if the latest annual accounts relate to a financial year which ended more than six months before that date”.

Member States may require, however, that an accounting statement shall not be required if all the shareholders and the holders of other securities conferring the right to vote of each of the companies involved in the merger have so agreed. The group proposes to make use of this Member State option.

*Section 13.11*

**Inspection of Documents**

- (1) The shareholders of each of the merging companies must be able, within a period of one month before the meeting called to approve the merger (see Section 12), to inspect and make copies of any of the documents listed below either at the registered office of that company or by freely accessing them on the company's website for downloading and printing.
- (2) The relevant documents are:
  - (a) the merger plan;
  - (b) where applicable, the directors' explanatory report;
  - (c) where applicable, the expert's report to shareholders;
  - (d) the companies' annual accounts and annual reports for the previous three financial years together with any supplementary accounting statement required by Section 10.

*Comments*

Section 11 is based on Article 11 of Directive 2011/35/EU.

*Section 13.12*

**General Meetings of Merging Companies**

- (1) Subject to Section 12 (8) and Section 14 (4), the merger plan must be approved by a majority in number, representing 2/3 in value, of each class of shareholders of each of the merging companies, present and voting, either in person or by proxy at a meeting.
- (2) Where the merger is a merger by formation of a new company, the memorandum or draft memorandum and articles or draft articles shall be approved by an ordinary resolution of each of the merging companies.
- (3) The board of directors or the management board, as the case may be, of each of the merging companies must report:
  - (a) to every meeting of the shareholders, or any class of shareholders, of that company summoned for the purpose of agreeing to the merger plan, and
  - (b) to the board of directors of the management board, as the case may be, of every other merging company, any material changes in the property and liabilities of that company between the date when the merger plan was adopted and the date of the meeting in question.
- (4) The board of directors or the management board, as the case may be, of each of the other merging companies must in turn:
  - (a) report those matters to every meeting of the shareholders, or any class of shareholders, of that company summoned for the purpose of agreeing to the merger plan; or
  - (b) send a report of those matters to every shareholder entitled to receive notice of such a meeting.
- (5) Section 12(3) and (4) do not apply if all the holders of shares and other securities conferring the right to vote in general meetings of each of the merging companies have so agreed.
- (6) If the merger only involves private limited companies, and if the shareholders have agreed under Section 7(2) that no merger plan should be drawn up, the following issues must be addressed in connection with the adoption of the merger:
  - (a) the names and any secondary names of the private limited companies, including whether the name or secondary name of any non-surviving company is to be adopted as a secondary name of the surviving company;
  - (b) the consideration offered for the shares in a non-surviving private limited company;
  - (c) the time from which any shares offered as consideration will confer on the holders a right to receive dividends;
  - (d) the time from which the rights and obligations of a non-surviving private limited company are considered to have been transferred for accounting purposes; and
  - (e) the articles of association if a new private limited company is formed by the merger.
- (7) If the merger only involves private limited companies, and if the shareholders have agreed under Section 7(2) that no merger plan should be drawn up, identical resolutions must have been passed by all of the existing private limited companies participating in the merger with regard to the requirements in Section 12(6).
- (8) In the case of any merger by acquisition, it is not necessary for the merger plan to be approved by the shareholders of the acquiring company if the court is satisfied that the conditions set out in Section 12(9) to (12) have been complied with.

(9) The first condition is that either:

(a) the publication of notice of receipt of the merger plan by the Registrar took place in respect of the acquiring company at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the company being acquired (or, if there is more than one company being acquired, any of them) summoned for the purposes of agreeing to the merger plan; or

(b) the merger plan is made freely available on the company's website, details of which have been notified to, and published by the Registrar, at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the company being acquired (or, if there is more than one company being acquired, any of them) summoned for the purposes of agreeing to the merger plan, and the merger plan remains available on the website throughout the period beginning one month before, and ending on, that date.

(10) The second condition is that each of the documents listed in the applicable paragraphs of Section 11 (2) relating to the acquiring company and the company being acquired (or, if there is more than one company being acquired, each of them):

(a) are available for inspection and copying by the shareholders of the acquiring company during the period beginning one month before, and ending on, the date of any such meeting as is mentioned in Section 12 (9) (a) to inspect that document at the registered office of that company; or

(b) are made freely available on the company's website and remain available on the website throughout the period beginning one month before, and ending on, the date of any such meeting as is mentioned in Section 12 (9) (a).

(11) The third condition is that no shareholder or shareholders of the acquiring company, holding not less than 5 % of the paid-up capital of the company which carried the right to vote at general meetings of the company (excluding any shares in the company held as treasury shares) has required, during that period, a meeting of the shareholders to be called for the purpose of deciding whether or not to agree to the merger.

(12) The board of directors or the management board, as the case may be, of each of the merging companies must notify the Registrar about the resolution on the merger or, as the case may be, deliver evidence that no resolution was necessary. The board of directors or the management board, as the case may be, must also notify the Registrar about the expert's declaration on the creditors' position as referred to in Section 9 (3).

(13) The Registrar shall publish notice of receipt of the documentation mentioned in Section 12 (12) and of the content of the expert's declaration on the creditors' position or that, according to Section 9 (5) no expert's report has been drawn up.

#### *Comments*

Article 7 of Directive 2011/35/EU requires that a merger is to be adopted by the general meeting in each of the merged companies with at least 2/3 majority. Some Member States such as Germany, Ireland and the UK require a higher majority of 75 %, but most Member States follow the Directive in requiring a 2/3 majority.

Article 9(2) of Directive 2011/35/EU contains a duty of the companies to inform their respective general meetings of any material change in the assets and liabilities between the date of preparation of the merger plan and the date of the general meetings which are to decide on the merger plan. According to Article 9 (3) of the Directive, Member States may provide that such information shall not be required if the shareholders and the holders of other securities conferring the right to vote have agreed to waive this requirement.

According to Article 8 of the Directive, the Member States need not require approval of the merger by the general meeting of the acquiring company if certain conditions are met. These conditions include that the merger plan is published, for the acquiring company, at least one month before the date fixed for the general meeting of the company or companies being acquired which are to decide on the merger plan. Further, all shareholders of the acquiring company must be entitled to inspect the documents at the registered office of the acquiring company. Finally, shareholders who own at least 5 % of the shares in the acquiring company may demand a general meeting of the acquiring company to be called to decide whether to approve the merger. This possibility of derogation is used in a number of Member States, including Denmark (Section 247 CA) and Sweden (Chapter 23, Section 15 CA). Germany applies the derogation for public companies (§ 62 Act on Transformations) but not for private companies.

The reason for derogating from the requirement of a decision by the general meeting in the acquiring company is that the merger, for the acquiring company, is a standard business acquisition and that there is less need for protecting the minority in a case where 90 % of the shares are already held by the acquiring company.

### *Section 13.13*

#### **Creditor Protection**

(1) Creditors whose claims antedate the publication as referred to in Section 7(4) and (5) and have not fallen due at the time of such publication may claim adequate securities if one of the following conditions is fulfilled:

- (a) the expert's declaration referred to in Section 9(3) concludes that the creditors are not sufficiently protected after the merger;
- (b) the expert's declaration referred to in Section 9(3) concludes that the financial situation of the merging companies requires additional safeguards for creditors;
- (c) no expert's report has been drawn up according to Section 9(5).

(2) Creditors claiming adequate securities under Section 13(1)(c) must credibly demonstrate that due to the merger the satisfaction of their claim is at stake and that no adequate safeguards have been obtained from the company.

(3) The creditors must file their claim no later than four weeks after the date on which the Registrars of all of the merging companies published the notice referred to in Section 12(13). The final implementation of the merger as referred to in Sections 19 can only be registered upon expiry of the time allowed for filing such claims.

### *Comments*

Article 13 of Directive 2011/35/EU requires that the Member States, in their national legislation, provide an adequate system of protection of the interests of creditors in the merging companies whose claims predated the publication of the merger plan and have not fallen due at the time of such publication. These principles also apply to debenture holders (see Article 14 of Directive 2011/35/EU). The Directive does not contain any further rules concerning how the creditors are to be secured. The legislations of the Member States contain different solutions.

The Polish Commercial Companies Code Article 496 includes a rule on priority of creditors, meaning that at the time of separate management of the assets of the companies, the creditors of each company shall enjoy priority of satisfaction from the assets of their original debtor over the creditors of the remaining merging companies. Creditors of a merging company who report their claims within six months of the date of the announcement of the merger and demonstrate with probability that their satisfaction is threatened by the merger, may require that their demands be secured.

Under German law (§ 22 Transformation Act) the creditors have the right to claim adequate securities if they can credibly demonstrate that due to the merger the satisfaction of their claims is at stake and that no adequate safeguards have been obtained from the company.

According to the Swedish Companies Act, the merger plan shall be reviewed by one or more auditors in respect of each of the acquiring companies and, in the event of a merger by acquisition, the company being acquired (cf. Chapter 23, Section 11). In the case of acquisition, it shall be specifically indicated in the statement whether the auditors, in their review, have found that the merger would jeopardize the payment of claims held by creditors of the company being acquired. If the auditors state that they have found that the merger jeopardizes the position of such creditors, the creditors must be notified (cf. Chapter 23, Section 19). The creditor protection works so that the creditors can prevent the merger if they do not receive payment or get securities for their claims (cf. Sections 22-23).

The Danish Companies Act has a similar solution. In addition to the statement referred to in Section 241, the valuation experts must make a declaration as to whether the creditors of each limited liability company can be considered to be sufficiently protected after the merger (Section 242 Danish Companies Act Companies Act). However, the shareholders may decide, by unanimous agreement, not to obtain a declaration by a valuation expert on the creditors' position, this equally means that a creditor can go to court to seek protection. If there is a declaration on the creditors' position, this will have to be filed in the companies' register. If there is no declaration, this fact will also have to be disclosed to the companies register and will be included in the register's public statement on the merger procedure (Section 244 Danish Companies Act).

Sections 9 and 13 follow a combined approach: In order to deliver the relevant information, the expert's report shall contain a declaration on the situation of the creditors. If the expert declares that the claims are sufficiently protected, the creditors have no right to require additional safeguards. If the expert's report is waived by the shareholders, the creditors may claim securities individually and will have to demonstrate that due to the merger the satisfaction of their claim is at risk.

#### *Section 13.14*

#### **Merger by Acquisition of a Wholly Owned Subsidiary**

- (1) This Section applies in the case of a merger by acquisition where all of the shares and other securities conferring the right to vote at general meetings of the company being acquired (or, if there is more than one company being acquired, of each of them) are held by or on behalf of the acquiring company.
- (2) The merger plan need not give the particulars mentioned in Section 7(3)(b), (c) or (d).
- (3) The requirements of the following Sections do not apply:
  - (a) Section 8 (directors' explanatory report),
  - (b) Section 9 (expert's report).
- (4) It is not necessary for the merger plan to be approved at a general meeting of each of the merging companies if the court is satisfied that the conditions in Section 14(5) and (6) are fulfilled and that no requirement as provided for in Section 14(7) has been made.
- (5) The publication of the merger plan as provided for in Section 7(4) and (5) must be effected as regards each company involved in the merger, at least one month before the merger takes effect.
- (6) At least one month before the merger takes effect, all shareholders of the acquiring company must be able to inspect and make copies of, at the company's registered office, the documents listed in Section 11(2)(a) to (d) relating to each company involved in the merger, unless such document was freely available on the company's website throughout that period.
- (7) One or more shareholders of the acquiring company, who together held no less than 5 % of the paid-up capital of the company which carries the right to vote at general meetings of the company (excluding any shares in the company held as treasury shares) are entitled to require a meeting of each class of shareholders to be called for the purpose of deciding whether or not to agree to the scheme.

*Section 13.15*

**Merger by Acquisition of a Non-wholly Owned Subsidiary**

- (1) This Section applies in the case of a merger by acquisition where 90 % or more (but not all) of the relevant securities of the company being acquired (or, if there is more than one company being acquired, of each of them) are held by or on behalf of the acquiring company.
- (2) If the conditions in Section 15(3) and (4) are met, the requirements of the following Sections do not apply:
  - (a) Section 8 (directors' explanatory report),
  - (b) Section 9 (expert's report),
  - (c) Section 10 (supplementary accounting statement),
  - (d) Section 11 (inspection of documents), and
  - (e) Section 12(3) and (4) (report on material changes of assets of merging company).
- (3) The first condition is that the merger plan provides that every other holder of relevant securities has the right to require the acquiring company to acquire those securities.
- (4) The second condition is that, if a holder of securities exercises that right, the consideration to be given for those securities is fair and reasonable.
- (5) It is not necessary for the merger plan to be approved at a meeting of the shareholders, or any class of shareholders, of the company being acquired if the court is satisfied that the conditions in Section 15(6) to (9) have been complied with.
- (6) The first condition is that either Section 15(6) (a) or (b) below is satisfied.
  - (a) This subsection is satisfied if publication of notice of receipt of the merger plan by the Registrar took place in respect of the company being acquired at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the acquiring company summoned for the purpose of agreeing to the scheme.
  - (b) This subsection is satisfied if the merger plan is freely available on the website of the company being acquired, the Registrar published notice giving details of that website in the Gazette at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the acquiring company summoned for the purpose of agreeing to the scheme, and the merger plan remained available on the website throughout the period beginning one month before, and ending on, the date of the meeting.
- (7) The second condition is that Section 15(6) (a) or (b) is satisfied for each of the documents listed in the applicable paragraphs of Section 11(2)(a) to (d) relating to the company being acquired and the acquiring company (or, if there is more than one company being acquired, each of them).
  - (a) This subsection is satisfied for a document if the shareholders of the company being acquired were able during the period beginning one month before, and ending on, the date mentioned in Section 15(6)(a) to inspect that document at the registered office of that company.
  - (b) This subsection is satisfied for a document if the document is freely available on the website of the company being acquired and the document remains available on the website throughout the period beginning one month before, and ending on, the date of the meeting.
- (8) The third condition is that the shareholders of the company being acquired were able to obtain copies of the documents mentioned in Section 11, or any part of those documents, on request and free of charge, throughout the period beginning one month before, and ending on, the date of the meeting.

(9) The fourth condition is that:

- (a) one or more shareholders of the company being acquired, who together held not less than 5 % of the paid-up capital of the company which carried the right to vote at general meetings of the company (excluding any shares in the company held as treasury shares) would have been able, during that period, to require a meeting of each class of shareholders to be called for the purpose of deciding whether or not to agree to the scheme; and
- (b) no such requirement was made.

*Comments*

Sections 14 and 15 are based on Articles 24-29 of Directive 2011/35/EU.

*Section 13.16*

**Protection of Holders of Securities to which Special Rights Attach**

- (1) A person who, other than in his capacity as shareholder, may exercise a particular right against a company being acquired, such as a right to a distribution of profits or a right to acquire shares, must obtain an equivalent right in the acquiring company.
- (2) Section 16(1) does not apply if:
  - (a) the holder has agreed otherwise, or
  - (b) the holder is, or under the merger plan is to be, entitled to have the securities purchased by the acquiring company on terms that the court considers reasonable.

*Comments*

This provision is derived from Directive 2011/35/EU, Article 15 and the Dutch Civil Code, Section 2:320; see also DCC 2:334.

*Section 13.17*

**Sell-out right of Dissenting Shareholders**

Any shareholder in any of the merging companies who voted against the approving of the merger in the general meeting may request the acquiring company to acquire his or her shares for cash, if the articles of the company in which he or she holds a share provide for such a sell-out right.

*Comments*

Shareholders in general are sufficiently protected by the merger procedure, in particular by the expert's report confirming the share exchange ratio to be fair and reasonable. The group therefore considers that there is no need to suggest a mandatory sell-out right as a general rule in the model act. It should be left to the articles of association to provide for a sell-out right in such cases.

*Section 13.18*

**Legal Scrutiny and Pre-Merger Certificate**

- (1) The competent court of each of the merging companies must check and certify the existence and validity of the legal acts and formalities required of the merging companies.
- (2) For each of the merging companies the board of directors or the management board, as the case may be, shall file an application for legal scrutiny which is accompanied at least by the following documents:
  - (a) the merger plan as approved by the general meeting of the merging companies;
  - (b) the minutes of the general meeting of the company;
  - (c) the directors' explanatory report;
  - (d) the expert's report;
  - (e) the supplementary balance sheet, if applicable.
- (3) If any document mentioned in Section 18(2) is dispensable in the particular case, the company must deliver documentation evidencing the applicability of the relevant exception. It shall also, at the request of the competent court, deliver any other documentation which is needed to scrutinize the legality of the merger.
- (4) The court has to issue a certificate confirming the legality of the merger. On receipt of this certificate the Registrar of the company will have to register the merger. The "acquiring" company Registrar must not register the merger unless he receives confirmation from the "acquired" company Registrar that the merger has been registered there.

*Comments*

Article 16 of Directive 2011/35/EU requires legal scrutiny of the merger which can be effected either by a public notary or by the supervision of a court or a public authority. Since the model act in general does not require notarization of corporate documents, the group opted for the model of supervision by a court.

In Member States, such as the Netherlands, where the merger plan is to be drawn up by a notary, there is no need for supervision by a court. Some Member States, such as Germany, apply both methods in requiring a notarial deed and nevertheless giving the court the competence to examine the legality of the merger.

*Section 13.19*

**Legal Effect of the Merger**

- (1) The merger shall be effective upon registration by the Registrar of the acquiring company.
- (2) From the effective date according to Section 19(1), a merger by acquisition or formation carried out in accordance with the requirements above shall have the following effects:
  - (a) the transfer, both as between the company being acquired and the acquiring company and as regards third parties, to the acquiring company of all the assets and liabilities of the company being acquired;
  - (b) the shareholders of the company being acquired become shareholders of the acquiring company;
  - (c) no shares in the acquiring company shall be exchanged, however, for shares in the company being acquired held either:
    - (i) by the acquiring company itself or through a person acting in his own name but on its behalf;  
or
    - (ii) by the company being acquired itself or through a person acting in his own name but on its behalf;
  - (d) the company being acquired ceases to exist.
  - (e) The acquiring company is obliged to effect, to the shareholders of the company (or companies) being acquired, any cash payment required by the merger plan.

(3) From the effective date according to Section 19(1), the merger may only be annulled by order of the court which it may do only if the legal requirements to draw up a merger plan or to approve the plan by general meeting of each of the merging companies have not been observed.

*Comments*

Section 19 is based on Article 19 and 22 of Directive 2011/35/EU.

*Section 13.20*

**Civil Liability of Management and Independent Persons towards Shareholders**

A director of any of the merging companies or an independent expert who has reported pursuant to Section 9 will be held liable for any loss or damage suffered by any shareholder or creditor by reason of their misconduct in the preparation or implementation of the merger.

*Comments*

Section 20 is based on Article 20 and 21 of Directive 2011/35/EU. The directive requires a provision on civil liability of board of directors or the management board, as the case may be, and experts towards the shareholders of the merging companies. Section 20 also includes liability towards creditors. This is due to the fact that creditor protection in Section 13 was linked to a declaration of the expert on the situation of the creditors. Since the creditors have no right to claim further securities if the expert's report states that their claims are sufficiently protected, the creditors should have a civil claim against an expert if he or she did not assess the risk correctly.

**CROSS-BORDER MERGERS**

*Section 13.21*

**Cross-border mergers**

Limited liability companies that are subject to this Act may participate in cross-border mergers in which the other participating companies are also limited liability companies and where a cross-border merger is permitted by the applicable company law.

*Comments*

The 10<sup>th</sup> Company Law Directive 2005/56/EEC contains rules on cross-border mergers. The Directive had to be implemented by Member States by 15 December 2007.

According to the ECJ Sevic case C-411/03, it is a breach of Article 54 TFEU on freedom of establishment to prohibit mergers between companies in at least two different Member States, when similar mergers are permitted under national law.

The Directive on cross-border mergers includes the same key elements contained in the rules on domestic mergers. Article 4 (1) (b) and (2) of the Directive refer to the provisions concerning national mergers which aim to protect creditors, shareholders and employees of the merging companies. In this way, the provisions of the Directive 2011/35/EU on national mergers also apply to cross-border mergers. This is supplemented with the demands of 10<sup>th</sup> Directive, which provides for cross-border mergers.

The EMCA Group has deliberated on the most appropriate form of regulating cross-border mergers. One way could be to follow the Directive so that, to a large extent, the provisions simply refer to the rules on domestic mergers. However, the Group is of the opinion that it will bring more clarity on the regulation, if the rules on cross-border mergers are complete.

Section 21 allows cross-border mergers between public as well as private companies, if the applicable company law permits such a cross-border merger.

The provision definitely covers cross-border mergers between companies which are governed by the law of EU or EEA Member States because these states can be expected to have implemented the relevant EU Directives and are bound by the EU freedom of establishment. Thus for example a Danish private company can merge with a German *Aktiengesellschaft* (AG) or a UK public company can merge with a German GmbH. Next to this the EMCA also opens the merger provisions to companies being governed by the law of other states, if the cross-border conversion is permitted by the applicable company law.

*Section 13.22*

**Merger Plan**

- (1) The board of directors or the management board, as the case may be, of each of the merging companies must draw up and sign a joint merger plan, which must include information and provisions on
- (a) the type, name and registered office of each of the merging companies, including, if applicable, of the newly formed company;
  - (b) the ratio applicable to the exchange of securities or shares representing the company capital and the amount of any cash payment;
  - (c) the amount of the appropriate cash compensation for a sell-out right under Section 30, if applicable;
  - (d) the terms relating to the allotment of shares in the acquiring company;
  - (e) the likely impact of the cross-border merger on employment in the merging companies;
  - (f) the date from which the holding of such shares entitles the holders to participate in profits and any special conditions affecting that entitlement;
  - (g) the date from which the transactions of the company being acquired shall be treated for accounting purposes as being those of the acquiring company;
  - (h) any special conditions, including special rights or restrictions, whether in regard to voting, participation in profits, share capital or otherwise, which will apply to shares or other securities issued by the acquiring company in exchange for shares or other securities in the company or companies being acquired;
  - (j) any payment or benefit in cash or otherwise, paid or given or intended to be paid or given to any independent person referred to in Section 24 and/or to any director of any of the merging companies insofar as it differs from the payment or benefit paid or given to other persons in respect of the cross-border merger and the consideration, if any, for any such payment or benefit;
  - (k) a draft instrument of incorporation and articles of association if a new limited liability company is formed by the cross-border merger.
  - (l) where appropriate, information on the procedures by which arrangements for the involvement of employees in the definition of their rights to participation in the company resulting from the cross-border merger are determined;
  - (m) information on the evaluation of the assets and liabilities which are transferred to the company resulting from the cross-border merger;
  - (n) dates of the merging companies' accounts used to establish the conditions of the cross-border merger.
- (2) For each of the merging companies the following particulars shall be published in the national gazette:
- (a) the type, name and registered office of each of the merging companies;
  - (b) the register in the sense of Article 3 (2) Directive 2009/101/EC where documentation on companies is filed for each of the merging companies;
  - (c) an indication, for each of the merging companies, of the arrangements made for the exercise of the rights of creditors and any minority shareholders of the merging companies and the address at which complete information on those arrangements may be obtained free of charge.

(3) Save as provided in Section 22 (4), the board of directors or the management board, as the case may be, of each of the merging companies must deliver a copy of the merger plan to the Registrar who must at least one month before the date of any meeting of that company summoned for the purpose of approving the merger (see Section 27), publish notice of receipt of the plan.

(4) Section 22 (3) does not apply in respect of a company if the merger plan is freely available on the company website (and the Registrar has been notified of the website address) throughout the period beginning one month before, and ending on, the date of any meeting of the company summoned for the purpose of approving the merger. In the case of a public company, the merger plan must be made freely available on the companies' websites.

(5) Where the cross-border merger is carried out by an acquiring company which holds all the shares and other securities conferring the right to vote in the company or companies being acquired, Section 22 (1) points (b), (c) and (d) do not apply.

#### *Comments*

The provision in Section 22 (1) implements Article 5 of Directive 2005/56/EC. Article 5 does not refer to rules on domestic mergers, but contains an independent enumeration of the information that the merger plan must include. The enumeration in Section 22 (1) follows the Directive. Section 22 (2) is based on Article 6 of Directive 2005/56/EC. Section 22 (3) and (4) are the same provisions as for domestic mergers (see Section 7 (4) and (5)). The exception of Section 7 (2) for shareholders of private companies to agree that no merger plan should be drawn up has not been applied for the cross-border merger, since Directive 2005/56/EC does not provide such exception. Section 22 (5) is based on Article 15 (1) Directive 2005/56/EC.

#### *Section 13.23*

### **Directors' Explanatory Report**

(1) The board of directors or the management board, as the case may be, of each of the merging companies shall draw up a detailed written report intended for the shareholders explaining and justifying the legal and economic aspects of the cross-border merger, in particular the share exchange ratio and, if applicable, the cash compensation for a sell-out right. That report shall also describe any special valuation difficulties which have arisen. It shall also explain the implications of the cross-border merger for shareholders, creditors and employees.

(2) The board of directors or the management board, as the case may be, of each of the merging companies shall inform the general meeting of their company and the board of directors or the management board of the other merging companies so that the latter may inform their respective general meetings of any material change in the assets and liabilities between the date of preparation of the merger plan and the date of the general meetings which are to decide on the merger plan.

#### *Comments*

According to the rules on domestic mergers, shareholders can agree to derogate from the requirement of preparing a directors' report, see above Section 8 (3). However, the 10<sup>th</sup> Directive on cross-border mergers, which applies to both private and public companies, requires that a merger statement must always be prepared in connection with a merger. Therefore, the possibility of derogating from preparing a merger statement is not included in Section 23.

#### *Section 13.24*

### **Expert's Examination and Report to Shareholders**

(1) One or more independent experts, acting on behalf of each of the merging companies, shall examine the merger plan and draw up a written report to the shareholders. The experts shall be entitled to secure from each of the merging companies all information they consider necessary for the discharge of their duties.

(2) The report must state in particular whether, in the expert's opinion, the share exchange ratio is fair and reasonable. The expert's statement must at least indicate the method or methods used to arrive at the share exchange ratio proposed and, if applicable, the cash compensation for a sell-out right; state whether such method or methods are adequate in the case in question, indicate the values arrived at using each such method and give an opinion on the relative importance attributed to such methods in arriving at the value decided on. The report shall also describe any special valuation difficulties which have arisen.

(3) The expert's report has to make a declaration as to whether the creditors of each of the merging companies whose claims predate the publication of the merger plan and have not fallen due at the time of such publication can be considered to be sufficiently protected after the merger or whether the financial situation of the merging companies requires particular safeguards.

(4) The independent experts shall be appointed by the competent court at the request of each merging company. At the request of all the merging companies, one or more joint experts may be appointed to draw up a single report on all the merging companies. The appointed expert shall be a person eligible for appointment as a statutory auditor.

(5) Neither an examination of the merger plan nor an expert report shall be required if all the shareholders and the holders of other securities conferring the right to vote of each of the merging companies in the merger have so agreed. The same applies where the cross-border merger is carried out by an acquiring company which holds all the shares and other securities conferring the right to vote in the company or companies being acquired.

#### *Comments*

Section 24 is similar to Section 9 on national mergers. It also takes into account Article 8 of Directive 2005/56/EC and the special remedy of minority shareholders to be entitled to sell their shares to the company being acquired (see Section 30). Section 24 (5), second sentence, is based on Articles 8 (4) and 15 (1) of Directive 2005/56/EC.

#### *Section 13.25*

#### **Supplementary Balance Sheet**

(1) This Section applies if the last annual accounts of any of the merging companies relate to a financial year ending more than 6 months before the board of directors or the management board, as the case may be, of the company adopt the merger plan.

(2) Where one of the merging companies falls within Section 25 (1) above, the board of directors or the management board, as the case may be, of the company must prepare a supplementary accounting statement, unless the shareholders and, where applicable, the holders of other securities conferring the right to vote, of each of the merging companies unanimously agree that no such statement is required.

(3) Where such statement is required, it must consist of a balance sheet, or a consolidated balance sheet, as the case may be, dealing with the state of affairs of the relevant company or group as at a date not more than three months before the merger plan was adopted by the board of directors or the management board, as the case may be, and the statement must be approved by the board of the relevant company.

(4) The supplementary balance sheet shall not be required if the company publishes a half yearly financial report in accordance with Article 5 of Directive 2004/109/EC and makes it available to shareholders in accordance with Section 26.

(5) The shareholders and all holders of other securities conferring the right to vote may agree that no interim balance sheet should be prepared, notwithstanding that the merger plan has been signed more than six months after the end of the financial year to which the company's most recent annual report relates.

*Comments*

Article 4 (1) (b) and (2) of Directive 2005/56/EC refer to the provisions concerning national mergers which aim towards protecting the creditors, shareholders and employees of the merging companies. In this way, the provisions of Directive 2011/35/EU on national mergers also apply to cross-border mergers. This is supplemented with the demands of Directive 2005/56/EC which provides for cross-border mergers. Hence, Section 25 is identical to Section 10 above.

*Section 13.26*

**Inspection of Documents**

- (1) The shareholders of each of the merging companies must be able, within a period of one month before the meeting called to approve the merger (see Section 27) to inspect, and make copies of, any of the documents listed below either at the registered office of that company or by freely accessing them on the company's website for downloading and printing.
- (2) The relevant documents are:
  - (a) the merger plan;
  - (b) the directors' explanatory report;
  - (c) where applicable, the expert's report to shareholders;
  - (d) the companies' annual accounts and annual reports for the last three financial years together with any supplementary accounting statement required by Section 25.

*Comments*

Section 26 is based on Section 11 regarding national mergers.

*Section 13.27*

**General Meetings of Merging Companies**

- (1) Subject to Section 27 (7), the merger plan must be approved by a majority in number, representing 2/3rd in value, of each class of shareholders of each of the merging companies, present and voting, either in person or by proxy at a meeting.
- (2) Where the merger is a merger by formation of a new company, the memorandum or draft memorandum and articles or draft articles shall be approved by an ordinary resolution of each of the merging companies.
- (3) The directors of each of the merging companies must report:
  - (a) to every meeting of the shareholders, or any class of shareholders, of that company summoned for the purpose of agreeing to the merger plan, and
  - (b) to the board of directors or the management board, as the case may be, of every other merging company, any material changes in the property and liabilities of that company between the date when the merger plan was adopted and the date of the meeting in question.
- (4) The board of directors or the management board, as the case may be, of each of the other merging companies must in turn:
  - (a) report those matters to every meeting of the shareholders, or any class of shareholders, of that company summoned for the purpose of agreeing to the merger plan, or
  - (b) send a report of those matters to every shareholder entitled to receive notice of such a meeting.
- (5) The general meeting of each of the merging companies may reserve the right to make implementation of the cross-border merger conditional on express ratification by it of the arrangements decided on with respect to the participation of employees in the company resulting from the cross-border merger.

(6) Section 27 (3) and (4) do not apply if all the holders of shares and other securities conferring the right to vote in general meetings of each of the merging companies have so agreed.

(7) In the case of any merger by acquisition, it is not necessary for the merger plan to be approved by the shareholders of the acquiring company if:

- (a) the acquiring company holds all the shares and other securities conferring the right to vote in the company or companies being acquired, or,
- (b) the court is satisfied that the conditions set out in Section 27 (8) to (10) have been complied with.

(8) The first condition is that either:

- (a) the publication of notice of receipt of the merger plan by the Registrar took place in respect of the acquiring company at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the company being acquired (or, if there is more than one company being acquired, any of them) summoned for the purposes of agreeing to the merger plan; or
- (b) the merger plan is made freely available on the company website, details of which have been notified to, and published by the Registrar, at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the company being acquired (or, if there is more than one company being acquired, any of them) summoned for the purposes of agreeing to the merger plan, and the merger plan remained available on the website throughout the period beginning one month before, and ending on, that date.

(9) The second condition is that each of the documents listed in the applicable paragraphs of Section 26 (2) relating to the acquiring company and the company being acquired (or, if there is more than one company being acquired, each of them):

- (a) are available for inspection and copying by the shareholders of the acquiring company during the period beginning one month before, and ending on, the date of any such meeting as is mentioned in Section 27 (8) (a) to inspect that document at the registered office of that company; or
- (b) are made freely available on the company website and remain available on the website throughout the period beginning one month before, and ending on, the date of any such meeting as is mentioned in Section 27 (8) (a).

(10) The third condition is that, no shareholder or shareholders of the acquiring company, holding not less than 5 % of the paid-up capital of the company which carried the right to vote at general meetings of the company (excluding any shares in the company held as treasury shares) has required, during that period, a meeting of the shareholders to be called for the purpose of deciding whether or not to agree to the merger.

(11) The board of directors or the management board, as the case may be, of each of the merging companies must notify the Registrar about the resolution on the merger or, as the case may be, deliver evidence that no resolution was necessary. The board of directors or the management board, as the case may be, must also notify the Registrar about the expert's declaration on the creditors' position as referred to in Section 24 (3).

(12) The Registrar shall publish notice of receipt of the documentation mentioned in Section 27 (11) and of the content of the expert's declaration on the creditors' position or that, according to Section 24 (5) no expert's report has been drawn up.

#### *Comments*

Article 9 of Directive 2005/56/EC requires approval of the cross-border merger by the general meeting of each of the merging companies. It refers to the provisions which are applicable to domestic mergers. Section 27 therefore is based on Section 12 which deals with national mergers.

Section 27 (5) is based on Article 9 (2) of Directive 2005/56/EC, Section 27 (7) (a) is based on Article 15 (1) of Directive 2005/56/EC.

*Section 13.28*

**Creditor Protection**

(1) Creditors whose claims antedate the publication as referred to in Section 22 (3) and (4) and have not fallen due at the time of such publication may claim adequate securities if one of the following conditions is fulfilled:

- (a) the expert's declaration referred to in Section 24 (3) concludes that the creditors are not sufficiently protected after the merger;
- (b) the experts' declaration referred to in Section 24 (3) concludes that the financial situation of the merging companies requires additional safeguards for creditors;
- (c) no expert's report has been drawn up according to Section 24 (5).

(2) Creditors claiming adequate securities under Section 28 (1) c) must credibly demonstrate that due to the merger the satisfaction of their claim is at stake and that no adequate safeguards have been obtained from the company.

(3) The creditors must file their claim no later than four weeks after the date on which the Registrars of all of the merging companies published the notice referred to in Section 27 (12). The final implementation of the merger as referred to in Section 33 can only be registered upon expiry of the time allowed for filing such claims.

*Comments*

Pursuant to Article 4 (2) of Directive 2005/56/EC the provisions and formalities for the protection of creditors shall be applied, taking into account the cross-border nature of the merger. The procedure whereby the creditors have to file their claims prior to the merger taking effect is also suitable for cross-border transactions. Section 28 on creditor protection therefore is similar to Section 13 on national mergers.

*Section 13.29*

**Protection of Holders of Securities to Which Special Rights Attach**

(1) A person who, other than in his capacity as shareholder, may exercise a particular right against a company being acquired, such as a right to a distribution of profits or a right to acquire shares, must obtain an equivalent right in the acquiring company.

(2) Section 29 (1) does not apply if:

- (a) the holder has agreed otherwise; or
- (b) the holder is, or under the merger plan is to be, entitled to have the securities purchased by the acquiring company on terms that the court considers reasonable.

*Comments*

This provision is similar to Section 16 on national mergers.

*Section 13.30*

**Sell-out Right of Dissenting Shareholders**

The company being acquired by another company not being subject to the same national law as the company being acquired has to offer, in the merger plan, to those of its shareholders who have opposed the merger at the general meeting to acquire their shares in return for appropriate cash compensation upon written request by such shareholders no later than four weeks after the date of the general meeting.

*Comments*

Article 4 (2) of Directive 2005/56/EC grants Member States the right to adopt provisions designed to ensure appropriate protection for minority shareholders who have opposed the cross-border merger. Some Member States, like Denmark, Germany, Italy and Spain, grant minority shareholders a sell-out right in a cross-border merger. While the sell-out right of dissenting shareholders is optional in the case of a national merger (see Section 17), it should be mandatory for cross-border mergers.

*Section 13.31*

**Merger by Acquisition of a Non-wholly Owned Subsidiary**

(1) This Section applies in the case of a merger by acquisition where 90 % or more (but not all) of the relevant securities of the company being acquired (or, if there is more than one company being acquired, of each of them) are held by or on behalf of the acquiring company.

(2) If the conditions in Section 31 (3) and (4) are met, the requirements of the following Sections do not apply:

- (a) Section 23 (directors' explanatory report),
- (b) Section 24 (expert's report),
- (c) Section 25 (supplementary accounting statement),
- (d) Section 26 (inspection of documents), and
- (e) Section 27 (3) and (4) (report on material changes of assets of merging company).

(3) The first condition is that the merger plan provides that every other holder of relevant securities has the right to require the acquiring company to acquire those securities.

(4) The second condition is that, if a holder of securities exercises that right, the consideration to be given for those securities is fair and reasonable.

*Comments*

Section 31 (1) to (4) are similar to Section 15 (1) to (4) on national merger. The option of not having the merger plan approved by a general meeting of the company being acquired (see Section 15 (5) for national mergers) has not been applied to the cross-border merger since Article 15 (2) of Directive 2005/56/EC only allows simplifications regarding the reports by an independent expert and the documents necessary for scrutiny.

*Section 13.32*

**Legal Scrutiny and Pre-Merger Certificate**

(1) The competent court of the company or companies being acquired must check and certify the existence and validity of the legal acts and formalities as regards that part of the procedure which concerns the merging companies subject to its national law.

(2) The board of directors or the management board, as the case may be, of the company or the companies being acquired shall file an application for legal scrutiny which is accompanied at least by the following documents:

- (a) the merger plan as approved by the general meetings of the merging companies;
- (b) the minutes of the general meeting of the company;
- (c) the directors' explanatory report;
- (d) the expert's report;
- (e) the supplementary balance sheet, if applicable.

(3) If any documents mentioned in Section 32 (2) are dispensable in the particular case, the company must deliver documentation evidencing the applicability of the relevant exception. It shall also, at the request of the competent court, deliver any other documentation which is needed to scrutinize the legality of the merger.

(4) The court has to issue without delay to each of the companies' subject to its national law a certificate conclusively attesting to the proper completion of the per-merger acts and formalities.

#### *Comments*

Section 32 is based on Articles 10 and 11 of Directive 2005/56/EC which requires legal scrutiny of the cross-border merger and the issuance of a pre-merger certificate conclusively attesting to the proper completion of the pre-merger acts and formalities.

Article 10 (3) of Directive 2005/56EC has not been implemented in the EMCA, since EMCA (unlike national systems like Austria or Germany) does not include a procedure to scrutinize and amend the ratio applicable to the exchange of shares.

#### *Section 13.33*

### **Legal Effect of the Merger**

(1) The court competent for the acquiring company must check and certify the existence and validity of the legal acts and formalities as regards that part of the procedure which concerns the merging companies subject to its national law including, if applicable, the formation of a new company resulting from the cross-border merger. The court shall in particular ensure that the merging companies have approved the common merger plan in the same terms and, where appropriate, that arrangements for employee participation have been made in accordance with Section 35. Section 32 (2) and (3) apply accordingly. The merging companies must also submit to the court the certificates referred to in Section 32 (4) within six months of its issue.

(2) The merger shall be effective upon registration by the Registrar of the acquiring company. The Registrar shall notify, without delay, the company register of the company or companies being acquired that the merger has taken effect. Deletion of the old registration, if applicable, shall be effected on receipt of that notification, but not before.

(3) From the effective date according to Section 33 (2), a merger by acquisition or formation carried out in accordance with the requirements above shall have the following effects:

(a) the transfer, both as between the company being acquired and the acquiring company and as regards third parties, to the acquiring company of all the assets and liabilities of the company being acquired;

(b) the shareholders of the company being acquired become shareholders of the acquiring company;

(c) no shares in the acquiring company shall be exchanged, however, for shares in the company being acquired held either:

(i) by the acquiring company itself or through a person acting in his own name but on its behalf;  
or

(ii) by the company being acquired itself or through a person acting in his own name but on its behalf;

(d) the rights and obligations of the merging companies arising from contracts of employment or from employment relationships and existing at the date on which the merger takes effect shall, by reason of that merger taking effect, be transferred to the acquiring company on the date on which the merger takes effect;

(e) the company being acquired ceases to exist.

(4) The acquiring company is obliged to make to the shareholders of the company (or companies) being acquired any cash payment required by the merger plan.

(5) From the effective date according to Section 33 (2), the merger cannot be declared null and void.

*Comments*

Section 33 is similar to Section 19 on national mergers and based on Articles 13 and 14 of Directive 2005/56/EC. Section 33 (5) is based on Article 17 of Directive 2005/56/EC.

*Section 13.34*

**Civil Liability of Management and Independent Persons towards Shareholders**

A director of any of the merging companies or an independent expert who has reported pursuant to Section 24 will be held liable for any loss or damage suffered by any shareholder or creditor by reason of their misconduct in the preparation or implementation of the merger.

*Comments*

Section 34 is similar to Section 20 on national mergers.

*Section 13.35*

**Employee Participation**

In the cases referred to in Article 16 (2) of Directive 2005/56/EC, the participation of employees in the acquiring company shall be regulated in accordance with the principles and procedures laid down in Article 16 (3) to (7) of Directive 2005/56/EC.

*Comments*

Article 16 of Directive 2005/56/EC provides for the protection of employee participation rights in certain circumstances. These procedures are designed in accordance with those already established by Directive 2001/86/EC on the involvement of employees in the European Company. The Directive on the European Company has to be implemented by every Member State and the procedure to be applied in case of a cross-border merger is to a large extent derived from that Directive. This procedure requires a detailed framework for establishing a special negotiation body of employees and for negotiations between this special negotiation body and the management bodies of the companies involved. These procedures do not belong to the core of company law but rather have to be adapted to the national systems of worker participation. Therefore, EMCA abstains from regulating such procedures deriving from the applicable national law.

PART 4  
CROSS-BORDER TRANSFER OF REGISTERED OFFICE – CROSS-BORDER  
CONVERSION

*Section 13.36*

**Cross-border Transfer of Registered Office**

- (1) Limited liability companies that are subject to this act may transfer their registered office cross-border thereby changing the applicable company law. The transfer shall not result in the winding up of the company or the creation of a new legal person.
- (2) A company may not transfer its registered office if proceedings for winding up, liquidation, insolvency or suspension of payments or other similar proceedings have been brought against it.
- (3) Companies from other jurisdictions may apply for registration under this Act, thereby transferring their registered office in the meaning of Section 36 (1), under the following conditions:
  - (a) the company has to present documentation to the Registrar conclusively evidencing the legal acts and formalities as regards the part of the procedure which is governed by its applicable national law prior to the cross-border transfer of the registered office;
  - (b) the company applying for reregistration will have to comply with the provisions of this Act on formation and registration. The company applying for reregistration must also submit to the court the certificate referred to in Section 45 (4) within six months of its issue.

*Comments*

It is established case law of the European Court of Justice (Case C 378/10 – Vale) that the right to accomplish a cross-border conversion is protected by the freedom of establishment. Limited liability companies may transfer their registered office from one Member State to another and thereby change the applicable law without having to be liquidated. The EMCA Group therefore is of the opinion that provisions on a cross-border conversion should be included in any modern Companies Act.

The EMCA Group tried to create substantive rules regulating the corporate operation as such. Following these rules, the transfer of the registered office shall lead to a change in the applicable company law. The group was aware of the fact that EU Member States apply different theories regarding the connecting factor which determines the applicable company law. That a change of the applicable company law, however, requires at least a transfer of the registered office of the company from the state of origin to the new state of incorporation, seems to be a common denominator.

Therefore the model created for the EMCA shall not be seen as a final decision between the “incorporation theory” and the “real seat theory”. An adapting state is free to add a provision whereby the transfer of the central administration is also required for a cross-border conversion. Also it should be noted, that the cross-border operation always requires the combination of two legal systems. This means that it depends on the other legal system involved whether the transfer of the registered office will be sufficient to change the applicable company law. The following provisions are to a certain extent derived from the Council Regulation (EC) No. 2157/2001 on the European Company. Article 8 of this Regulation already provides for a cross-border transfer of the registered office. Other parts of the following provisions are derived from the procedure of the cross-border merger which involves in a comparable way the need to protect particular interests, such as those of minority shareholders, creditors and employees.

Section 36 (1) is derived from Article 8 (1) Regulation (EC) No. 2157/2001, Section 36 (2) is derived from Article 8 (15) of that Regulation.

*Section 13.37*

**Cross-border Transfer Plan**

- (1) The board of directors of the management board, as the case may be, of the company must draw up and sign a cross-border transfer plan, which must include information and provisions on
- (a) the current name, registered office and number of the company;
  - (b) the proposed registered office of the company after the transfer;
  - (c) the proposed articles of association of the company;
  - (d) any implication the transfer may have on employees' involvement;
  - (e) the proposed transfer time table;
  - (f) the amount of the appropriate cash compensation for a sell-out right under Section 44;
  - (g) any other rights provided for the protection of shareholders and creditors;
- (2) The following particulars shall be published in the national gazette:
- (a) the type, name and registered office of the company;
  - (b) the register in the sense of Chapter 3 Section 6 of this Act where documentation on companies is filed for the company;
  - (c) an indication of the arrangements made for the exercise of the rights of creditors and any minority shareholders of the company and the address at which complete information on those arrangements may be obtained free of charge.
- (3) Save as provided in Section 37 (4), the board of directors or the management board, as the case may be, of the company must deliver a copy of the cross-border transfer plan to the Registrar who must at least one month before the date of any meeting of that company summoned for the purpose of approving the cross-border transfer (see Section 41), publish notice of receipt of the plan.
- (4) Section 37 (3) does not apply in respect of a company if the cross-border transfer plan is freely available on the company website (and the Registrar has been notified of the website address) throughout the period beginning one month before, and ending on, the date of any meeting of the company summoned for the purpose of approving the transfer. In the case of a public company, the cross-border transfer plan must be made freely available on the companies' websites.

*Comments*

The provision in Section 37 are based on Article 8 (2) Regulation (EC) No. 2157/2001/EC, on the one hand, and on Section 22 on the cross-border merger, on the other hand.

*Section 13.38*

**Directors' Explanatory Report**

The board of directors or the management board, as the case may be, of the company shall draw up a detailed written report explaining and justifying the legal and economic aspects of the transfer and explaining the implications of the transfer for shareholders, creditors and employees.

*Comments*

Section 38 is based on Article 8 (3) Regulation (EC) No. 2157/2001.

*Section 13.39*

**Expert's Examination and Report to Shareholders**

- (1) One or more independent experts, acting on behalf of the company, shall examine the cross-border transfer plan and draw up a written report to the shareholders. The experts shall be entitled to secure from the company all information they consider necessary for the discharge of their duties.
- (2) The report must state in particular whether, in the expert's opinion, the cash compensation for the sell-out right (see Section 44) is fair and reasonable. The expert's statement must at least indicate the method or methods used to arrive at the value of the cash compensation; state whether such method or methods are adequate in the case in question, indicate the values arrived at using each such method and give an opinion on the relative importance attributed to such methods in arriving at the value decided on. The report shall also describe any special valuation difficulties which have arisen.
- (3) The independent experts shall be appointed by the competent court at the request of the company. The appointed expert shall be a person eligible for appointment as a statutory auditor.
- (4) Neither an examination of the cross-border transfer plan nor an expert report shall be required if all the shareholders and the holders of other securities conferring the right to vote of the company have so agreed.

*Comments*

Section 39 is similar to Section 9 on national mergers and Section 24 on cross-border mergers. Even though there is no need to evaluate a share exchange ratio in the case of a cross-border transfer of the registered office, the sell-out right of the minority shareholders (see Section 44) requires a fair and reasonable valuation of the cash compensation to be offered for the shares. Court litigation as to whether the compensation is fair and reasonable could considerably delay or even block the transfer. The Act therefore proposes to leave the evaluation to an independent expert who will be liable for any misconduct (see Section 47).

The expert's report is not necessary if all the shareholders have so agreed. In such a case usually the shareholders will unanimously approve the transfer. If there are no opposing shareholders, there will be nobody to claim a sell-out right in the sense of Section 44 and no expert's report will be required.

*Section 13.40*

**Inspection of Documents**

- (1) The shareholders of the company must be able, within a period of one month before the meeting called to approve the transfer (see Section 41) to inspect, and make copies of, any of the documents listed below either at the registered office of the company or by freely accessing them on the company's website for downloading and printing.
- (2) The relevant documents are:
  - (a) the cross-border transfer plan;
  - (b) the directors' explanatory report;
  - (c) where applicable, the expert's report to shareholders;

*Comments*

Section 40 is based on Article 8 (4) of Regulation (EC) No. 2157/2001.

*Section 13.41*

**General Meeting Approving the Transfer**

- (1) The cross-border transfer plan must be approved by a majority in number, representing 2/3rd in value, of each class of shareholders of the company, present and voting, either in person or by proxy at a meeting.
- (2) The general meeting may reserve the right to make implementation of the cross-border transfer of registered office, conditional on express ratification by it of the arrangements decided on with respect to the participation of employees.
- (3) The board of directors or the management board, as the case may be, of the company must notify the Registrar about the resolution on the transfer.
- (4) The Registrar shall publish notice of receipt of the documentation mentioned in Section 41 (3).

*Comments*

Section 41 is based on Article 8 (6) of Regulation (EC) No. 2157/2001. Section 41 (1) and (2) are similar to the provisions on cross-border mergers (see Section 27 (1) and (5)) and is due to the fact that there may be a need for negotiations on employee involvement in the course of the cross-border transfer procedure (see Section 48).

*Section 13.42*

**Creditor Protection**

Creditors whose claims predate the publication as referred to in Section 37 (3) and (4) and have not fallen due at the time of such publication may claim adequate securities if they can credibly demonstrate that due to the cross-border transfer of registered office the satisfaction of their claim is at risk and that no adequate safeguards have been obtained from the company. The creditors must file their claim no later than four weeks after the date on which the Registrar of the company published the notice referred to in Section 41 (4). The final implementation of the transfer as referred to in Section 46 can only be registered upon expiry of the time allowed for filing such claims.

*Comments*

Unlike a merger, the transfer of the registered office usually will not affect the position of the creditors. The company will continue to exist under a new applicable law, but the assets and liabilities of the company remain unchanged. Therefore, the need for creditor protection is less obvious than in the case of a cross-border merger. There may be, however, exceptional cases where the transfer is accompanied by a transfer of assets or where the transfer could be part of an abusive way to weaken the position of creditors. Section 42 takes account of such cases offering to creditors the opportunity to demonstrate why they think that, due to the cross-border transfer of the registered office, the satisfaction of their claims is at risk. A similar provision can be found in the German Act accompanying the introduction of the European Company (§ 13 SE-Ausführungsgesetz). Article 8 (7) of Regulation (EC) No. 2157/2001 expressly gives Member States the right to lay down requirements to adequately protect creditors in the case of a cross-border transfer of the registered office.

*Section 13.43*

**Protection of Holders of Securities to Which Special Rights Attach**

- (1) A person who, other than in his capacity as shareholder, may exercise a particular right against the company, such as a right to a distribution of profits or a right to acquire shares, must obtain an equivalent right in the company after the cross-border transfer of the registered office.
- (2) Section 43 (1) does not apply if:
  - (a) the holder has agreed otherwise, or
  - (b) the holder is, or under the cross-border transfer plan is to be, entitled to a sell-out right as mentioned in Section 44.

*Comments*

This provision is similar to Section 29 on cross-border mergers. It protects holders of securities who might lose their specific rights attached to the security by transferring the company into another legal system.

*Section 13.44*

**Sell-out Right of Dissenting Shareholders**

The company has to offer, in the cross-border transfer plan (Section 37 (1) f), to those of its shareholders who have opposed the transfer at the general meeting to acquire their shares in return for appropriate cash compensation upon written request by such shareholders no later than four weeks after the date of the general meeting.

*Comments*

The provision is similar to Section 30 regarding the cross-border merger. The interest of minority shareholders is comparable in a situation of a cross-border transfer of the registered office. This is also acknowledged by Article 8 (5) of Regulation (EC) No. 2157/2001 which allows Member States to ensure appropriate protection for minority shareholders who oppose the transfer.

The cross-border transfer leads to the application of another legal system which may have less or different rules on minority protection. Therefore, minority shareholders who opposed the transfer in the general meeting should have the possibility of leaving the company prior to the transfer. The value of the compensation shall be determined by independent experts (see Section 39).

*Section 13.45*

**Legal Scrutiny and Pre-transfer Certificate**

(1) The competent court of the company must assess and certify the validity of those acts and formalities required by and governed by its national law.

(2) The board of directors or the management board, as the case may be, of the company shall file an application for legal scrutiny which is accompanied at least by the following documents:

- (a) the cross-border transfer plan as approved by the general meeting;
- (b) the minutes of the general meeting of the company;
- (c) the directors' explanatory report;
- (d) the expert's report.

(3) If any documents mentioned in Section 45 (2) have been dispensed with in the particular case, the company must deliver documentation evidencing the applicability of the relevant exception. It shall also, at the request of the competent court, deliver any other documentation which is needed to scrutinize the legality of the cross-border transfer of the registered office.

(4) The court must issue without delay to the company a certificate conclusively attesting to the proper completion of the pre-transfer acts and formalities.

*Comments*

Section 45 is similar to Section 32 on cross-border merger and is also derived from Article 8 (8) of Regulation (EC) No. 2157/2001 on the cross-border transfer of the registered office of a European Company.

*Section 13.46*

**Legal Effect of the Transfer of the Registered Office**

(1) The cross-border transfer of the registered office shall be effective upon registration by the Registrar of the new register. The Registrar or the competent court, as the case may be, of the new register must assess and certify the validity of the acts and formalities carried out by the company and which are required by the procedure of the new registration. The Registrar shall notify, without delay, the company register where the company has been incorporated prior to the transfer that the transfer has taken effect. Deletion of the old registration shall be effected on receipt of that notification, but not before.

(2) From the effective date according to Section 46 (1), the transfer cannot be declared null and void.

*Comments*

Section 46 is similar to Section 33 on cross-border mergers and is also based on Article 8 (9) to (12) of Regulation (EC) No. 2157/2001.

*Section 13.47*

**Civil Liability of Management and Independent Persons towards Shareholders**

A director of the company or an independent expert who has reported pursuant to Section 38 will be held liable for any loss or damage suffered by any shareholder or creditor by reason of their misconduct in the preparation or implementation of the transfer.

*Comments*

Section 47 is similar to Section 34 on cross-border mergers.

*Section 13.48*

**Employee Participation**

The principles and procedures laid down in Article 16 (3) to (7) of Directive 2005/56/EC shall apply, mutatis mutandis, to the cross-border transfer of the registered office if the company, in the six months before the publication of the cross-border transfer plan as referred to in Section 37, is operating under an employee participation system within the meaning of Article 2 (k) of Directive 2001/86/EC and where the national law applicable to the company after the cross-border transfer of the registered office does not provide for at least the same level of employee participation.

*Comments*

In the case of a cross-border transfer of the registered office, the applicable system of employee participation may be affected. In the case of a cross-border mergers, Article 16 of Directive 2005/56/EC provides for the protection of employee participation rights in such cases. A comparable system has been established by Directive 2001/86/EC on the involvement of employees in the European Company. Section 48 refers to the principles to be applied in the case of a cross-border merger. These principles should be either applied by analogy or should be implemented in a special act on employee protection in cross-border restructurings. Such procedures are, however, not part of the core of company law but have to be adapted from the national systems of worker participation.

PART 5  
DIVISIONS

GENERAL PROVISIONS

*Section 13.49*

**Definitions**

(1) A “division by acquisition” is the operation whereby a company is wound up without liquidation and transfers to more than one company all its assets and liabilities in exchange for the issue of shares in the acquiring companies to the shareholders of the company being divided and, as the case may be, a cash payment.

(2) A “division by the formation of new companies” is the operation whereby a company is wound up without liquidation and transfers to more than one company incorporated by it, all its assets and liabilities in exchange for the issue to the shareholders of the company being divided of shares in the new companies and, as the case may be, a cash payment.

(3) For the purpose of this Part on Divisions the “companies involved in the division” shall mean all the companies participating in the division. “The company being divided” shall mean the company which is going to be wound up without liquidation and transferring all its assets to the “acquiring companies”, the latter meaning the companies to which the assets are transferred – be it an existing company (in the case of a division by acquisition) or a new company (in the case of a division by formation of new companies).

*Comments*

The definitions are based on Articles 2 and 21 of Directive 82/891/EEC on national divisions. The requirement that the shareholders of the company being divided must receive, if applicable, a cash payment not exceeding 10 % of the nominal value of the shares can be derogated from (cf. Article 24 of the Directive). Thus, the 10 % limitation has not, for example, been implemented in the Danish Companies Act and in the German Act on Transformations. According to these national provisions, a division may also take place where no consideration is made in form of shares or payment, or where cash payment exceeds 10 % of the nominal value of the shares. The EMCA takes the same view meaning that the non-cash payment may be more than 10 %.

*Section 13.50*

**Companies in Liquidation**

A division by acquisition or by formation of new companies may also be effected where the company which is ceasing to exist is in liquidation, provided that this option is restricted to companies which have not yet begun to distribute their assets to their shareholders.

*Comments*

Section 50 makes use of the options contained in Article 3(2) and Article 4(2) of Directive 2011/35/EU on national mergers which also apply to divisions (see Article 2 (2) and Article 21 (2) of Directive 82/891/EEC).

## DOMESTIC DIVISIONS

### *Section 13.51*

#### **Division Plan**

- (1) Subject to Section 51 (2) where a division of either type specified in Section 49 is proposed to be entered into, the board of directors or the management board, as the case may be, of the companies involved in the division must draw up and agree a division plan.
- (2) If the division only involves private limited companies, the shareholders may agree that no division plan should be drawn up (but see Section 56 (8)).
- (3) If the division involves public limited companies, the division plan must state, at least:
  - (a) the type, name and registered office of each of the companies involved in the division, including, if applicable, of the newly formed companies;
  - (b) the ratio applicable to the exchange of securities or shares representing the company capital and the amount of any cash payment;
  - (c) the terms relating to the allotment of shares in the acquiring company;
  - (d) the date from which the holding of such shares entitles the holders to participate in profits and any special conditions affecting that entitlement;
  - (e) the precise description and allocation of the assets and liabilities to be transferred to each of the acquiring companies;
  - (f) the date from which the transactions of the company being divided shall be treated for accounting purposes as being those of one or other of the acquiring companies;
  - (g) any special conditions, including special rights or restrictions, whether in regard to voting, participation in profits, share capital or otherwise, which will apply to shares or other securities issued by the acquiring companies in exchange for shares or other securities in the company being divided;
  - (h) any payment or benefit in cash or otherwise, paid or given or intended to be paid or given to any independent person referred to in Section 53 and/or to any director of any of the companies involved in the division insofar as it differs from the payment or benefit paid or given to other persons in respect of the division and the consideration, if any, for any such payment or benefit;
  - (j) a draft instrument of incorporation and articles of association if a new limited liability company is formed by the division.
- (4) Save as provided in Section 51 (5), the board of directors or the management board, as the case may be, of each of the companies involved in the division must deliver a copy of the division plan to the Registrar who must at least one month before the date of any meeting of that company summoned for the purpose of approving the division (see Section 56), publish notice of receipt of the plan.
- (5) Section 51 (4) does not apply in respect of a company if the division plan is freely available on the company's website (and the Registrar has been notified of the website address) throughout the period beginning one month before, and ending on, the date of any meeting of the company summoned for the purpose of approving the division. In the case of a public company, the division plan must be made freely available on the company's website.

#### *Comments*

According to Article 3 Directive 82/891/EEC the administrative or management bodies – depending on whether the company applies a one-tier or a two-tier system (see Chapter 8) – of the companies involved in the division shall draw up a division plan in writing. The Directive is only applicable to public companies, therefore Section 51 (2) allows for an exception in the case of a private company if all the shareholders agree.

The division plan must be published in accordance with Article 4 of Directive 82/891/EEC. But a company shall be exempt from the publication requirement if it makes the division plan available on its website (see amendments to Article 4 of Directive 82/891/EEC by Article 3 of Directive 2009/109/EC).

*Section 13.52*

**Directors' Explanatory Report**

- (1) The board of directors or the management board, as the case may be, of each of the companies involved in the division shall draw up a detailed written report explaining the division plan and setting out the legal and economic grounds for them, in particular the share exchange ratio and the criterion determining the allocation of shares. That report shall also describe any special valuation difficulties which have arisen.
- (2) The board of directors or the management board, as the case may be, of each of the companies involved in the division shall inform the general meeting of their company and the board of directors or the management board of the other companies involved in the division so that the latter may inform their respective general meetings of any material change in the assets and liabilities between the date of preparation of the division plan and the date of the general meetings which are to decide on the division plan.
- (3) The report referred to in Section 52 (1) and/or the information referred to in Section 52 (2) shall not be required if all the shareholders and the holders of other securities conferring the right to vote of each of the companies involved in the division have so agreed.

*Comments*

Section 52 is based on Article 7 Directive 82/891/EEC. Section 52 (3) makes use of the option to waive the requirement of a directors' report by unanimous shareholder vote (see Article 10 of Directive 82/891/EEC).

*Section 13.53*

**Expert's Examination and Report to Shareholders**

- (1) One or more independent experts, acting on behalf of each of the companies involved in the division, shall examine the division plan and draw up a written report to the shareholders. The experts shall be entitled to secure from each of the companies involved in the division all information they consider necessary for the discharge of their duties.
- (2) That report must state in particular whether, in the expert's opinion, the share exchange ratio is fair and reasonable. The expert's statement must at least indicate the method or methods used to arrive at the share exchange ratio proposed; state whether such method or methods are adequate in the case in question; indicate the values arrived at using each such method and give an opinion on the relative importance attributed to such methods in arriving at the value decided on. The report shall also describe any special valuation difficulties which have arisen.
- (3) The expert's report has to make a declaration as to whether the creditors of each of the companies involved in the division, whose claims antedate the publication of the division plan and have not fallen due at the time of such publication, can be considered to be sufficiently protected after the division or whether the financial situation of the companies involved in the division requires particular safeguards.
- (4) The independent experts shall be appointed by the competent court at the request of each company involved in the division. At the request of all the companies involved in the division, one or more joint experts may be appointed to draw up a single report on all the companies involved in the division. The appointed expert shall be a person eligible for appointment as a statutory auditor.
- (5) Neither an examination of the division plan nor an expert report shall be required if all the shareholders and the holders of other securities conferring the right to vote of each of the companies involved in the division have so agreed.

*Comments*

Section 53 is based on Article 8 Directive 82/891/EEC. Section 53 (4) makes use of the option to appoint one or more independent experts for all the merging companies (see Article 8 (1) Directive). Section 53 (5) makes use of the option to waive the requirement of an expert's report by unanimous shareholder vote (see Article 10 of Directive 82/891/EEC). Section 53 (3) is part of the creditor protection regime and will be explained below (see Section 57).

*Section 13.54*

**Supplementary Balance Sheet**

- (1) This Section applies if the last annual accounts of any of the companies involved in the division relate to a financial year ending more than 6 months before the board of directors or the management board, as the case may be, of the company adopts the division plan.
- (2) Where one of the companies involved in the division falls within Section 54 (1) above, the board of directors or the management board, as the case may be, of the company must prepare a supplementary accounting statement, unless the shareholders and, where applicable, the holders of other securities conferring the right to vote, of each of the companies involved in the division, unanimously agree that no such statement is required.
- (3) Where such statement is required, it must consist of a balance sheet, or a consolidated balance sheet, as the case may be, dealing with the state of affairs of the relevant company or group as at a date not more than three months before the division plan (see above Section 51) was adopted by the board of directors or the management board, as the case may be, and the statement must be approved by the board of the relevant company.
- (4) The supplementary balance sheet shall not be required if the company publishes a half yearly financial report in accordance with Article 5 of Directive 2004/109/EC and makes it available to shareholders in accordance with Section 55.

*Comments*

The rules in Section 54 are based on Article 9 of Directive 82/891/EEC. Article 9 (1) (c) states that “All shareholders shall be entitled to inspect at least the following documents at the registered office at least one month before the date of the general meeting which is to decide on the draft terms of division: [...] where applicable, an accounting statement drawn up as at a date which must not be earlier than the first day of the third month preceding the date of the draft terms of division, if the latest annual accounts relate to a financial year which ended more than six months before that date”.

Member States may require, however, that an accounting statement shall not be required if all the shareholders and the holders of other securities conferring the right to vote of each of the companies involved in the division have so agreed (see Article 10 of Directive 82/891/EEC). The EMCA group proposes to make use of this Member State option.

*Section 13.55*

**Inspection of Documents**

- (1) The shareholders of each of the companies involved in the division must be able, within a period of one month before the meeting called to approve the division (see Section 56), to inspect and make copies of any of the documents listed below either at the registered office of that company or by freely accessing them on the company's website for downloading and printing.
- (2) The relevant documents are:
  - (a) the division plan;
  - (b) where applicable, the directors' explanatory report;
  - (c) where applicable, the expert's report to shareholders;
  - (d) the companies' annual accounts and annual reports for the previous three financial years together with any supplementary accounting statement required by Section 54.

*Comments*

Section 55 is based on Article 9 of Directive 82/891/EEC.

*Section 13.56*

**General Meetings of Companies Involved in the Division**

- (1) Subject to Section 56 (8) and Section 58 (2), the division plan must be approved by a majority in number, representing 2/3 in value, of each class of shareholders of each of the companies involved in the division, present and voting, either in person or by proxy at a meeting.
- (2) Where the division is a division by formation of a new company, the memorandum or draft memorandum and articles or draft articles shall be approved by an ordinary resolution of each of the companies involved in the division.
- (3) The board of directors or the management board, as the case may be, of each of the companies involved in the division must report:
  - (a) to every meeting of the shareholders, or any class of shareholders, of that company summoned for the purpose of agreeing to the division plan, and
  - (b) to the board of directors or the management board, as the case may be, of every other merging company, any material changes in the property and liabilities of that company between the date when the division plan was adopted and the date of the meeting in question.
- (4) The board of directors or the management board, as the case may be, of each of the other companies involved in the division must in turn:
  - (a) report those matters to every meeting of the shareholders, or any class of shareholders, of that company summoned for the purpose of agreeing to the division plan; or
  - (b) send a report of those matters to every shareholder entitled to receive notice of such a meeting.
- (5) Section 56 (3) and (4) do not apply if all the holders of shares and other securities conferring the right to vote in general meetings of each of the companies involved in the division have so agreed.
- (6) If the division only involves private limited companies, and if the shareholders have agreed under Section 51 (2) that no division plan should be drawn up, the following issues must be addressed in connection with the adoption of the division:
  - (a) the names and any secondary names of the private limited companies, including whether the name or secondary name of any non-surviving company is to be adopted as a secondary name of the surviving company;
  - (b) the consideration offered for the shares in a non-surviving private limited company;

- (c) the time from which any shares offered as consideration will confer on the holders a right to receive dividends;
  - (d) the time from which the rights and obligations of a non-surviving private limited company are considered to have been transferred for accounting purposes;
  - (e) the precise description and allocation of the assets and liabilities to be transferred to each of the acquiring companies;
  - (f) provision for the treatment of assets or liabilities not explicitly allocated, especially of assets or liabilities unknown on the date on which the division is prepared, providing that not explicitly allocated assets and liabilities shall be allocated in the same proportion;
  - (g) the allocation to the shareholders of the company being divided of shares in the acquiring companies and the criterion upon which such allocation is based; and
  - (h) the articles of association if a new private limited company is formed by the division.
- (7) If the division only involves private limited companies, and if the shareholders have agreed under Section 51 (2) that no division plan should be drawn up, identical resolutions must have been passed by all of the existing private limited companies participating in the division with regard to the requirements in Section 56 (2). If this is not the case, the resolution to implement the division is considered to have lapsed.
- (8) In the case of any division by acquisition, it is not necessary for the division plan to be approved by the shareholders of the acquiring company if the court is satisfied that the conditions set out in Section 56 (9) to (12) have been complied with.
- (9) The first condition is that either:
- (a) the publication of notice of receipt of the division plan by the Registrar took place in respect of the acquiring company at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the company being divided summoned for the purposes of agreeing to the division plan; or
  - (b) the division plan is made freely available on the company website, details of which have been notified to, and published by the Registrar, at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the company being divided summoned for the purposes of agreeing to the division plan, and the division plan remains available on the website throughout the period beginning one month before, and ending on, that date.
- (10) The second condition is that each of the documents listed in the applicable paragraphs of Section 55 (2) relating to the acquiring company and the company being divided:
- (a) are available for inspection and copying by the shareholders of the acquiring company during the period beginning one month before, and ending on, the date of any such meeting as is mentioned in Section 56 (9) (a) to inspect that document at the registered office of that company; or
  - (b) are made freely available on the company website and remain available on the website throughout the period beginning one month before, and ending on, the date of any such meeting as is mentioned in Section 56 (9) (a).
- (11) The third condition is that, no shareholder or shareholders of the acquiring company, holding not less than 5 % of the paid-up capital of the company which carried the right to vote at general meetings of the company (excluding any shares in the company held as treasury shares) has required, during that period, a meeting of the shareholders to be called for the purpose of deciding whether or not to agree to the division.
- (12) The board of directors or the management board, as the case may be, of each of the companies involved in the division must notify the Registrar about the resolution on the division or, as the case may be, deliver evidence that no resolution was necessary. The board of directors or the management board, as the case may be, must also notify the Registrar about the expert's declaration on the creditors' position as referred to in Section 53 (3).

(13) The Registrar shall publish notice of receipt of the documentation mentioned in Section 56 (12) and of the content of the expert's declaration on the creditors' position or that, according to Section 53 (5) no expert's report has been drawn up.

*Comments*

Article 5 of Directive 82/891/EEC requires that a division is to be adopted by the general meeting in each of the companies involved in the division with at least 2/3 majority. Some Member States such as Germany, Ireland and the UK require a higher majority of 75 %, but most Member States follow the Directive in requiring a 2/3 majority.

Article 7 (3) of Directive 82/891/EEC contains a duty of the companies to inform their respective general meetings of any material change in the assets and liabilities between the date of preparation of the division plan and the date of the general meetings which are to decide on the division plan. According to Article 10 of the Directive, Member States may provide that such information shall not be required if the shareholders and the holders of other securities conferring the right to vote have agreed to waive this requirement.

According to Article 6 of the Directive, the Member States need not require approval of the division by the general meeting of an acquiring company if certain conditions are met. These conditions include that the division plan is published, for the acquiring company, at least one month before the date fixed for the general meeting of the company or companies being divided which are to decide on the division plan. Further, all shareholders of the acquiring company must be entitled to inspect the documents at the registered office of the acquiring company. Finally, shareholders who own at least 5 % of the shares in the acquiring company may demand a general meeting of the acquiring company to be called to decide whether to approve the division. The reason for derogating from the requirement of a decision by the general meeting in the acquiring company is that the division, for the acquiring company, is a standard business acquisition and that there is less need for protecting the minority in a case where 90 % of the shares are already held by the acquiring company.

*Section 13.57*

**Creditor Protection**

(1) Creditors whose claims antedate the publication as referred to in Section 51 (4) and (5) and have not fallen due at the time of such publication may claim adequate securities if one of the following conditions is fulfilled:

- (a) the expert's declaration referred to in Section 53 (3) concludes that the creditors are not sufficiently protected after the division;
- (b) the expert's declaration referred to in Section 53 (3) concludes that the financial situation of the companies involved in the division requires additional safeguards for creditors;
- (c) no expert's report has been drawn up according to Section 53 (5).

(2) Creditors claiming adequate securities under Section 57 (1) (c) must credibly demonstrate that due to the division the satisfaction of their claim is at stake and that no adequate safeguards have been obtained from the company.

(3) The creditors must file their claim no later than four weeks after the date on which the Registrars of all of the companies involved in the division published the notice referred to in Section 56 (13). The final implementation of the division as referred to in Sections 62 and 63 can only be registered upon expiry of the time allowed for filing such claims.

(4) In so far as a creditor of an acquiring company to which the obligation has been transferred in accordance with the division plan has not obtained satisfaction, the acquiring companies will be jointly and severally liable for that obligation.

*Comments*

Article 12 of Directive 82/891/EEC requires that the Member States, in their national legislation, provide an adequate system of protection of the interests of creditors in the companies involved in the division whose claims predated the publication of the division plan and have not fallen due at the time of such publication. These principles also apply to debenture holders (see Article 12 (5) of Directive 82/891/EEC).

Sections 53 and 57 follow the same approach as has been regulated in this Act for mergers (see Section 9 and 13): In order to deliver the relevant information, the expert's report shall contain a declaration on the situation of the creditors. If the experts declare that the claims are sufficiently protected, the creditors have no right to require additional safeguards. If the expert's report is waived by the shareholders, the creditors may claim securities individually and will have to demonstrate that due to the division the satisfaction of their claim is at risk.

Based on Article 12 (3) of Directive 82/891/EEC, Section 57 (4) introduces an additional safeguard in so far as a creditor will be entitled to sue not only the acquiring company to which his claim has been transferred but also the other acquiring company or companies.

*Section 13.58*

**Division by Acquisition of a Wholly Owned Subsidiary**

(1) This Section applies in the case of a division by acquisition where all of the shares and other securities conferring the right to vote at general meetings of the company being divided are held by or on behalf of the acquiring companies.

(2) It is not necessary for the division plan to be approved at a general meeting of each of the companies being involved in the division if the court is satisfied that the conditions in Section 58 (3) and (4) are fulfilled.

(3) The publication of the division plan as provided for in Section 51 (4) and (5) must be effected as regards each company involved in the division, at least one month before the division takes effect.

(4) At least one month before the division takes effect, all shareholders of the acquiring companies must be able to inspect and make copies of, at the company's registered office, the documents listed in Section 55 (2) (a) to (d) relating to each company involved in the division, unless such document was freely available on the company's website throughout that period.

(5) Where a general meeting of the company being divided is not summoned, the information provided for in Section 52(2) covers any material change in the assets and liabilities after the date of preparation of the division plan.

*Section 13.59*

**Division by Acquisition of a Non-wholly Owned Subsidiary**

(1) This Section applies in the case of a division by acquisition where 90 % or more (but not all) of the relevant securities of the company being divided are held by or on behalf of the acquiring companies.

(2) It is not necessary for the division plan to be approved at a meeting of the shareholders, or any class of shareholders, of an acquiring company if the court is satisfied that the conditions in Section 59 (3) to (5) have been complied with.

(3) The first condition is that publication of notice of receipt of the division plan by the Registrar took place in respect of the acquiring company at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the company being divided summoned for the purpose of agreeing to the scheme.

(4) The second condition is that the shareholders of the acquiring company were able during the period beginning one month before, and ending on, the date mentioned in Section 59 (3) to inspect the documents specified in Section 55 (2) at the registered office of that company.

(5) The third condition is that one or more shareholders of the acquiring company, who together held not less than 5 % of the paid-up capital of the company which carried the right to vote at general meetings of the company (excluding any shares in the company held as treasury shares) would have been able, during the period set out in Section 59 (3), to require a meeting of each class of shareholders to be called for the purpose of deciding whether or not to agree to the division plan, and that no such requirement was made.

*Comments*

Sections 58 and 59 are based on Articles 6 and 20 of Directive 82/891/EEC, as amended by Article 3 of Directive 2009/109/EC.

*Section 13.60*

**Protection of Holders of Securities to Which Special Rights Attach**

(1) A person who, other than in his capacity as shareholder, may exercise a particular right against a company being divided, such as a right to a distribution of profits or a right to acquire shares, must obtain an equivalent right in the acquiring companies.

(2) Section 60 (1) does not apply if:

(a) the holder has agreed otherwise, or

(b) the holder is, or under the division plan is to be, entitled to have the securities purchased by the acquiring companies on terms that the court considers reasonable.

*Comments*

This provision is similar to Section 16 on mergers and based on Article 13 of Directive 82/891/EEC.

*Section 13.61*

**Sell-out right of Dissenting Shareholders**

Any shareholder in any of the companies involved in the division who voted against the approving of the division in the general meeting may request the acquiring companies to acquire his or her shares for cash, if the articles of the company in which he or she holds a share provide for such a sell-out right.

*Comments*

Shareholders in general are sufficiently protected by the division procedure, in particular by the expert's report confirming the share exchange ratio to be fair and reasonable. The group therefore considers that there is no need to suggest a mandatory sell-out right as a general rule in the model act. It should be left to the articles of association to provide for a sell-out right in such cases.

*Section 13.62*

**Legal Scrutiny and Pre-division Certificate**

(1) The competent court of each of the companies involved in the division must check and certify the existence and validity of the legal acts and formalities required of the companies involved in the division.

(2) For each of the companies involved in the division the board of directors or the management board, as the case may be, shall file an application for legal scrutiny which is accompanied at least by the following documents:

- (a) the division plan as approved by the general meeting of the companies involved in the division;
- (b) the minutes of the general meeting of the company;
- (c) the directors' explanatory report;
- (d) the expert's report;
- (e) the supplementary balance sheet, if applicable.

(3) If any documents mentioned in Section 62 (2) is dispensable in the particular case, the company must deliver documentation evidencing the applicability of the relevant exception. It shall also, at the request of the competent court, deliver any other documentation which is needed to scrutinize the legality of the division.

(4) The court has to issue a certificate confirming the legality of the division. On receipt of this certificate the Registrar of the company will have to register the division. The Registrar of each the company being divided must not register the division unless he receives confirmation from the Registrars of all the acquiring companies that the division has been registered there.

*Comments*

Article 14 of Directive 82/891/EEC requires legal scrutiny of the division which can be effected either by a public notary or by the supervision of a court or a public authority. Since the model act in general does not require notarization of corporate documents, the group opted for the model of supervision by a court.

In Member States, such as the Netherlands, where the division plan is to be drawn up by a notary, there is no need for supervision by a court. Some Member States, such as Germany, apply both methods in requiring a notarial deed and nevertheless giving the court the competence to examine the legality of the division.

*Section 13.63*

**Legal Effect of the Division**

(1) The division shall be effective upon registration by the Registrar of the company being divided.

(2) From the effective date according to Section 63 (1), a division by acquisition or by formation of a new company carried out in accordance with the requirements above shall have the following effects:

- (a) the transfer, both as between the company being divided and the acquiring companies and as regards third parties, to each of the acquiring companies of all the assets and liabilities of the company being divided; such transfer shall take effect with the assets and liabilities being divided in accordance with the allocation laid down in the division plan;
  - (b) the shareholders of the company being divided become shareholders of the acquiring companies;
  - (c) no shares in an acquiring companies shall be exchanged, however, for shares in the company being divided held either
    - (i) by that acquiring company itself or through a person acting in his own name but on its behalf; or
    - (ii) by the company being divided itself or through a person acting in his own name but on its behalf;
  - (d) the company being divided ceases to exist.
- (3) The acquiring companies are obliged to effect, to the shareholders of the company being divided, any cash payment required by the division plan.
- (4) Where an asset is not allocated by the division plan and where the interpretation of this plan does not make a decision on its allocation possible, the asset or the consideration therefor is allocated to all the acquiring companies in proportion of the share of the net assets allocated to each of those companies under the division plan.
- (5) Where a liability is not allocated by the division plan and where the interpretation of this plan does not make a decision on its allocation possible, each of the acquiring companies will be jointly and severally liable for it.
- (6) From the effective date according to Section 63 (1), the nullity of the division must be ordered in a court judgement. The court can only declare nullity of the division if the legal requirements to draw up a division plan or to approve the plan by general meeting of each of the companies involved in the division have not been observed.

*Comments*

Section 63 is based on Articles 17 and 19 of Directive 82/891/EEC.

*Section 13.64*

**Civil Liability of Management and Independent Persons towards Shareholders**

A director of any of the companies being involved in the division or an independent expert who has reported pursuant to Section 53 will be held liable for any loss or damage suffered by any shareholder or creditor by reason of their misconduct in the preparation or implementation of the division.

*Comments*

Section 64 is based on Article 18 of Directive 82/891/EEC. The directive requires a provision on civil liability of board of directors or the management board, as the case may be, and experts towards the shareholders of the companies involved in the division. Section 64 also includes liability towards creditors. This is due to the fact that creditor protection in Section 57 is linked to a declaration of the experts on the situation of the creditors. Since the creditors have no right to claim further securities if the expert's report states that their claims are sufficiently protected, the creditors should have a civil claim against an expert if he or she did not assess the risk correctly.

## CROSS-BORDER DIVISIONS

### *Section 13.65*

#### **Cross-Border Divisions**

Limited liability companies that are subject to this Act may participate in cross-border divisions in which the other participating companies are also limited liability companies and where a cross-border merger is permitted by the applicable company law.

#### *Comments*

Whereas the cross-border merger is dealt with by the Directive 2005/56/EEC there is no EU directive on the cross-border division. According to the ECJ Sevic case C-411/03, however, it is considered to be part of the EU freedom of establishment to participate in cross-border transactions, when similar transactions are permitted under national law. Since the EMCA, Part 5, regulates the division of national companies, there is also a need to regulate cross-border divisions.

It seems that so far no Member State of the EU or the EEA has introduced provisions on a cross-border division. The following provisions therefore are partly based on the provisions of this Act on national divisions and partly, insofar as the interests of shareholders, creditors and employees are particularly affected by the cross-border nature of the transaction, on the provisions of this Act on cross-border mergers.

*Section 13.66*  
**Division Plan**

(1) The board of directors or the management board, as the case may be, of the companies involved in the division must draw up and agree a division plan which must include information and provisions on:

- (a) the type, name and registered office of each of the companies involved in the cross-border division, including, if applicable, of the newly formed companies;
- (b) the ratio applicable to the exchange of securities or shares representing the company capital and the amount of any cash payment;
- (c) the amount of the appropriate cash compensation for a sell-out right under Section 74, if applicable;
- (d) the terms relating to the allotment of shares in the acquiring company;
- (e) the precise description and allocation of the assets and liabilities to be transferred to each of the acquiring companies;
- (f) the likely impact of the cross-border division on employment in the companies involved in the division;
- (g) the date from which the holding of such shares entitles the holders to participate in profits and any special conditions affecting that entitlement;
- (h) the date from which the transactions of the company being acquired shall be treated for accounting purposes as being those of the acquiring company;
- (i) any special conditions, including special rights or restrictions, whether in regard to voting, participation in profits, share capital or otherwise, which will apply to shares or other securities issued by the acquiring company in exchange for shares or other securities in the company or companies being acquired;
- (k) any payment or benefit in cash or otherwise, paid or given or intended to be paid or given to any independent person referred to in Section 68 and/or to any director of any of the companies involved in the cross-border division insofar as it differs from the payment or benefit paid or given to other persons in respect of the division and the consideration, if any, for any such payment or benefit;
- (l) a draft instrument of incorporation and articles of association if a new limited liability company is formed by the division.
- (m) where appropriate, information on the procedures by which arrangements for the involvement of employees in the definition of their rights to participation in the company resulting from the cross-border division are determined;
- (n) information on the evaluation of the assets and liabilities which are transferred to the company resulting from the cross-border division;
- (o) dates of the companies' accounts involved in the division used to establish the conditions of the cross-border division.

(2) For each of the companies involved in the cross-border division the following particulars shall be published in the national gazette:

- (a) the type, name and registered office of each of the companies involved in the cross-border division;
- (b) the register in the sense of Article 3 (2) Directive 2009/101/EC where documentation on companies is filed for each of the companies involved in the cross-border division;
- (c) an indication, for each of the companies involved in the cross-border division, of the arrangements made for the exercise of the rights of creditors and any minority shareholders of the companies and the address at which complete information on those arrangements may be obtained free of charge.

(3) Save as provided in Section 66 (4), the board of directors or the management board, as the case may be, of each of the companies involved in the division must deliver a copy of the division plan to the Registrar who must at least one month before the date of any meeting of that company summoned for the purpose of approving the division (see Section 71), publish notice of receipt of the plan.

(4) Section 66 (3) does not apply in respect of a company if the division plan is freely available on the company website (and the Registrar has been notified of the website address) throughout the period beginning one month before, and ending on, the date of any meeting of the company summoned for the purpose of approving the division. In the case of a public company, the division plan must be made freely available on the companies' websites.

*Comments*

Section 66 is based on Section 51 on national divisions and Section 22 on cross-border mergers.

*Section 13.67*

**Directors' Explanatory Report**

(1) The board of directors or the management board, as the case may be, of each of the companies involved in the cross-border division shall draw up a detailed written report explaining the division plan and setting out the legal and economic grounds for them, in particular the share exchange ratio and the criterion determining the allocation of shares. That report shall also describe any special valuation difficulties which have arisen.

(2) The board of directors or the management board, as the case may be, of each of the companies involved in the division shall inform the general meeting of their company and the board of directors or the management board of the other companies involved in the division so that the latter may inform their respective general meetings of any material change in the assets and liabilities between the date of preparation of the division plan and the date of the general meetings which are to decide on the division plan.

*Comments*

Section 67 is based on Section 52 on national divisions and Section 23 on cross-border mergers.

*Section 13.68*

**Expert's Examination and Report to Shareholders**

(1) One or more independent experts, acting on behalf of each of the companies involved in the division, shall examine the division plan and draw up a written report to the shareholders. The experts shall be entitled to secure from each of the companies involved in the division all information they consider necessary for the discharge of their duties.

(2) That report must state in particular whether, in the expert's opinion, the share exchange ratio is fair and reasonable. The expert's statement must at least indicate the method or methods used to arrive at the share exchange ratio proposed and, if applicable, the cash compensation for a sell-out right; state whether such method or methods are adequate in the case in question; indicate the values arrived at using each such method and give an opinion on the relative importance attributed to such methods in arriving at the value decided on. The report shall also describe any special valuation difficulties which have arisen.

(3) The expert's report has to make a declaration as to whether the creditors of each of the companies involved in the division, whose claims antedate the publication of the division plan and have not fallen due at the time of such publication, can be considered to be sufficiently protected after the division or whether the financial situation of the companies involved in the division requires particular safeguards.

(4) The independent experts shall be appointed by the competent court at the request of each company involved in the division. At the request of all the companies involved in the division, one or more joint experts may be appointed to draw up a single report on all the companies involved in the division. The appointed expert shall be a person eligible for appointment as a statutory auditor.

(5) Neither an examination of the division plan nor an expert report shall be required if all the shareholders and the holders of other securities conferring the right to vote of each of the companies involved in the division have so agreed.

*Comments*

Section 68 is based on Section 53 on national divisions and Section 24 on cross-border mergers.

*Section 13.69*

**Supplementary Balance Sheet**

(1) This Section applies if the last annual accounts of any of the companies involved in the division relate to a financial year ending more than 6 months before the board of directors or the management board, as the case may be, of the company adopt the division plan.

(2) Where one of the companies involved in the division falls within Section 69 (1) above, the board of directors or the management board, as the case may be, of the company must prepare a supplementary accounting statement, unless the shareholders and, where applicable, the holders of other securities conferring the right to vote, of each of the companies involved in the division, unanimously agree that no such statement is required.

(3) Where such statement is required, it must consist of a balance sheet, or a consolidated balance sheet, as the case may be, dealing with the state of affairs of the relevant company or group as at a date not more than three months before the division plan was adopted by the board of directors or the management board, as the case may be, and the statement must be approved by the board of the relevant company.

(4) The supplementary balance sheet shall not be required if the company publishes a half yearly financial report in accordance with Article 5 of Directive 2004/109/EC and makes it available to shareholders in accordance with Section 70.

*Comments*

Section 69 is based on Section 54 on national divisions.

*Section 13.70*

**Inspection of Documents**

(1) The shareholders of each of the companies involved in the division must be able, within a period of one month before the meeting called to approve the division (see Section 71), to inspect and make copies of any of the documents listed below either at the registered office of that company or by freely accessing them on the company's website for downloading and printing.

(2) The relevant documents are:

(a) the division plan;

(b) where applicable, the directors' explanatory report;

(c) where applicable, the expert's report to shareholders;

(d) the companies' annual accounts and annual reports for the previous three financial years together with any supplementary accounting statement required by Section 69.

*Comments*

Section 70 is based on Section 55 on national divisions.

*Section 13.71*

**General Meetings of Companies Involved in the Cross-border Division**

- (1) Subject to Section 71 (6), the division plan must be approved by a majority in number, representing 2/3 in value, of each class of shareholders of each of the companies involved in the cross-border division, present and voting, either in person or by proxy at a meeting.
- (2) Where the division is a division by formation of a new company, the memorandum or draft memorandum and articles or draft articles shall be approved by an ordinary resolution of each of the companies involved in the division.
- (3) The board of directors or the management board, as the case may be, of each of the companies involved in the division must report:
  - (a) to every meeting of the shareholders, or any class of shareholders, of that company summoned for the purpose of agreeing to the division plan, and
  - (b) to the board of directors or the management board, as the case may be, of every other merging company, any material changes in the property and liabilities of that company between the date when the division plan was adopted and the date of the meeting in question.
- (4) The board of directors or the management board, as the case may be, of each of the other companies involved in the division must in turn:
  - (a) report those matters to every meeting of the shareholders, or any class of shareholders, of that company summoned for the purpose of agreeing to the division plan; or
  - (b) send a report of those matters to every shareholder entitled to receive notice of such a meeting.
- (5) Section 71 (3) and (4) do not apply if all the holders of shares and other securities conferring the right to vote in general meetings of each of the companies involved in the division have so agreed.
- (6) In the case of any division by acquisition, it is not necessary for the division plan to be approved by the shareholders of the acquiring company if the court is satisfied that the conditions set out in Section 71 (7) to (9) have been complied with.
- (7) The first condition is that either:
  - (a) the publication of notice of receipt of the division plan by the Registrar took place in respect of the acquiring company at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the company being divided summoned for the purposes of agreeing to the division plan; or
  - (b) the division plan is made freely available on the company website, details of which have been notified to, and published by the Registrar, at least one month before the date of the first meeting of shareholders, or any class of shareholders, of the company being divided summoned for the purposes of agreeing to the division plan, and the division plan remains available on the website throughout the period beginning one month before, and ending on, that date.
- (8) The second condition is that each of the documents listed in the applicable paragraphs of Section 70 (2) relating to the acquiring company and the company being divided:
  - (a) are available for inspection and copying by the shareholders of the acquiring company during the period beginning one month before, and ending on, the date of any such meeting as is mentioned in Section 71 (7) (a) to inspect that document at the registered office of that company; or
  - (b) are made freely available on the company website and remain available on the website throughout the period beginning one month before, and ending on, the date of any such meeting as is mentioned in Section 71 (7) (a).
- (9) The third condition is that, no shareholder or shareholders of the acquiring company, holding not less than 5 % of the paid-up capital of the company which carried the right to vote at general meetings of the company (excluding any shares in the company held as treasury shares) has required, during that period, a meeting of the shareholders to be called for the purpose of deciding whether or not to agree to the division.

(10) The board of directors or the management board, as the case may be, of each of the companies involved in the division must notify the Registrar about the resolution on the division or, as the case may be, deliver evidence that no resolution was necessary. The board of directors or the management board, as the case may be, must also notify the Registrar about the expert's declaration on the creditors' position as referred to in Section 68 (3).

(11) The Registrar shall publish notice of receipt of the documentation mentioned in Section 71 (10) and of the content of the expert's declaration on the creditors' position or that, according to Section 68 (5) no expert's report has been drawn up.

*Comments*

Section 71 is based on Section 56 on national mergers and Section 27 on cross-border mergers.

*Section 13.72*

**Creditor Protection**

(1) Creditors whose claims antedate the publication as referred to in Section 66 (3) and (4) and have not fallen due at the time of such publication may claim adequate securities if one of the following conditions is fulfilled:

(a) the expert's declaration referred to in Section 68 (3) concludes that the creditors are not sufficiently protected after the division;

(b) the expert's declaration referred to in Section 68 (3) concludes that the financial situation of the companies involved in the division requires additional safeguards for creditors;

(c) no expert's report has been drawn up according to Section 68 (5).

(2) Creditors claiming adequate securities under Section 72 (1) (c) must credibly demonstrate that due to the cross-border division the satisfaction of their claim is at stake and that no adequate safeguards have been obtained from the company.

(3) The creditors must file their claim no later than four weeks after the date on which the Registrars of all of the companies involved in the division published the notice referred to in Section 71 (11). The final implementation of the division as referred to in Section 76 and 77 can only be registered upon expiry of the time allowed for filing such claims.

(4) In so far as a creditor of an acquiring company to which the obligation has been transferred in accordance with the division plan has not obtained satisfaction, the acquiring companies will be jointly and severally liable for that obligation.

*Comments*

Section 72 is based on Section 57 on national divisions and on Section 28 on cross-border mergers.

*Section 13.73*

**Protection of Holders of Securities to Which Special Rights Attach**

(1) A person who, other than in his capacity as shareholder, may exercise a particular right against a company being divided, such as a right to a distribution of profits or a right to acquire shares, must obtain an equivalent right in the acquiring companies.

(2) Section 73 (1) does not apply if:

(a) the holder has agreed otherwise, or

(b) the holder is, or under the division plan is to be, entitled to have the securities purchased by the acquiring companies on terms that the court considers reasonable.

*Comments*

Section 73 is based on Section 60 on national divisions and on Section 29 on cross-border mergers.

*Section 13.74*

**Sell-out Right of Dissenting Shareholders**

The company being divided has to offer, in the division plan, to those of its shareholders who have opposed the cross-border division at the general meeting to acquire their shares in return for appropriate cash compensation upon written request by such shareholders no later than four weeks after the date of the general meeting if the acquiring company is not subject to the same national law as the company being divided.

*Comments*

Section 74 is based on Section 30 on cross-border mergers.

*Section 13.75*

**Division by Acquisition of a Non-wholly Owned Subsidiary**

(1) This Section applies in the case of a division by acquisition where 90 % or more (but not all) of the relevant securities of the company being divided are held by or on behalf of the acquiring companies.

(2) It is not necessary for the division plan to be approved at a meeting of the shareholders, or any class of shareholders, of an acquiring company if the court is satisfied that the conditions in Section 75 (3) to (4) have been complied with.

(3) The first condition is that the cross-border division plan provides that every other holder of relevant securities has the right to require the acquiring companies to acquire those securities.

(4) The second condition is that, if a holder of securities exercises that right, the consideration to be given for those securities is fair and reasonable.

*Comments*

Section 75 is based on Section 31 on cross-border mergers.

*Section 13.76*

**Legal Scrutiny and Pre-division Certificate**

(1) The competent court of the company being divided must check and certify the existence and validity of the legal acts and formalities required of the company.

(2) For the company being divided the board of directors or the management board, as the case may be, shall file an application for legal scrutiny which is accompanied at least by the following documents:

- (a) the division plan as approved by the general meeting of the companies involved in the division;
- (b) the minutes of the general meeting of the company;
- (c) the directors' explanatory report;
- (d) the expert's report;
- (e) the supplementary balance sheet, if applicable.

(3) If any document mentioned in Section 76 (2) is dispensable in the particular case, the company must deliver documentation evidencing the applicability of the relevant exception. It shall also, at the request of the competent court, deliver any other documentation which is needed to scrutinize the legality of the division.

(4) The court has to issue without delay to each of the companies' subject to its national law a certificate conclusively attesting to the proper completion of the per-division acts and formalities.

*Comments*

Section 76 is based on Section 62 on national divisions and on Section 32 on cross-border mergers.

*Section 13.77*

**Legal Effect of the Division**

(1) The court with jurisdiction over the acquiring companies must assess and certify the validity of the acts and formalities carried out by the companies as regards compliance with the relevant national law including, if applicable, the formation of a new company resulting from the cross-border division. The court shall in particular ensure that the companies involved in the cross-border division have approved the common division plan in the same terms and, where appropriate, that arrangements for employee participation have been made in accordance with Section 79. Section 76 (2) and (3) apply accordingly. The acquiring companies must also submit to the court the certificate referred to in Section 76 (4) within six months of its issue.

(2) The cross-border division shall be effective upon registration by the Registrar of the company being divided. The Registrar shall notify, without delay, the company register of the companies being acquired that the cross-border division has taken effect. Deletion of the old registration, if applicable, shall be effected on receipt of that notification, but not before.

(3) From the effective date according to Section 77 (2), a division by acquisition or by formation of a new company carried out in accordance with the requirements above shall have the following effects:

(a) the transfer, both as between the company being divided and the acquiring companies and as regards third parties, to each of the acquiring companies of all the assets and liabilities of the company being divided; such transfer shall take effect with the assets and liabilities being divided in accordance with the allocation laid down in the division plan;

(b) the shareholders of the company being divided become shareholders of the acquiring companies;

(c) no shares in an acquiring companies shall be exchanged, however, for shares in the company being divided held either:

(i) by that acquiring company itself or through a person acting in his own name but on its behalf;  
or

(ii) by the company being divided itself or through a person acting in his own name but on its behalf;

(d) the rights and obligations of the companies involved in the cross-border division arising from contracts of employment or from employment relationships and existing at the date on which the division takes effect shall, by reason of that division taking effect, be transferred to the acquiring companies on the date on which the division takes effect;

(e) the company being divided ceases to exist.

(4) The acquiring companies are obliged to make, to the shareholders of the company being divided, any cash payments required by the division plan.

(5) Where an asset is not allocated by the division plan and where the interpretation of this plan does not make a decision on its allocation possible, the asset or the consideration therefore is allocated to all the acquiring companies in proportion of the share of the net assets allocated to each of those companies under the division plan.

(6) Where a liability is not allocated by the division plan and where the interpretation of this plan does not make a decision on its allocation possible, each of the acquiring companies will be jointly and severally liable for it.

(7) From the effective date according to Section 77 (2), the cross-border division cannot be declared null and void.

*Comments*

Section 77 is based on Section 63 on national divisions and on Section 33 on cross-border mergers.

*Section 13.78*

**Civil Liability of Management and Independent Persons towards Shareholders**

A director of any of the companies being involved in the division or an independent expert who has reported pursuant to Section 68 will be held liable for any loss or damage suffered by any shareholder or creditor by reason of their misconduct in the preparation or implementation of the division.

*Comments*

Section 78 is based on Section 64 on national divisions.

*Section 13.79*

**Employee Participation**

In the cases referred to in Article 16 (2) of Directive 2005/56/EC, the participation of employees in the acquiring companies shall be regulated in accordance with the principles and procedures laid down in Article 16 (3) to (7) of Directive 2005/56/EC.

*Comments*

Section 79 is based on Section 35 on cross-border mergers.

## CHAPTER 14 DISSOLUTION AND LIQUIDATION

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## General Comments<sup>71</sup>

### 1. EU law

So far there are no EU rules on voluntary dissolutions of companies via liquidation. In 1987, the European Commission introduced the Draft Liquidation Directive,<sup>72</sup> which has not been developed further in the following years. Many of the situations stated in the Draft Directive can be found in all Member States. Where investments are made in a company in another Member State it is in principle desirable that a similar legal protection regarding the procedure involved in liquidation is offered to shareholders or creditors.

Cross-border investments are common and increasing and thus it makes it relevant to offer shareholders and creditors an equal protection *regardless their own identities or that of the company* they have invested in. This was also the aim of the Draft Liquidation Directive.

The draft Directive aimed to limit the situations in which a company may be dissolved automatically by way of legislation (e.g. involuntary dissolution). This aim is also expressed in Article 12 of the 1<sup>st</sup> Company Law Directive (2009/101/EC), which limits the cases in which a company may be declared invalid. The same applies to the Single-Member Company Directive (2009/102/EC), which requires that a certain situation – i.e. all shares being held by a single shareholder – does not lead to the company's automatic dissolution.

In all circumstances, the Draft Liquidation Directive required that disclosure is ensured in connection with all dissolution decisions. Moreover, the draft directive established the principle of a procedure which is effected by liquidators over whose appointment the shareholders are to have a say. The liquidators are liable for damages in case of negligence resulting in loss and they may be dismissed on substantial grounds.

Banks and other financial institutions were not subject to the Draft Liquidation Directive.

When an SE transfers its registered office outside the Community, or in any other manner no longer complies with the requirements of Article 7 of the SE-Regulation, the member state must take appropriate measures to ensure compliance or take necessary measures to ensure that the SE is liquidated.

The EU Regulation on Insolvency Proceedings 1346/2000 came into force on 31 May 2002, now recast Regulation 2015/848 which applies to proceedings opened after 26 June 2017.<sup>73</sup> The main purposes of the Regulation are to set rules governing where in the EU, insolvency proceedings have to be opened, which country's laws have to apply to those proceedings and to ensure that the proceedings and the effect of the proceedings are recognized throughout the EU. The overall effect of these rules is to make it easier to deal with the affairs of an insolvent debtor who has affairs in more than one EU country.

The Regulation aims to increase legal certainty by providing clear rules, which determine jurisdiction, ensure that courts handling different proceedings will work closely with one another when debtors are faced with insolvency proceedings in several Member States, and provide reliable information to creditors by binding Member States to publish key decisions regarding the commencement of insolvency proceedings.

The main advantage of the Regulation is that it establishes a clear structure for the commencement and recognition of insolvency proceedings where there is a cross-border element involving business in more than one Member State and the centre of main interests of the debtor is located in the EU.

### 2. National law

As mentioned above, so far there is no EU harmonization regarding the dissolution and liquidation of a company. However, the rules in the different Member States are quite similar. Unless it involves a transfer, the liquidation of a company usually includes the following steps:

- notifying the body that initially registered the company to cancel the company license or employers' entry in the register;
- complying with social security and tax obligations;

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<sup>71</sup> The working group on Chapter 14 was chaired by Professor Evangelhos Perakis (University of Athens, Greece) and included Professor Monica Fuentes (Complutense University of Madrid, Spain).

<sup>72</sup> Draft Proposal DOC XV/43/87-EN.

<sup>73</sup> The Regulation is directly applicable in all Member States except Denmark, so litigants can plead it in the national courts.

- selling off the company's property;
- paying off any outstanding company debts.

Procedures to liquidate a company are a matter for each Member State and vary from one country to the other. The EU Member States regulate the winding up of a company in different national laws, for example in the Companies Act in Cyprus, Denmark, Finland, France (for voluntary liquidation), Germany, Greece, Ireland, Slovenia, Sweden; in the general Commercial Code in the Czech Republic, Estonia, Latvia and Slovakia; in the Civil Code in Italy.

The core insolvency legislation is regulated in national insolvency law (e.g. Austrian Insolvency Act 2010, Belgium Bankruptcy Law 1997, Bulgarian Trade Act 1999, Czech Insolvency Act 2006, Danish Bankruptcy Act 2011, Dutch Bankruptcy Act 2007, Estonian Bankruptcy Act 2004, Finnish Bankruptcy Act 2004, French Commercial Code of 2000, German Insolvency Code 1994, Greek Bankruptcy Code 2007, Hungarian Bankruptcy and Liquidation Proceedings Act 1991, Irish Companies Act 2012, Italian Insolvency Law 1942, Latvian Insolvency Law 2010, Lithuanian Enterprise Bankruptcy Law 2016, Maltese Commercial Code 2003, Polish Act on Bankruptcy and Reorganization 2009, Portuguese Insolvency and Business Recovery Code 2004, Romanian Law on insolvency proceedings 2014, Slovakian Act on Bankruptcy and Restructuring 2006, Slovenian Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act 2007, Spanish Bankruptcy Law 2003, Swedish Bankruptcy Act 1987, UK Insolvency Act 1986).

One of the most important insolvency developments in recent years has been the recognition that the activity of companies and the nature of company structures (especially groups of companies) is such that insolvency of any size necessarily involves a cross-border element. EC Regulation 1346/2000 on Insolvency Proceedings reflects these issues and came into effect on 31 May 2002 (except for Denmark), now recast Regulation 2015/848. The Regulation does not attempt to harmonize insolvency procedures throughout the EU, however, and generally the applicable law is the national law of the state in which proceedings are opened. The Regulation applies only when the debtor has its business within the EU (other than Denmark) and it deals only with procedures, assets and creditors within the EU.

### 3. Considerations

The EMCA Group has pledged to adopt a “functional approach” to the topics to be included in the EMCA. In this sense it could be argued that company law and insolvency law can constitute (and in fact they do constitute) one single topic or at least a “continuum” and therefore, insolvency law should/might be included in the EMCA. However, this has the inherent risk of burdening EMCA with a very large amount of legislation, not always connected with company law considerations, which might discourage the states from adopting it. It should also be mentioned that insolvency law (especially today) is national in many aspects and deeply influenced by considerations of stakeholders' protection. In the UK, the response to the “functional approach” has not consisted in incorporating insolvency into company law but rather the opposite, i.e. relocating dissolution and liquidation from company to insolvency law. Besides, creditor protection as a procedural system is highly path-dependent and not easy to harmonize.

In this respect it is worth quoting Paul Davies:<sup>74</sup>

*“The provisions relating to winding up and dissolution are now to be found almost exclusively in the Insolvency Act 1986 and Part IV of the Insolvency Rules and not in the Companies Act: and rightly so where the company is insolvent. But although insolvency is the most common reason for winding up, it is far from being the only one and, when the company is fully solvent, it seems, on the face of it, somewhat illogical to treat the process as part of insolvency law rather than company law. The reason why the legislation relating to liquidation of solvent companies is in the Insolvency Act is probably to avoid duplicating those many provisions that apply whether or not the company is insolvent – to repeat them in the Companies Act would have added substantially to the length of the combined legislation”.*

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<sup>74</sup> P. Davies, *Gower & Davies' Principles of Modern Company Law*, 8<sup>th</sup> ed. (Sweet & Maxwell, 2008), p. 1217.

On this basis, the EMCA Group has decided to include the matters of winding up and dissolution in the EMCA and not leave them to the insolvency legislation. On the other hand, in the Group' opinion, the matters regarding insolvency itself should be left to the national insolvency legislation.

PART 1  
DEFINITIONS

*Section 14.01*  
**Definitions**

In the present Chapter the following definitions shall apply:

- (a) “Dissolution” means the occurrence of one of the events enumerated in Part 2 of the present Chapter, and which marks the beginning of the liquidation period.
- (b) “Liquidation” means the procedure for the winding up of the dissolved company and its affairs.
- (c) “Extinction” of the company means the completion of the liquidation of the dissolved company and the disappearance of the legal personality of the latter; it is evidenced by the de-registration of the company.
- (d) “Insolvency” means a situation when a debtor is generally unable to pay its debts as they mature or when the debtor’s liabilities exceed the value of its assets; “Insolvency proceedings” mean the collective proceedings commenced in cases of insolvency, which are subject to court supervision, either for reorganization or liquidation.

*Comments*

The current (mainly continental European) use of the term “dissolution” refers to the fact that a company is dissolved and (immediately thereafter) put into liquidation (“*Auflösung*” and “*Abwicklung*”, “*dissolution*” and “*liquidation*”, “*scioglimento*” and “*liquidazione*”, “*opløsning*” and “*liquidation*”, “*disolución*” and “*liquidación*”, “*dissolução*” and “*liquidação*”, “*λύση*” and “*εκκαθάριση*” etc.). Therefore, dissolution happens first and liquidation follows.

Elsewhere, and mainly in the UK, the terms are used inversely. First is the winding up and last (upon completion of the latter) comes the “dissolution” of the company, meaning the moment, where the company loses its legal personality and is extinguished (see title of the Chapter IX of the UK Insolvency Act 1986: “Dissolution of Companies *after* Winding up”).

In Chapter 14 the terms are used in their “continental” version. “*Dissolution*” is the moment where the company for the reasons stated in Part 2 enters the phase of “*liquidation*”, while the final disappearance of the company is called “*extinction*” (extinción, cancellazione, *περάτωση*), evidenced by the “*de-registration*” of the company.

Re 4) These definitions essentially reproduce those adopted by the Uncitral Legislative Guide on Insolvency Law (2005), p. 5.

PART 2  
DISSOLUTION OF THE COMPANY

*Section 14.02*

**Dissolution by Resolution of the General Meeting**

(1) The company can be dissolved at any time by resolution of the shareholders' general meeting, taken with the qualified majority of at least two-thirds of the votes cast as well as at least two-thirds of the share capital represented at the general meeting (Section 29 of Chapter 11 of EMCA), unless the articles of association provide for a higher majority.

(2) A resolution of the general meeting providing for the transfer of the registered seat of the company to another country shall not cause the dissolution of the company, if the country of destination does not oppose the transfer of the seat and the legal personality of the company is continued in that country.

*Comments*

Under the EMCA a company is dissolved in three categories of cases: in the case of “voluntary” dissolution (Section 2), in cases of “automatic” dissolution (i.e. dissolution by operation of the law, Section 3) and when the court orders its dissolution (Sections 4 and 5).

In Section 2 the “voluntary” dissolution is provided. It is added that the transfer of the company's seat to another country (either a Member State or a third country) does not entail the dissolution of the company, if the receiving country recognizes that transfer. This provision is in conformity with European Court of Justice case law relating to the transfer of the statutory seat. However, since EMCA is national and not EU law, the above provision does not oblige Member States to recognize the transfer.

In many countries, a “serious” loss of the subscribed capital may also lead to (voluntary) dissolution by decision of the general meeting. This is in principle provided by Directive 2012/30/EU (Article 19), which, in such a case, requires the general meeting “to consider whether the company should be wound up or any other measures taken”. This rule is to be found in EMCA Chapter 8, Section 30.

Re 1) A qualified majority is usually required (e.g. Danish Companies Act Section 217, German AktG § 262(2), Greece, Article 47a of Law 2190/1920). In Spain (see Article 364, 193, 201 of the Companies Act), an ordinary majority suffices.

*Section 14.03*

**Causes of Automatic Dissolution**

The company shall be automatically dissolved,

- (a) When the duration of the company expires, unless the shareholders' general meeting before the expiration has decided to extend it;
- (b) If the competent court has opened insolvency proceedings in respect of the company, unless the insolvency law of that court provides otherwise.
- (c) If the competent court has denied to open insolvency proceedings because of insufficiency of assets of the company able to cover the cost of such proceedings.

*Comments*

Re a) Subsection a provides that a company is dissolved upon expiration of its term. However, the shareholders' meeting can extend its duration by decision taken *before* the expiration. If such decision comes *after* the expiration, the company is “reactivated” in conformity with Section 24. Also, in the EMCA, the articles of associations can provide that the duration of the company can be illimited, See Chapter 2, Section 4.

Re b): Subsection b provides that insolvency proceedings, when opened by the court, entail in principle the dissolution of the company. However, this matter has some ambiguities. Some countries accept the dissolution of the company when insolvency proceedings are commenced (for example Germany, Greece, Poland,) and this is the idea of Subsection b. In some other countries (such as Spain), the dissolution comes only when the liquidation phase of the insolvency proceedings has been initiated (the latter fits better with the idea of preservation of the undertaking). The problem is compounded by the fact that the *lex concursus* (law applicable to the insolvency proceeding) and the *lex societatis* (law applicable to the company) do not necessarily coincide.

Re 3) The grounds for dissolution under this provision reflects situations provided for in some national laws (e.g. German Insolvency Law § 26; Greek Insolvency Code Article 6 § 2), whereby the court will reject a request to open insolvency proceedings, which would otherwise dissolve the company, because the available assets are insufficient to cover the costs of the procedure.

#### *Section 14.04*

### **Causes of Judicial Dissolution**

The company can be dissolved by a non-appealable court decision issued at the request of any person having a legitimate interest,

- (a) In the case of nullity of the company pronounced by the competent court;
- (b) If the company's object has been implemented or when its implementation has become illegal or manifestly impossible, unless the general meeting has modified the articles of association so that the objects of the company are modified, expanded or limited.

#### *Comments*

Section 4 provides for the cases where a company is dissolved as a consequence of a court decision.

Re a) A first case of judicial dissolution occurs when the court pronounces the nullity of the company. Under Section 13 of Chapter 3, “the EMCA contains no special provisions on situations where a company should be declared null and void. As a result thereof, the EMCA does not contain provisions on the effects of the nullity. However, it does not entirely preclude that a company can be declared null by a court decision”. Therefore, the wording of the above Section 4 covers this eventuality. Thus the pronouncement of nullity is mentioned in Section 4 as one of the causes of dissolution.

In all cases where action by a court is envisaged, the jurisdiction needs to be specified. This however, is a general issue and the EMCA leaves the matter to the national legislator who wishes to adopt the EMCA. In many cases it may be appropriate to leave the matter to the Registration Authority.

#### *Section 14.05*

### **Other Causes of Judicial Dissolution**

The company can be dissolved by a non-appealable court decision,

- (a) Issued at the request of any shareholder, if the organs of the company have been paralyzed for a non-temporary reason, including equal participations, and this has caused the impossibility of the company to function;
- (b) Issued in the cases and at the request of the persons prescribed in the articles of association of the company;
- (c) In the cases of Section 33 of Chapter 11 (liquidation due to fraud on the minority) and of Section 11 of Chapter 12 (compulsory dissolution).

#### *Comments*

In Section 5 the grounds for (judicial) dissolution may be invoked only by certain persons, whereas the grounds specified in Section 4 are absolute and may be relied upon by any party having a legitimate interest.

Re a): This is for example the case in France (Civil Code Article 1844-7, applicable to all companies) and in Greece (Law on companies limited by shares Article 48a).

Re b): It should be possible to specify grounds for dissolution in the articles of association as, for example, under the Spanish Corporate Enterprise Act Article 362, but contrast the German AktG § 262. This would allow for the freedom, for example, to fix a time limit in the articles for the company's existence, not by reference to a specific duration, but also by reference to the occurrence of certain events. However, for reasons of legal certainty, it is better not to have automatic dissolution but have the court decide whether the grounds for dissolution, as provided by the articles, have indeed occurred.

Re c): This Subsection refers to the right of the Registrar to request the court to dissolve a company. It is inspired by the Danish Companies Act Section 225, the Finnish Companies Act Section 20:4, the Greek Law on companies limited by shares Article 48, and the Portuguese Companies Code Article 143.

#### *Section 14.06*

### **Registration of Dissolution**

(1) The management board or the liquidator shall cause the registration of the dissolution of the company in the Register. With the exception of the cases provided in Section 3, the dissolution shall take effect as from such registration.

(2) Until the registration of the dissolution has been made, the general meeting of the company by resolution taken with qualified majority can revoke a dissolution previously agreed to by the general meeting in accordance with Section 2 (1).

(3) Should registration of the dissolution not occur within a reasonable time, any person having a legitimate interest may ask the court to order the registration. The management board and the liquidator are liable for any damage caused by the delay.

#### *Comments*

Re 1) It is important to register the dissolution as it results in a change of the company's purpose, i.e. the company is no longer doing business. See for example Czech Commercial Code 68(1) and German AktG § 263.

RE 2) In order to protect the interests of the shareholders in the value of the company as a going concern it should be ensured that a qualified majority has the right to reverse dissolution of the company before the registration has been effected (e.g. Polish Commercial Companies Code Article 460). Thus, the general meeting may always decide, with the same majority, to withdraw its decision on the company's dissolution, i.e. to cancel the liquidation in progress, as long as the dissolution has not been registered (cf. Danish Companies Act Section 231).

Re 3) National law must regulate the scope of liability of the liquidator (see Sections 22 – 23 below).

#### *Section 14.07*

### **Interim Duties of the Management Board**

Until the liquidator assumes his/her duties, the management board of the company shall continue to manage the company with a view to avoid detriment to the integrity and the value of the company's assets.

#### *Comments*

Section 7 is intended to bridge the gap between the moment of dissolution of the company and the time when the liquidator or the liquidators assume their duties. During that period, the pre-existing management must remain in duty and carry out any necessary transactions in order to preserve the company's assets until the appointment of liquidators. However, even after the liquidator has assumed his/her duties, the previous management still has a duty to assist the liquidator (Sections 13 Subsection 4 and 17 Subsection 17 of this Chapter)

Section 7 is inspired by the Danish Companies Act Section 229, the German AktG § 265(1) and the Italian Civil Code Article 2486.

PART 3  
LIQUIDATION OF THE COMPANY

*Section 14.08*

**The Phase of Liquidation**

- (1) The dissolution of the company shall be followed by its liquidation. When the dissolution of the company is caused by the opening of insolvency proceedings, the rules of insolvency law shall apply.
- (2) Instead of placing a company into liquidation, the court may order the immediate cancellation of the company from the Register without liquidation, if the assets of the company are not adequate to cover the costs of liquidation, or if there is no information about the existence of assets, unless a shareholder, a creditor or a third party undertakes to bear the costs of the liquidation. The court may act upon request of the liquidator or shareholders holding at least the 5 % of the capital or, in case of no par value shares, the 5 % of the total number of the shares issued.

*Comments*

The decision to carry out the dissolution of the business marks the beginning of the liquidation process and the appointment of one or more liquidators. After its dissolution, a company only continues to exist for the purpose of its liquidation.

Re 2) Section 8(2) is inspired by German Insolvency Law (§ 26 InsO) (see also article 3 of Greek Insolvency Law), which provides that insolvency proceedings are not to be opened if the available assets are insufficient to cover the costs of the procedure, cf. also German AktG 264 (2). See also Finnish Companies Act Section 20-2. The purpose of this provision is to avoid a liquidation procedure if in fact there is practically nothing to liquidate.

*Section 14.09*

**The Company during Liquidation**

- (1) During liquidation the company maintains its legal personality. The name of the company must mention the fact that the company is “in liquidation”.
- (2) During liquidation the shareholders maintain their rights.
- (3) The rules concerning the functioning of the organs, including the auditors, as well as the organization and the operation of the company shall apply also during the period of liquidation, unless the law provides otherwise or such rules are inconsistent with the manner and the purpose of liquidation.
- (4) During liquidation the company may merge or be divided. It can also be subject to insolvency proceedings under the conditions and in accordance with applicable insolvency law.
- (5) Unless otherwise provided by the law, the liquidation shall be governed by the provisions of the articles of association.
- (6) The period of liquidation constitutes one financial period.
- (7) During liquidation the commencement or the continuation of execution against the assets of the company is suspended.

*Comments*

Re 1) The fact that the company is in liquidation is recorded in the national Register (see Section 6) and the words “in liquidation” are added (cf. Czech Commercial Code § 70(2), Danish Companies Act Article 234 and Polish Commercial Companies Code § 461(2)). The legal personality of the company is not affected by reason of its dissolution, for as long as the liquidation proceedings are not completed.

Re 2) The status of the shareholders is unaffected by the liquidation.

Re 3) From the moment a liquidator is appointed, he adopts the legal position which the administrative, management or supervisory bodies had before liquidation, presumptively in accordance with ordinary company law principles. The company law provisions applicable to undissolved companies continue to apply until completion of the liquidation, unless required otherwise by law or by the purpose of the liquidation (cf. German AktG § 264(3)).

Re 4) Dissolution and the ensuing liquidation proceedings do not prohibit a merger or a division of the dissolved company. It is also possible to open insolvency proceedings if the conditions of the latter are met, for example if there has been a “cessation of payments” of the company during liquidation. In the first case (merger etc.) the company will normally be reactivated as per Article 24 of this Chapter. In the second case insolvency law will henceforth apply.

Re 5) The provision of Subsection 5 states that the liquidation proceedings will be governed by the articles of association, “unless otherwise stated in the law”. This means that the articles can contain provisions on the manner in which liquidation has to be conducted, if such provisions are not contrary to the law, mainly in matters concerning the protection of creditors.

[Re 7) This provision, if followed by the national legislator, essentially means that the liquidation procedure will resemble a collective procedure. The liquidation will be smoother and quicker and equal treatment of creditors will be better served.

#### *Section 14.10*

#### **Appointment of Liquidator**

(1) The liquidation is carried out by one or more liquidators, natural persons or legal entities, shareholders or third parties. Persons disqualified from being members of the management board are not allowed to act as liquidators.

(2) Unless the articles of association or the general meeting of shareholders provide otherwise, the liquidation is carried out by one liquidator. At the request of shareholders holding at least the 10 % of the capital or, in case of no par value shares, the 10 % of the total number of the shares issued the court may increase the number of liquidators.

(3) The liquidator shall be appointed by the court in the case of judicial dissolution and by the general meeting by an majority resolution in all other cases.

(4) if the dissolved company remains without a liquidator and no action is taken for the appointment or the replacement of the liquidator within a reasonable time, a liquidator shall be appointed by the court at the request of any person having a legitimate interest.

#### *Comments*

Section 10 deals with the nomination of liquidators. Subsection 1 allows for one or more liquidators. While the general rule is one liquidator, under Subsection 2, the articles may require the appointment of more liquidators. Thus, the appointment of one liquidator - which is the simplest solution - is possible only if the articles do not require more liquidators. In all instances the court may nominate additional liquidators, if this is justified by the circumstances, mainly in cases of complicated and difficult liquidations.

Re 1) This provision should be coordinated with the provision regarding the appointment of directors, since the latter cannot be legal persons (see EMCA, Chapter 8, Section 18). As a rule, a liquidator must be a qualified insolvency practitioner (cf. UK Insolvency Act Sections 230 (19- (5), 389 and 390, the Lithuanian Civil Code Article 2.108 Part 3). This means that in principle the liquidator must be – amongst other requirements – typically a member of a recognized professional body and independent of the company concerned.

Re 2) This provision provides for minority protection, allowing shareholders holding 10 % of the share capital to apply to the court for the appointment of additional liquidator(s) who will liquidate the company together with the liquidator elected at the general meeting (cf. Polish Commercial Companies Code Article 463 § 2).

Re 3 and 4) In the case where a resolution for voluntary liquidation has been passed, the shareholders shall appoint the liquidator (cf. UK Insolvency Act Section 91(1)), unless otherwise provided by the law or the articles of association. Where there is no liquidator appointed for whatever reason, the court may appoint one (cf. UK Insolvency Act Section 108).

*Section 14.11*

**Replacement of Liquidator**

- (1) The general meeting has the right to replace the liquidator at any time, provided that such replacement is on the agenda.
- (2) At the request of shareholders holding at least the 10 % of the capital or, in case of no par value shares, the 10 % of the total number of the shares issued and upon serious grounds, including the unjustified delay of the liquidation, the court may replace the liquidator or the liquidators, specifying the functions to be performed by the new liquidator or liquidators.

*Comments*

Re 1) The replacement of the liquidator is a serious matter and such matter needs to be mentioned on the agenda of the general meeting called to replace him. Admittedly, since the agenda is drawn up by the liquidator himself, the replacement becomes obviously more difficult. On the other hand a minority of shareholders has the right to convene a general meeting specifying the agenda.

Re 2) Section 380.1 of the Spanish Corporate Enterprise Act requires 20 % of the capital and requires a serious ground (“*iusta causa*”). In Germany, liquidators who have not been appointed by the court may be removed by the shareholders’ meeting at any time. Bulgarian law demands 5 %, Lithuanian law 10 %..

*Section 14.12*

**Applicable Rules on Liquidator**

- (1) As soon as the liquidator is appointed, he/she replaces the former management board and the former supervisory board.
- (2) Unless otherwise provided in the law or the articles of association the provisions regarding the management board shall apply to the liquidator. The term of office of the liquidator shall be equal to that of the liquidation period.
- (3) The appointment and the replacement of liquidators shall be registered in the Register.

*Comments*

Re 1) When a company is in liquidation, it is represented by its management until a liquidator has been nominated (see also Section 7 of this Chapter). After that, the company is represented by the liquidator who replaces the management. This implies that all company’s bodies, except for the general meeting, lapse as a result of the liquidation (see also Section 9 of this Chapter). The liquidator carries out the liquidation and the winding up of the company until the end of the liquidation proceedings. See for example Finnish Companies Act Section 20:9(1) and Swedish Companies Act Section 25:30.

Re 2) The liquidator shall be subject to the provisions of the EMCA on the management and supervisory board (cf. Finnish Companies Act Section 20:9(1)). A liquidator shall act instead of the management and shall be charged with the duty of carrying out the liquidation.

Re 3) Once appointed, the liquidator shall be registered (cf. Czech Commercial Code Section 71(2) (within 10 days) Danish Companies Act Article 220, Finnish Companies Act Section 20:10, German AktG § 266 and Polish Commercial Companies Code § 464(1)).

The remuneration of the liquidator follows the general rules applicable to the management board.

*Section 14.13*

**General Duties and Powers of Liquidator**

- (1) Upon assuming their duties, the liquidator shall take possession of all assets of the company and shall manage and administer them for the purposes of an efficient liquidation.
- (2) An efficient liquidation is a liquidation procedure, which in the shortest time period is likely to bring the maximum return to the creditors and the shareholders.
- (3) The liquidator shall have the power to represent the company vis-à-vis third parties in the same way as the management board. Unless the articles of association or the general meeting provide otherwise, all liquidators, should more than one be appointed, acting jointly, shall represent and bind the company. However, a notice to the company can validly be made to any liquidator.
- (4) If requested by the liquidator, the last management board of the company shall assist the liquidator in the operations of the liquidation.

*Comments*

Duties owed by the liquidator are duties owed to the company and not to individual shareholders, creditors or other stakeholders. Title to the company's assets is not automatically vested in the liquidator but remains vested in the company. When carrying out his/her functions, the liquidator acts as an agent of the company. The basic duty of the liquidator in all types of liquidations is to wind up the company's affairs, to collect in and realise the company's assets and to make distributions to the creditors in accordance with the statutory scheme, with any surplus being returned to shareholders.

Re 1) This Subsection provides that the liquidator is vested with managerial duties for the purpose of liquidating the company.

Re 3) If more than one liquidator have been appointed, all the liquidators are authorized to represent the company jointly, unless the articles or the body with authority to make such appointment provide otherwise (cf. German AktG § 269(2)). If a statement with legally binding effect is to be made to the company, it shall suffice if such statement is made to one liquidator (cf. German AktG § 269(2)). The power of the liquidator to represent the company may not be limited, see for example German AktG § 269 (5), and Polish Commercial Companies Code § 469.

Re 4) Former members of the management, if so required, must cooperate in the liquidation proceedings (cf. Spanish Corporate Enterprise Act Article 374(2)).

*Section 14.14*

**Invitation of Creditors to Notify Their Claims**

- (1) Upon assuming their duties, the liquidator shall invite creditors to notify their claims against the company with supporting documents, if any, within a time period of not less than three months. The invitation shall be published in the Register and in newspapers according to the reasonable judgement of the liquidator in one or more languages that creditors are expected to understand. The liquidator shall also proceed to individual invitation of creditors, if this is possible.
- (2) Notification of a claim is not a prerequisite for the payment of the creditor. However, creditors who notify after the deadline fixed for notification and who were not known to the company may demand satisfaction of their claims only from the as yet undistributed assets of the company.

*Comments*

Re 1) The liquidator is obliged to notify the company's creditors to file their claims, referring in such notice to the dissolution of the company (cf. Danish Companies Act Section 221(1), the Finnish Companies Act Section 20:14, German AktG § 267 and Polish Commercial Companies Code). The time period, however, varies in the different Member States (e.g. reasonable period but not shorter than 3 months in the Czech Republic, 3 months in Denmark and 6 months in Poland). The EMCA Group considers a three-month period is appropriate as it gives the creditors sufficient time to demand satisfaction of their claims. The liquidator will also be obliged to invite the creditors on an individual basis, if this is possible, mainly when creditors and their addresses are known.

Re 2) Section 14(2) gives late and unknown creditors the opportunity to make their claims after the deadline and to demand satisfaction of their claims from the as yet undistributed assets of the company (cf. Polish Commercial Companies Code § 475).

*Section 14.15*

**Information to be Provided to Shareholders during Liquidation**

(1) During the liquidation the shareholders have the right to be informed about the progress of the liquidation. The information must be given periodically, at least once in every semester. The means of information can be chosen by the liquidator so as to ensure that this information reaches all shareholders in a timely and equal manner.

(2) If the liquidation is not completed in one year as from the dissolution of the company, the liquidator shall convene a general meeting, to which they shall present a detailed report and a balance sheet about the operations of liquidation, the reasons of the delay and the prospects of its conclusion. This report and the balance sheet shall be registered in the Register and posted on the company's website. If during the liquidation new operations are carried out, these must be explained in the notes accompanying the balance sheet.

(3) The balance sheet provided in this Section shall be audited, if the law so requires for the balance sheets of the company, and it must be submitted for approval to the general meeting.

(4) This Section shall apply for all subsequent years, subject to Section 16.

*Comments*

Re 1) Shareholders must be notified of the liquidation progress (cf. Spanish Enterprise Act Article 388(1)). Notice must be given by the most effective means.

Re 2-4): Companies in liquidation must continue to submit a balance sheet, until the liquidation has been completed (cf. Danish Companies Act Section 224). These provisions are inspired by the Italian Civil Code Article 2490.

*Section 14.16*

**Acceleration Plan**

(1) If after three years as from its commencement the liquidation is not concluded, the liquidator shall present to the general meeting a plan for the acceleration of the liquidation. In this plan the liquidator shall state the reasons for the delay and shall propose adequate measures for the completion of the liquidation as soon as possible. Such measures may consist in agreements with third parties for the settlement of claims or liabilities of the company, such as waiving of rights, compromises, termination of judicial or arbitration procedures, prepayment of debts, collection of future debts at a discount, termination of contracts, transfer of assets to third parties or arbitration agreements.

(2) If the general meeting approves the acceleration plan, the liquidator is obliged to implement it. His/her responsibility for the actions provided in the plan arise only to the extent that the liquidator provided insufficient, false or misleading information to the general meeting.

*Comments*

The Acceleration Plan is inspired by the Greek Law on companies limited by shares, Article 49. The purpose of the acceleration plan is to secure that the liquidation process is finished without undue delay. Similar provisions are not found in other Member States' company laws.

*Section 14.17*

**Operations of Liquidation**

(1) Within three months of the opening of liquidation the liquidator has the duty to draw up an inventory of all assets of the company as well as a balance sheet. The members of the previous management board have the duty to assist the liquidator in drawing up the inventory and the balance sheet and, if they have a legitimate interest, have the right to add their own remarks on the latter.

(2) The liquidator shall conclude all pending affairs of the company. He can also undertake new operations, if they serve the purposes of an efficient liquidation.

(3) The liquidator shall liquidate all assets of the company. To the extent possible, the company's undertaking shall be sold as a going concern.

(4) The liquidator shall collect all claims and pay all debts of the company. He shall also claim any unpaid capital to the extent that this is necessary for the purposes of liquidation. Non-mature or disputed debts may be paid by depositing the relevant amount in accordance with the general rules.

(5) Any liquidation surplus shall be distributed to the shareholders. Such distribution shall not be made before all debts to known creditors have been paid; however, if adequate security is provided, an interim distribution may be made before that time.

(6) The liquidator shall keep the accounts and the books of the company.

(7) If the company has sufficient assets for the payment of the creditors, the articles of association can provide, or the general meeting can decide a different manner of disposal of the assets or the attribution of certain assets to one or more shareholders, provided that an independent chartered accountant has previously evaluated such assets and confirmed their sufficiency for the payment of the creditors.

*Comments*

This Section deals with the liquidation proceedings.

Re 1) The three-month period starts from the day where the liquidation has been registered, cf. Section 6. Within three months of the start of the liquidation the liquidator must prepare an inventory and a balance sheet for the company to the date on which it was dissolved.

Re 2) The liquidator shall close current business, collect receivables, perform obligations and liquidate the assets of the company. He/she will have the right to sue the former management of the company for damages. New business shall be transacted only where needed to close current business (cf. Greek Law on companies limited by shares Article 49(4), Polish Commercial Companies Code § 468 and Spanish Corporate Enterprise Act Article 384). The aim of this is to take the actions necessary to terminate the operations of the company, in an orderly manner.

Re 3) The liquidator shall carry out the sale of the assets of the company as a whole in order to obtain the best price available.

Re 4) Money, securities and other documents as well as valuables may be deposited by the debtor for the creditors in accordance with the general rules (like for example the „*Hinterlegung*”, as per § 372 of the German Civil Code). See a similar provision in the Polish Commercial Companies Act § 473.

Re 5) Liquidation proceeds may not be distributed to shareholders until all debts to creditors have been settled. Any surplus shall be distributed pursuant to the rules in the articles of association or, in the absence thereof, established by the general meeting (cf. Danish Companies Act Section 222 and Spanish Corporate Enterprise Act Article 3391(1)).

Re 7) If the articles of association or the general meeting so permit and the assets are sufficient to repay creditors, it is possible that certain arrangements are provided regarding the disposal of the assets. For example, it is possible for certain members to be paid their share by returning assets to them that they previously contributed to the company, provided that such assets continue to form part of the company's estate. If that is going to be done and there is no surplus left to pay each member his share in cash after the rest of the assets have been sold and the company's creditors have been paid, the member or members who are to receive their share in kind must pay the difference in cash to the other members (cf. Portuguese Code of Commercial Companies Article 148 and Spanish Corporate Enterprise Act Article 393).

*Section 14.18*

**Final Balance Sheet**

At the end of the operations of liquidation and before any distributions are made, the liquidator shall draw up and submit to the shareholders the following statements: Final financial statements, a general report on the operations of liquidation and (in case of insufficiency of assets) a draft distribution plan. The distribution plan shall rank creditors in accordance with the general national rules. The liquidator shall cause the registration of the above statements in the Register.

The financial statements provided in this Section shall be audited, if the law so requires for the balance sheets of the company.

*Comments*

Once the liquidation procedures have been concluded, the liquidator must present a report on the assets and financial position of the company (through an inventory and balance sheet) and a report on the actions taken and proposed distribution of the assets left after outstanding transactions have been carried out, credit collection, and payment of debts (cf. Czech Commercial Code Section 75(1), Danish Companies Act Article 224, Finnish Companies Act Section 20:16, Greek Law on companies limited by shares Article 49(5) and Spanish Corporate Enterprise Act Article 390(1)).

*Section 14.19*

**Final General Meeting**

(1) Within ninety days following the registration of the statements of Section 18, a general meeting of shareholders shall be convened by the liquidator.

(2) The agenda of the above general meeting shall include the approval of the above statements.

(3) Within a month as from the approval by the general meeting of the above statements, any creditor or shareholder may oppose the distribution plan before the court. The court may order changes to the plan in accordance with the rights and the ranking of each applicant. Distributions may be made before the court's judgement only insofar as the creditors or shareholders' position is not affected by the opposition.

(4) Any liquidation dividends, which have not been collected by shareholders or creditors, in accordance with the directions of the liquidator, shall be deposited by the liquidator in a bank in the name of the creditors or the shareholders who did not collect them.

*Comments*

The statements prepared under Section 18 of this Chapter must be submitted to the general meeting for approval (cf. Czech Commercial Code Section 75(1), Danish Companies Act Article 224, Greek Law on companies limited by shares Article 49(5) and Spanish Corporate Enterprise Act Article 390(1)).

Re 3) The resolution of the general meeting approving the balance sheet, the report and the proposal for distribution of the assets may be challenged by members who did not vote in favor of it within 1 month from the date on which the resolution was passed (cf. Czech Commercial Code Section 75(2), Spanish Corporate Enterprise Act Article 390(2)).

Re 4) A similar provision can be found in the Spanish Corporate Enterprise Act Article 394(2).



PART 4  
EXTINCTION OF THE COMPANY

*Section 14.20*

**Extinction – De-registration – Books**

- (1) Upon completion of liquidation, the company shall be extinguished and its legal personality terminated.
- (2) A company shall not be extinguished if the company is reactivated in accordance with Section 24 of the present Chapter.
- (3) The liquidator shall cause the cancellation of the extinguished company from the Register (de-registration).
- (4) The books and records of the extinguished company shall be kept for a period of ten years by the person appointed to that effect by the general meeting or as directed by the court. The right to inspect them by those who had that right before the extinction can be exercised if the person making the request prepays any expenses.

*Comments*

Re 1-3) After the completion of the winding-up process, the company is removed from the Register and it ceases to exist (cf. Czech Commercial Code Section 75b(2), Danish Companies Act Article 224, Finnish Companies Act Section 20:17 Polish Commercial Companies Code § 478, Spanish Corporate Enterprise Act Article 396 and UK Insolvency Act Sections 201(1), (2) and 205(1), (2)).

Re 4) A similar provision can be found in the German AktG § 273(2), the Italian Civil Code Article 2496, and the Polish Commercial Companies Code § 476.

*Section 14.21*

**Subsequent Appearance of Assets or Liabilities**

- (1) If after de-registration of the company new assets are discovered, the liquidator shall liquidate such assets and distribute the proceeds to the creditors and, if possible, to the shareholders. If a liquidator does not exist or refuse to act, the court of the last seat of the company shall appoint a substitute at the request of any person having a legitimate interest. This paragraph shall not apply if the new assets are inadequate for covering the costs of the continued liquidation.
- (2) The liquidator or the substitute may re-register the company, to the extent this is necessary for the completion of the operations of paragraph 1. The court may also order re-registration.
- (3) Paragraph 1 shall apply mutatis mutandis if new liabilities are discovered, but only to the extent that new assets make their payment possible. However, the creditors have the right to claim from the shareholders any monies received by the shareholders as proceeds of the liquidation as well as from the liquidator, if he/she is in fault.

*Comments*

Re 1 – 2) The liquidator of a company, which has been deleted from the register following liquidation or compulsory dissolution, is obliged to continue the liquidation if additional funds have become available for distribution. The court may appoint a new liquidator and/or order that the company be restored to register if this is necessary. However, only the liquidation procedure is resumed (cf. Czech Commercial Code Section 75b, Danish Companies Act Section 235, Finnish Companies Act Section 20:18 and UK Companies Act Section 1029).

Re 3) Similar provisions can be found in the Italian Civil Code Article 2495, in the Portuguese Companies Code Article 163, and the Spanish Corporate Enterprise Act Article 399(1). However, the Polish Commercial Companies Code does not include an obligation to return proceeds received in good faith, cf. § 475(2).



PART 5  
CIVIL LIABILITY

*Section 14.22*

**Civil Liability of Liquidator**

The liability of the liquidator is governed by the provisions on the liability of directors.

*Comments*

For the provisions governing the liability of directors, see EMCA Chapter 10.

*Section 14.23*

**Civil Liability of Previous Management after Dissolution**

The members of the last management board may be liable to the shareholders and the creditors for failing to assist with the liquidation of the company in accordance with the provisions of this Chapter (Sections 7, 13 Subsection 4 and 17 Subsection 1) where that failure to assist can be shown to have caused direct loss to the shareholders and creditors.



PART 6  
REACTIVATION OF THE COMPANY

*Section 14.24*

**Conditions of Reactivation**

- (1) The company, which has been dissolved, can be reactivated if circumstances change such that the grounds for dissolution are no longer relevant and the shareholders' general meeting has so decided. The decision of the general meeting shall be taken with the qualified majority.
- (2) Such reactivation is not permitted if liquidation has been completed or the most significant assets of the company have already been liquidated.
- (3) The liquidator or the new management board shall cause the re-registration of the company in the Register.

*Comments*

Re 1) The company can be reactivated following a decision passed at a shareholders' meeting.

Re 2) In Denmark this is the case if no distribution has been made, cf. Danish Companies Act Section 231.

*Section 14.25*

**Effects of Reactivation**

- (1) Following the registration of the reactivation, the reactivated company resumes its operations. If the general meeting so decides, the reactivated company can at the same time be converted into another legal form or be merged with another company.
- (2) The general meeting that decides the reactivation shall also appoint a new management board [or a supervisory board].

*Comments*

The effect of restoration is that the company is deemed to have continued in existence as if it has not been struck off (cf. UK Companies Act Section 1028(1)).



## CHAPTER 15 GROUPS OF COMPANIES

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## General Comments<sup>75</sup>

### 1. EU Law

There is no specific regulation on groups by European Union law. A proposal of a ninth directive,<sup>76</sup> which was largely inspired by German law, was dropped by the end of 1980s, due to the lack of support for this approach.

### 2. National Law

Groups of companies are a major economic phenomenon. Since the middle of the last century, enterprises have increasingly chosen to organize and to conduct their business activities in the form of a network of individual separate companies rather than as a single corporate entity: therefore, the group of companies – and not the single company – is the prevailing form of the modern enterprise.

As a legal phenomenon, groups are a well-known and established topic in several sectors of the law, either in a national or in a European context, e.g. tax law, accounting law, competition law, labour law, and so on. Yet, its treatment in the area of company law has proved to be a difficult, disparate and mostly unsolved issue.

At the national Member States level, there are four major approaches: comprehensive regulation, partial regulation, case law recognition of the interest of the group, and lack of treatment (except what is required by EU directives).

The first approach consists in a global and comprehensive regulation of groups of companies. This approach originates in Germany (1965), and has been followed suit closely by Portugal (1986), Hungary (1988-2012), Czech Republic (1991-2012), Slovenia (1993) and Croatia (1993). It can be noted that this approach has also been adopted in Albania (2008) and Turkey (2012). Outside Europe, it also influenced countries such as Brazil (1976). Austria and Poland, although being very close in legal tradition to Germany (like all other countries who adopted the German approach), chose not to adopt it. However, the Austrian case law on groups is at least as rigid as in Germany.

A second approach consists in a partial or selective regulation, which deals with some major questions of groups of companies without aiming, however, to regulate it in a complete and comprehensive manner. This is the case of Italy, which adopted a new regime for groups in 2003 (Italian Civil Code Article 2497 et seq.). Italian law recognizes the interest of the group. It is influenced by German law but is considered to be more flexible.

The third approach is the French one. It derives from the 1985 *Rozenblum* decision of the French Supreme Court. In that decision, the court recognized the interest of the group. As a consequence, the directors of a subsidiary may take into consideration the interest of the group when making a decision that prejudices the subsidiary, provided that several conditions are satisfied. This flexible case law approach is recognized in other Member States (e.g. Belgium, Estonia, Luxembourg, the Netherlands, the Nordic countries and Spain).

Finally, some Companies Acts have no specific provisions on group interest. This approach is followed for instance in the UK. However, as regards the UK, it should be remembered that directors of a subsidiary are able to take into account the interests of the group in making their decisions. The risk of unduly favouring the parent is mitigated by the risk of the subsidiary director's personal liability for wrongful trading. From a functional perspective, the British approach might not be very different from the French one.

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<sup>75</sup> The working group on Chapter 15 was chaired by Professor Pierre-Henri Conac (University of Luxembourg, Luxembourg) and included Professor José Engrácia Antunes (Catholic University of Portugal (Porto), Portugal) and Professor Isabelle Urbain-Parleani (University of Paris-Descartes, France).

<sup>76</sup> Preliminary Draft of a Directive Based on Article 54, 3 (g) on Harmonization of the Law of Groups of Companies (Part I - EEC Doc. XI/328/74-E, Part II - EEC Doc. XV/593/75-E). A German version of the draft can be found in M. Lutter, *Europäisches Gesellschaftsrecht*, 2<sup>nd</sup> ed. (Walter de Gruyter, 1984), pp. 187-225.

Apart from these formal distinctions, the real difference is between Member States that recognize or not the interest of the group. The issue is whether the directors of a subsidiary can permit some disadvantage to the subsidiary in the pursuit of the interests of the group, without having to compensate the subsidiary for this damage immediately, or within a short time period, and to the full amount? The EMCA group has chosen to recognize the group interest.

The “Forum Europaeum on Group Law”, composed of a group of Academics, published in 2000 a proposition for a European regulation of groups of companies based on some standards and rules – entitled “The Corporate Group Law Principles and Proposals”.<sup>77</sup> This proposal was influenced by German law (“*Konzernrecht*”), although the drafters moved away from the system put in place in 1965. It was also influenced by French case law (the so-called “Rozenblum” doctrine), and by French and UK law (“*obligations aux dettes*”, wrongful trading). The starting point and aim of the Forum Europaeum was, to a certain extent, different from the one of EMCA, since the goal was to adopt a European Community solution, and not a national Act. Therefore, once the basic standards were set, many points were left to Member States discretion and options were suggested. The proposal of the Forum Europaeum was not adopted at the EU level, due apparently to a lack of support by professionals, at the time, for such regulation. However, the work of the Forum Europaeum has been used as a basis for the EMCA Chapter 15 on Groups.

The decision of the Forum Europaeum to recognize the group interest showed the way forward. Since 2000, several Member States have moved in this direction, through statute or case law. The Czech Republic moved from the German approach to the Rozenblum doctrine when introducing their new Commercial code in 2014. In 2015, two decisions of the Supreme Court of Estonia and Spain introduced the Rozenblum doctrine in their respective jurisdictions. Some Member States are also considering moving in this direction. A 2014 report in Greece supported the implementation into Greek law of the Rozenblum doctrine even while adopting some elements of German law. No Member State has moved from Rozenblum, or similar, doctrines toward the rigid approach of compensating any losses, although, some elements of the German approach have been usually included (e.g. dependency report, sell-out right). Therefore, it appears that the Rozenblum doctrine has reached a status approaching *ius commune* for Member States that recognize the interest of the group. Currently, a majority of Member States recognize the interest of the group to a certain extent either through case law or legislation. A minority of Member States do not recognize the interest of the group at all or only in particular situations.

The debate on the recognition of the group interest was also relaunched at the EU level by the Report of the Reflection Group on the Future of EU Company Law (2011)<sup>78</sup> which called the European Commission to consider “subject to evidence that it would be a benefit to take action at the EU level, to adopt a recommendation recognising the interest of the group.”<sup>79</sup> Since 2012, there have also been calls for an EU intervention, based on the French Rozenblum approach, such as the 2015 Proposal of the Forum Europaeum on Company Groups (FECG), “to facilitate the management of cross-border company groups in Europe” (2015), calling for a directive,<sup>80</sup> and the 2015 report of the French Think Tank Club des Juristes “Towards Recognition of the Group Interest in the European Union” calling for a Framework recommendation.<sup>81</sup> In 2016, the European Company Law Experts (ECLE) also recommended that the Commission develop an EU “instrument” on Related Party Transactions with a special regime within groups where companies could take into account the interest of other group companies or of a group as a whole.<sup>82</sup> Also, in October 2016, the Informal Company Law Expert Group (ICLEG), attached to the European Commission, published “Report on the recognition of the interest of the group”.<sup>83</sup>

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<sup>77</sup> The steering committee of the “Forum Europaeum on Group Law” was composed of Professors Peter Hommelhoff, Klaus J. Hopt, Marcus Lutter, Peter Doralt, Jean-Nicolas Druey, and Eddy Wymeersch.

<sup>78</sup> The members of the Reflection Group were José Engrácia Antunes, Theodor Baums, Blanaid Clarke, Pierre-Henri Conac, Luca Enriques, András Hanák, Jesper Lau Hansen, Harm-Jan de Kluiver, Vanessa Knapp, Noëlle Lenoir, Leena Linnainmaa, Stanislaw Soltysinski and Eddy Wymeersch. Many members of the Reflection Group are also members of the EMCA.

<sup>79</sup> Report of the Reflection Group On the Future of EU Company Law (2011), p. 65. The report is available at: [http://ec.europa.eu/internal\\_market/company/modern/reflectiongroup\\_report\\_en.pdf](http://ec.europa.eu/internal_market/company/modern/reflectiongroup_report_en.pdf).

<sup>80</sup> Forum Europaeum on Company Groups, *Proposal to Facilitate the Management of Cross-Border Company Groups in Europe*, ECFR 2015, pp. 299–306.

<sup>81</sup> Club des Juristes (CDJ), *Towards Recognition of the Group Interest in the European Union?*, June 2015.

<sup>82</sup> European Company Law Experts, *A proposal for reforming group law in the European Union – Comparative Observations on the Way Forward*, 2016. The article is available on <https://europeancompanylawexperts.wordpress.com/>.

<sup>83</sup> The ICLEG Report on the Report on the recognition of the interest of the group is available on : [http://ec.europa.eu/justice/civil/files/company-law/icleg\\_recommendations\\_interest\\_group\\_final\\_en.pdf](http://ec.europa.eu/justice/civil/files/company-law/icleg_recommendations_interest_group_final_en.pdf)

The group of companies, being an economic reality and being also dealt with in many other legal branches, should also be recognized and regulated by Company Law. However, the EMCA does not aim to develop a global and systematic legal regulation for groups, based on a rigid conception of the autonomy of the single company and aiming basically at the protection of subsidiary companies, its minority shareholders and creditors. Instead, the main objective of the EMCA Chapter on Groups of Companies is to establish a cluster of rules aiming to facilitate and enhance the flexibility of the formation, organization and functioning of this leading form of business organization.

### 3. Considerations

The EMCA Chapter on groups is focused on the issue at the heart of group reality: the management of the group. Protection of subsidiary companies and related interests (shareholders, creditors) should not be ignored, of course, but it should not be achieved through excessively burdensome rules. The Chapter also pays special attention to the parent corporation. It complements the traditional “bottom-up” approach of groups of companies (exclusively focused on the subsidiary or dependent companies) by a “top-down” perspective, which takes into account the effects of the group at the level of its parent corporation. Likewise, the regulation distinguishes between wholly-owned and not wholly-owned subsidiaries, as protection is less necessary in the former case and the functioning of the group should be as flexible as possible. Finally, the EMCA Chapter on groups takes also into account the international nature of many groups. In order to reach these general goals, the EMCA Chapter on groups includes the following main principles and rules:

In order to enhance and facilitate the functioning of the group, the Chapter proposes that

- the *right of a parent company to give instructions to a subsidiary* is recognized, without creating a specific liability or burden on the parent company, as this power corresponds to reality. Companies Acts which entitle the parent company with a legal power of direction over subsidiaries only on the condition that an over-reaching protection is granted to creditors, minority shareholders and the subsidiary itself, have proven to provide a legal regime which is deemed to be too rigid and with little practical efficacy.
- the *right to manage the group and its constituent members in the interests of the group* is also recognized. The EMCA Chapter on groups is inspired by the *Rozenblum* doctrine. This will provide protection for the management of the parent and subsidiary company against liability (civil and criminal), under certain conditions, when they manage the companies as one entity, which is the reality of a group.
- the *right to squeeze-out minority shareholders* is accepted within a group.
- the *international dimension of the group*, where applicable, is recognized.
- *intra-group transactions*: related party transactions are subject to approval by the board of directors in the EMCA. This follows the UK approach of submitting related party transactions to a decision of the board, except, in listed companies, when they cross certain thresholds. Therefore, exemptions from approval by the general shareholders’ meeting of intra-group transactions are not needed in the EMCA Chapter on Groups.

The protection of minority shareholders and creditors at the level of the subsidiary company is assured through general provisions, like in the United Kingdom, with some specific rights:

- as to minority shareholders: sell-out rights (US *appraisal rights*);
- as to creditors: introduction of parent liability.

The protection of shareholders at the level of the parent company is also taken into account, namely by creating special mechanisms aimed at ensuring shareholders in the parent company have access to information concerning the subsidiary’s affairs.



PART 1  
DEFINITIONS

*Section 15.01*

**Definition of a Group**

A group is the entity comprising the parent company and all its national and foreign subsidiaries or entities, unless otherwise indicated.

*Comments*

In a comparative perspective, the definition of a group has been mainly constructed on the basis of two different concepts. One is the concept of “unified management” (e.g., Section 18 of German Corporation Act). The other is the concept of control (e.g., Section 1159 (1) UK Companies Act, Section 7 of the Danish Companies Act, Section 12(1) of the Finnish Companies Act, Article 22 of the Directive 2013/34/EU of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, etc.).

The EMCA definition of a group of companies adopts the latter view. The definition was inspired by the pre 2011 version of IAS 27 Consolidated Financial Statements and Accounting for Investment in Subsidiaries and IFRS 10 Consolidated Financial Statements, which replaced IAS 27 and has been endorsed by the European Commission.<sup>84</sup> The notion of control is the basis for consolidation in IFRS 10 as it was in the pre-2011 version of IAS 27.

The term company in “parent company” refers to the definition of “company” in the EMCA. A natural person cannot be a “parent company”.

The parent company is a national company unless otherwise indicated. The term “entity” refers to any unincorporated body such as a trust.

Because of the reference to “all its national and foreign subsidiaries”, the term “subsidiaries” in this Chapter includes both national and foreign companies, unless otherwise provided. Most Companies Acts do not refer to foreign subsidiaries. One exception is Finnish law, which refers to “national and foreign” subsidiaries. Section 12 of the Finnish Companies Act Group holds that “(1) If a limited liability company exercises control over another domestic or foreign corporation or foundation, as referred to in Chapter 1, Section 5, of the Accounting Act, the limited liability company shall be the parent company and the other corporation or foundation a subsidiary. The parent company and its subsidiaries form a group”.

The definition of the group or parent and subsidiary (See. Section 2) applies in this Chapter and in all the EMCA, unless otherwise provided.

*Section 15.02*

**Definition of Parent and Subsidiary**

A “subsidiary” is a company subjected to the control, as defined in Sections 5 and 6, of another company, the “parent” company, either directly or indirectly through another subsidiary.

*Comments*

Several Companies Acts refer to the concept of control as the core concept of the definition of “group” or of the parent-subsidiary relationships (Section 1159 (1) UK Companies Act, Section 7 of the Danish Companies Act, Section 12(1) of the Finnish Companies Act, Section 42 of the Spanish Commercial Code). The same approach is evident in Article 22 of the Directive 2013/34/EU of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings.

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<sup>84</sup> Commission regulation (EU) no. 1254/2012 of 11 December 2012, OJ EU L 360/1, 29.12. 2012.

Other Member States have a definition of subsidiary which is limited to holding more than 50 % of capital or votes (e.g. Article L. 233-1 of the French Commercial Code). This approach seems too restrictive. A company should be considered a subsidiary as soon as it is controlled.

Control may be held by the parent company over a subsidiary either directly or indirectly. Companies are affiliated if one is a subsidiary of the other or both are subsidiaries of the same company. The term “affiliated companies” (or the UK Companies Act “associated companies”) is sometimes used in Companies Acts but is not predominant. Therefore, it is not used in the EMCA itself since rules for affiliated companies can be applied by using the term subsidiary or member of the group.

#### *Section 15.03*

### **Definition of a Wholly-owned Subsidiary**

A “wholly-owned company” is a company with no other shareholders except its parent company or any other subsidiary of its parent company or persons acting on behalf of its parent or such subsidiaries.

#### *Comments*

A definition of wholly-owned subsidiary is useful since, in the absence of minority shareholders, more flexibility should be allowed in the operations and the management of the group. This definition is limited to companies whose capital is owned at 100 % by the parent company, either directly or by other 100 % owned companies.

This provision is inspired from the UK (Section 1159 (2) UK Companies Act).

#### *Section 15.04*

### **Definition of Control**

Control is the power to govern, alone or with other shareholders, the financial and operating policies of a subsidiary. It may be *de jure* or *de facto*.

#### *Comments*

This definition is inspired by the pre 2011 version of IAS 27 Consolidated Financial Statements and Accounting for Investment in Subsidiaries. For instance, Danish law has also adopted the definition from IAS 27 with the exception of the sentence “so as to obtain returns from its activities”. This term is also excluded from the EMCA Chapter on groups due to the fact that it is an economic concept.

The willingness to hold the shares for the long term or not should not be taken into consideration in order to decide whether or not there is control.

#### *Section 15.05*

### **Definition of De Jure Control**

Control of a subsidiary exists where a company owns, directly or indirectly, more than half of the voting rights in that subsidiary, unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control.

#### *Comments*

The definition of *de jure* control is inspired by the pre 2011 version of IAS 27 Consolidated Financial Statements and Accounting for Investment in Subsidiaries. The owning of majority of votes is also considered in most Companies Acts as a criterion for the assessment of control over a company (e.g., Czech Republic, Denmark, France, Germany, Poland, Portugal, Slovakia, Spain). In some countries, the presumption of control linked to majority voting rights is irrebuttable (e.g., Czech Republic, France, Poland) where in others it is a rebuttable presumption (e.g., Denmark, Germany, Portugal).

The organization of control in two different articles facilitates the identification by outside parties of the basis of the control.

*Section 15.06*

**Definition of De Facto Control**

Where one company holds half or less than half of the voting rights in another company, control exists if the former has:

- (a) the right to exercise more than half of the voting rights by virtue of an agreement with other investors;
- (b) the right to control the financial and operating policies of a company under any articles of association or agreement;
- (c) the right to appoint or remove the majority of the members of the governing body, and this body has control of the business; or
- (d) the right to exercise the actual majority of votes at general meetings or an equivalent body and thus the actual control of the business. Control is presumed when a majority of the members of the governing body of a company has been appointed by a company holding half or less than half of the voting rights in the company (the Relevant Company) for two successive financial years. The Relevant Company is deemed to have effected such appointments if, during that financial year, it held a fraction of the voting rights greater than 40 %, and if no other shareholder directly or indirectly held a fraction greater than its own.

*Comments*

Re a) The term “power”, used by the pre 2011 version of IAS 27 Consolidated Financial Statements and Accounting for Investment in Subsidiaries, has been substituted by the term “right”, as it is more usual in Company law and is not an economic term.

Re c) The governing body is the board of directors in a company with a unitary board or the supervisory board in a company with a two-tier board.

The right to appoint a majority of the members of the governing body, despite not having a majority of the votes, can originate, from the specific structure of the company (e.g. *Société par actions simplifiée* in France) or from law.

In case the right to appoint and to remove is not held by the same persons, control will be deemed to be exercised by the person who can remove the members of the governing body.

Re d) Presumptions should play a major role in defining the existence of a factual control, as some companies might want to pretend that they are not controlling another company. Therefore, the burden of proof has been reversed in a way that it should be up to that company to allege and demonstrate that it does not have control. The first and second presumption originates from the Directive 2013/34/EU of 26 June 2013 and French law (Article L. 233-16 of the Commercial Code).

The definition of factual control, adopted in Subsection d, is inspired by the pre 2011 version of IAS 27.

*Section 15.07*

**Calculation of Participation**

In calculating voting right for the purpose of Sections 5 and 6, rights to subscription and purchase of shares carrying voting rights that are currently exercisable or convertible are to be included.

Any voting rights attaching to shares owned by the subsidiary itself or by its subsidiaries must be disregarded in the determination of the voting rights in a subsidiary held by the parent company.

*Comments*

Similar provisions are found in Germany (Section § 20, par. 2 of German Corporation Act), Denmark (Section 7(4) of Danish Companies Act), etc. The consideration of the so-called future or potential voting rights is common in capital market laws, relating to the disclosure of significant shareholdings. However, there are several Companies Acts which do not take into account this potential capital (e.g. France).

Paragraph (2) is necessary, because otherwise the real controlling influence of the parent company would be underestimated.

*Section 15.08*

**Duty to Disclose Control**

(1) The management of the parent company must inform in writing the management of a subsidiary as soon as control has been established or removed.

(2) As soon as it is informed, the subsidiary, unless it is a foreign subsidiary and such obligation is not recognized by the law of the country whose rules apply to the subsidiary, must inform without delay the parent company of the number of shares and voting rights held by it in the parent company, and in any other companies.

*Comments*

Re (1). It is necessary for a subsidiary company to be informed of the acquisition or the end of control by the parent company, so that the former knows its legal situation, since certain rules apply only to controlled companies. Moreover, this written declaration or notification could also operate as a sort of publicity or transparency for groups of companies, since the existence of a group is based on a control linkage between parent and subsidiaries. This type of provision can be found in some national Companies Acts (e.g., Section 134 of the Danish Companies Act, Section 15 of Finnish Companies Act). A similar -but not identical- duty of information (“*deberes de información de la pertenencia al grupo*”), complemented by a duty of publicity on the commercial registry (“*Deber de inscripción del grupo*”), was also provided by the 2013 Spanish Proposal of a Code on Commercial Companies (Sections 291-7 and 291-8).

According to paragraph 2, in case of establishing control, it is necessary also for the subsidiary to inform the parent company of any shares or voting rights held in other companies, since this can have the effect of extending the scope of the group, by extension to previously existing subsidiaries or by creation of new ones thanks to the addition of shares and/or voting rights held by the parent and the new subsidiary.

This duty only applies to national subsidiaries (but also in respect to foreign parent companies), since the law of a State cannot impose obligations on foreign companies.

PART 2  
GROUP MANAGEMENT

*Section 15.09*

**Right of a Parent Company to Give Instructions to the Management of a Subsidiary**

(1) A parent company, acting as a shareholder in the general shareholders' meeting or through its board of directors or senior management, has the right to give instructions to the organ of management of its subsidiaries. A subsidiary may receive instructions from any parent company, including a foreign parent company.

(2) Subject to the conditions specified in Section 16 and the exceptions in Subsection (3), the organ of management of a subsidiary shall comply with the instructions issued by its parent.

(3) The following members of the management of a subsidiary are not bound by any instruction:

(a) Directors and managers who were not appointed by the parent company or by the controlling shareholder, but as a result of provisions in the articles of associations, or a shareholders' agreement or of any law or regulation.

(b) Directors who are defined as "independent directors" according to the applicable Corporate Governance Code, when the company is subject to such a code.

(c) Directors who are employee representatives.

(4) A non-wholly-owned subsidiary needs to disclose in the Commercial registry whether or not its management is directed by the parent. In the absence of a contrary disclosure, a wholly-owned subsidiary is presumed to be subject to instructions of its parent company and does not need to make a disclosure in the Commercial registry, except to disclose that it is wholly-owned. This disclosure is for the information of third parties and shareholders only.

*Comments*

As a matter of fact, in groups, subsidiaries receive instructions, whether oral or written, from the management of the parent company because subsidiaries are usually managed according to business lines. However, in the overwhelming number of Companies Acts, this reality is not recognized due to the predominance of the concept of the legal autonomy of the subsidiary. This provision is designed to reconcile law and the reality by treating subsidiaries in a different way than autonomous companies. It does so by giving a legal status to instructions, which should provide more legal certainty for the managers and directors of the parent as well as of the subsidiary.

Some national legal orders (e.g., Germany, Section 322 AktG) recognize a legal power of direction to parent companies only on the condition that a "legal group" is formed, that is, the parent assumes in advance special rights and liabilities toward the subsidiary (e.g., duty to cover annual losses), its creditors (e.g., unlimited liability in the case of wholly-owned subsidiaries in Germany) or its minority shareholders (e.g., compensation and sell-out rights).

Likewise, the Forum Europaeum had a similar view and proposed that the parent, under certain conditions, be "entitled by unilateral declaration to assume the management of the subsidiary". However, the regime proposed by Forum Europaeum was subject to certain rules which are not adopted by the EMCA. This approach was similar to the German intercompany agreements for contractual groups (Section 291-307 AktG).

The Forum Europaeum proposal made the right to assume management of the company conditional on an "unilateral declaration", which would need to be "registered in the Commercial Registers of both the parent and subsidiary". This proposal is not adopted here as it would be a formal requirement, which does not seem necessary, since the EMCA does not create a special liability towards third parties only because instructions are given (see however Section 17 on parent liability).

However, the EMCA provides that a non-wholly-owned subsidiary needs to disclose in the Commercial registry whether or not its management is directed by the parent. This disclosure is for the information of third parties and shareholders only. It does not trigger any specific right and is simply a matter of transparency. It is at the discretion of the directors to decide at what point to publish the declaration, taking into account the number of instructions received, their importance, or simply the existence of a group-wide policy.

The Forum Europaeum proposal also made the right to assume management of the company conditional on the parent company holding “a sufficient majority to enable it to alter the articles of association of a subsidiary”. The EMCA does not adopt this limitation since, as soon as control is established, whatever the level, the management and the board of directors of the subsidiary will normally feel compelled to follow instructions by the parent company. For the same reason, it is not proposed to limit this power to give instruction to wholly-owned companies.

Finally, in the proposal of the Forum Europaeum, the legal consequence of the Group Declaration include the assumption of the parent of liability for losses in the subsidiary in case of winding-up (creditor-protection) and the obligation to compensate minority shareholders in the subsidiary (minority protection).

The approach chosen in the EMCA is to consider groups and the power of direction of parent companies over subsidiaries as a reality, which has not to be formally “legalized” or “declared”. Why would the parent company form a “legal group” with its subsidiaries, if the price for obtaining a legitimation of its power of direction were so high? Why would the parent enter into such a “unilateral declaration” and face an increased risk of liability when, as a matter of fact, it could already instruct the subsidiary as to how to act?

The subsidiary must fulfill the instructions given by the parent company. Otherwise, the managers and directors of the subsidiary shall resign. Instructions issued by the parent company are binding on the subsidiary.

Accepting the power of direction of parent companies over subsidiaries as a “de facto” phenomenon, does not mean to accept that it can be exercised without any limits or constraints.

First of all, the right of the parent to issue binding instructions to subsidiaries is limited by the conformity to the interests of the group (Section 16 of this Chapter). If the instructions are contrary to the interests of the subsidiary and not in conformity with the conditions set in Section 16, the organ of management of the subsidiary will be liable for breach of their duty of care if they execute such instructions.

Secondly, minority shareholders of the subsidiary are sufficiently protected either by the general rules or by sell-out rights, providing them with an exit route from the group.

Thirdly, creditors and third parties also have protection, in case of subsidiary insolvency, by the general provision of parent liability of Section 17.

Finally, some organs of management of a subsidiary are not bound by the instructions of the parent company. This is the case in subsidiaries where such organs are not appointed by the parent company. For instance, in Italy, some members of the board of directors in listed companies are appointed to represent minority shareholders. The exception covers appointments under a shareholders’ agreement which may entitle a non-controlling shareholder to representation on the board. The reason is that specific protection that minority shareholders have bargained for should not be removed by the fact that the company belongs to a group. This protection should be respected.

Although the EMCA recognizes that the situation of listed subsidiary is specific and protection of the public should be set at a higher level, Section 9 applies to them. The reason is that there is no logical reason to distinguish between listed and non-listed companies, especially provided that there are significant protections in other chapters for minority shareholders (sell-out rights) and creditors (wrongful parent liability). However, the rule should not apply to “independent directors”, who are being required by listed companies regulations and corporate governance codes, since it would be contrary to their independence. The same exception also applies explicitly to “directors who are employee representatives”.

The right to give instructions is vested in the company organ entitled to manage and represent the company according to the EMCA, including senior management. Instructions may have any form (written, oral, etc.) and may only be addressed to the organ of management of the subsidiary. This includes the board of directors of the subsidiary. The right to give instructions benefits any parent company, not just the direct parent company. This will provide flexibility in the organization of the group, since the ultimate parent company can let another subsidiary -with regional competence for instance- give instructions to sub-subsidiaries.

The right to give instructions benefits any parent company, as to all subsidiaries, including foreign subsidiaries as long as the foreign law allows subsidiaries to receive instructions from a parent company. Similarly, the EMCA provides, in Paragraph (1), that subsidiaries can receive instructions from a foreign parent company.

#### *Section 15.10*

#### **Right of Access to Information at the Level of the Subsidiary**

The board of directors, or equivalent body, and the management of the parent company, including a foreign one, has the right to obtain any information from a subsidiary, unless such communication would violate the law of a country which applies to the subsidiary or the rights of third parties.

#### *Comments*

Groups need information from the subsidiaries for legal reasons, such as drawing up the accounts. Groups which are acting as integrated entities usually also need information from the subsidiaries for business reasons, such as assuring quality control across subsidiaries.

A similar provision exists in some national Companies Acts (e.g. Denmark). Of course, the right of access to information of the parent company is subject to limits. The reference to the violation of the “the law of the country which applies to the subsidiary” includes different types of rules (e.g. banking secrecy) and different types of companies (national and foreign subsidiaries). These are not just the laws of the country where the subsidiary is incorporated but also of those countries where it operates. Likewise, rights of the third parties may not be affected by such right of access to information (e.g. transfer of valuable data, like client data).

This provision will also facilitate the enforcement of the special investigation mentioned in Section 16, since the management of the parent company, when requested by a special examiner, will not be able to argue that it cannot access this information. This power should be recognized also to a foreign parent company.

#### *Section 15.11*

#### **Right to Squeeze-out**

- (1) A parent company, controlling more than 90 % of the shares and votes of the subsidiary, has the right to purchase the remaining shares.
- (2) The provisions of Section 34 of Chapter 11 of the EMCA apply to the purchase.

#### *Comments*

The right to squeeze-out is also recognized in Chapter 11 “General Meeting and Minority Protection” when the majority shareholder holds more than 90 % of the shares and a corresponding share of the votes. The shareholder can be a natural or legal person so that the right to squeeze-out is not limited to group situations. Therefore, the provision in the Chapter on groups simply refers to the one in Chapter 11. However, a reference to the relevant provisions in Chapter 11 has been left in the Chapter on Groups since the existence of a squeeze-out right, although not limited to groups, is a significant part of the regime on groups.

The right to squeeze-out is recognized in Section 34 of Chapter 11.

The right to squeeze out minority shareholders is recognized in many national laws (Section 70 of the Danish Companies Act, §§ 327a-327f of the German AktG, Section 49c of Greek Corporation Law, Section 490 of the Portuguese Companies Act). In several others, it is restricted to listed companies (e.g., “*offre publique de retrait obligatoire*” in France, “*diritto di acquisto*” in Italy, etc.). Section 11 applies to listed and unlisted subsidiaries alike. It only applies to subsidiaries which are subject to the EMCA.

The possibility to squeeze-out minority shareholders is the counterpart of the sell-out rights included in the EMCA. It is also a way to facilitate the formation of fully-integrated groups.

Also Article 15 of the Thirteenth Directive on takeovers, under certain conditions, grants any shareholder acquiring 90 % (or more, depending on the Member State) of the voting shares of a listed corporation through a tender offer, the right to cash out minorities at a fair price.

The Forum Europaeum also proposed the creation of a squeeze-out right when a shareholder holds 90 % or 95 % of the shares.

The Danish Companies Act, especially as to the determination of the redemption price, served as model for Section 34 of chapter 11.

According to EMCA, a company can have a single shareholder (see Chapter 2 Formation of Companies).

PART 3  
PROTECTION OF SHAREHOLDERS OF THE PARENT COMPANY

*Section 15.12*

**Right of Information and to Request a Special Investigation**

The relationship between the companies of the group, including companies formerly members of the group, are subject to the rights of information and the right to request a special investigation, as provided in Section 32 of Chapter 11.

*Comments*

Most national companies law provides for some sort of investigation rights.

This provision, which is linked to the right to ask questions in Chapter 11 (General Meetings and Principles of Minority Protection), aims to prevent the management of the parent company from refusing to answer questions about the situation of the group as a whole on the basis that the information is located at the level of a subsidiary. Similar provisions can be found in some legal orders (e.g., Section 102 of the Danish Companies Act, Section 290 of the Portuguese Companies Act, Section 32 of the Swedish Companies Act).

Likewise, whereas the right to request a special investigation is a general right covered in the Chapter on shareholders' meeting and minority protection, it is particularly important in groups, especially since the information might be available only at the level of the subsidiary. The Forum Europaeum was of the same view and proposed that the parent, under certain conditions, should be "entitled by unilateral declaration to assume the management of the subsidiary". However, the regime proposed by the Forum Europaeum proposal was more restrictive. It required a reasonable suspicion of "gross breach" of the law or of the articles of association, and not just a simple breach.

PART 4  
PROTECTION OF SHAREHOLDERS AND CREDITORS OF THE SUBSIDIARY

*Section 15.13*

**Corporate Opportunity within a Group**

When a subsidiary is not wholly-owned, a parent company, including a foreign one, must not itself or through another subsidiary exploit a corporate opportunity of that subsidiary unless it has received the approval of the disinterested directors of the subsidiary, and if there are none, of the non-controlling shareholders of the subsidiary.

*Comments*

A parent company may be a director of the subsidiary and, in that capacity, it would be subject to the general prohibition of benefiting from corporate opportunities, unless it has received the approval of the board by the disinterested directors (see EMCA Section 6 of Chapter 9, Directors' duties). However, a parent company might not always be a director, for instance because it is located several levels above the level of the subsidiary. Therefore, section 13 complements the prohibition applicable to directors.

In the case of a subsidiary, it is less possible to rely on disinterested directors of the subsidiary.

The prohibition applies to a foreign parent company. It also applies to a national parent company regarding its foreign subsidiaries.

*Section 15.14*

**Right of Shareholders to Request a Special Investigation**

The shareholders of a subsidiary can request a special investigation in the parent company in relation to a decision which has affected that subsidiary, under the same conditions as mentioned in Section 12.

*Comments*

The right of the expert to investigate should also apply upstream. The Forum Europeum proposal included this point but it was not very specific. This possibility of an upstream special investigation is provided for by Dutch company law (Section 351, al. 2, of the Dutch Civil Code).

The right of shareholders to request a special investigation into decisions of the parent company is limited to decisions which have affected the subsidiary.

*Section 15.15*

**Right to Sell-out**

(1) When a parent company owns directly or indirectly more than 90 % of the shares and of the voting rights of a subsidiary, any other shareholder(s) may request that their shares be purchased by the parent company.

(2) The shareholders of a subsidiary can request in court that the parent company or another person designated by it purchase their shares.

(3) Companies can opt-out of the sell-out right if the shareholders agree to the opt out by the majority required to alter the articles of association.

(4) The provisions of Section 35 of Chapter 11 of the EMCA apply to the purchase.

*Comments*

The EMCA offers minority shareholders a right to sell-out. When a parent owns, directly or indirectly, more than 90 % of the shares and of the voting rights, the minority shareholders may request, in court, that their shares to be purchased by the parent or another person designated by it. The provision in paragraph 15 (1) is the equivalent to the squeeze-out right of Section 11. It only applies to a subsidiary which is subject to the EMCA, even if the parent company is not.

A similar provision is recognized today by national laws, like Poland (“reversed squeeze-out” of Section 418 of the Polish Companies Act), Portugal (“right to be bought” of Section 490, n<sup>o</sup> 5 and 6 of Portuguese Companies Act) or Hungary (Section 3: 53(1) and 3 : 324(2) of the new Hungarian Civil Code). In several other Member States the sell-out right is restricted to listed companies (e.g., France).

A very interesting regime on sell-out rights is to be found in the part on groups of the Italian Civil Code (Article 2497-quater), which was introduced in 2003. The Italian regime served as a model for Section 15(1), but with some differences since fewer EMCA situations give rise to a right to sell-out. On the one hand, the EMCA was mindful not to create a situation where the ease of exercising the right of withdrawal would force groups to maintain a higher level of cash than would be necessary for business purposes. On the other hand, the EMCA does not subject the exercise of sell-out rights to the fact that the parent company exercises direction over the subsidiary.

Re 2) The provision is not framed restrictively despite the cost to the parent company of having to maintain sufficient liquidity to cover sell-out rights. It proved difficult to find a common trigger for the sell-out right. Therefore, the idea is that the national legislature or judges should specify the grounds, depending on the practice in that jurisdiction.

The provision in paragraph (2) would allow shareholders who consider that they are the victims of an abuse by majority shareholders to file a petition in court requesting their shares to be bought back. Section 31 of Chapter 11 includes a provision equivalent to the “abuse of majority” (the General Meeting may not pass a resolution which obviously is likely to give certain shareholders or others an undue advantage over other shareholders of the company). The provision in Section 15 does not refer to the German concept of an “important cause” (“wichtiger Grund”), which would also be applicable here and leaves a significant freedom to judges to decide. In addition to an abuse of majority, such cases could be, for instance, unfair prejudice, the lack of payment of dividends for a long period, the existence of detrimental related party transactions, etc.

*Section 15.16*

**Interest of the Group**

(1) If the management of a subsidiary, whether or not as a result of an instruction issued by the parent company, acts in a way contrary to the interests of the subsidiary, a director or manager shall not be deemed to have acted in breach of their fiduciary duties if

- (a) the decision is in the interests of the group as a whole, and
- (b) the management, acting in good faith on the basis of the information available to them and that would be available to them if they complied with their fiduciary duties before taking the decision, may reasonably assume that the loss/damage/disadvantage will, within a reasonable period, be balanced by benefit/gain/advantage, and
- (c) the loss/damage/disadvantage, referred to in the first sentence hereof, is not such as would place the continued existence of the company in jeopardy.

(2) If the subsidiary is wholly-owned, paragraph (1)(b) does not apply.

(3) The management of the subsidiary may refuse to comply with instructions from the parent company if the conditions set in paragraph (1) are not satisfied.

*Comments*

Section 16 is a complement to Section 9 (*Right of a parent company to give instructions to the management of a subsidiary*) and recognizes the notion of the “interest of the group”. It creates a basic rule, in compliance with which directors and managers of a company, member of a group, may either exercise or be subject to a directing and coordinating activity.

The recognition of the interest of the group would be helpful not only for the parent company but also for the directors of the subsidiary company. As mentioned in the Report of the Reflection Group on the Future of EU Company Law (2011) “a major advantage of the recognition of the interest of the group is that it provides more clarity to the directors of the subsidiary as to which transaction or operations they can approve.”<sup>85</sup> The recognition of the interest of the group provides, to a certain extent, this legal certainty.

Section 16 does not provide a definition of the “interest of the group”. The reason is that a satisfactory definition would be very difficult, if not impossible, to find given the almost infinite diversities of situations in groups. Therefore, it is left to judges to decide on a case-by-case basis. This approach creates some uncertainty but which should be rather limited because judges usually do not tend to second-guess the business decisions of management, as long as the company has not filed for bankruptcy.

In general, the lack of definition should act as a supplementary protection for minority shareholders or for creditors alike by allowing judges to apply Section 16 in a flexible way.

The approach of the EMCA is similar to the one adopted by most if not all national Companies Acts for an individual company. The notion of “social interest” of a company is usually not defined for the same reasons as it should not be defined for a group. Because of the lack of definition, there is no requirement that the interest of the group should tend towards a harmonization of the interest of the parent company and the subsidiary. However, in certain circumstances, a judge applying Section 16 could adopt this approach.

The approach is influenced by the French *Rozenblum* case, which is a criminal case law. In France, the main criminal law tool against self-dealing is the provision against abuse of corporate assets (*abus de biens sociaux*). It punishes, among others, board chairmen, directors or managing directors of a public limited company or a limited liability company who “use the company’s property or credit, in bad faith, in a way which they know is contrary to the interests of the company, for personal purposes or to favor another company or undertaking in which they have a direct or indirect interest”. The penalty is a prison term of up to five years (with no minimum). French courts have created a special safe harbor in case of abuse of corporate assets within groups (the so-called “*Rozenblum doctrine*”). This doctrine admits a “group defense” under certain conditions. First, there must be a group characterized by capital links between the companies. Second, there must be strong, effective business integration among the companies within the group. Third, the financial support from one company to another company must have an economic quid pro quo and may not break the balance of mutual commitments between the concerned companies. Fourth, the support from the company must not exceed its possibilities. In other words, it should not create a risk of bankruptcy for the company. This approach is also adopted in the German Criminal Code (Section 266 German Criminal Code (*Strafgesetzbuch*)).

Section 16 is inspired by the Rozenblum doctrine but with some simplifications. The Rozenblum doctrine is sometimes considered, in and outside France, to be obscure and its successful application hardly predictable due to the number of conditions to be satisfied. Therefore, Section 16 adopts a simpler and more flexible approach. The main difference is that there is no requirement that the group has a balanced and firmly established structure. However, the existence of an interest of the group implies that there must be a long-term and coherent group policy. The Forum Europaeum also adopted the Rozenblum approach but with some modifications. The Forum Europaeum proposal made this protection conditional on there being evidence of compliance with instructions which would “be recorded in a continuous manner” and that the management would report on their reliance on these provisions at “the next general meeting of the subsidiary”. This approach is not kept in the EMCA, since it would be formalistic.

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<sup>85</sup> Report of the Reflection Group On the Future of EU Company Law (2011), p. 60.

Many European countries have similar approaches to the French “Rozenblum doctrine”. This is the case in the Nordic countries, in Belgium, in the Netherlands (“Nimox doctrine”), in Italy (“*teoria dei vantaggi compensative*”). The Czech Republic recently moved toward a regime similar to Rozenblum (Section 71 and following, of Czech Law No. 90/2012 on commercial companies and cooperatives, Business Corporations Act).

In the UK, directors are able to take into account of the interests of the group in reaching a decision about what will promote the company’s success for the benefit of its members. If there is a doubt that something is in the interests of the company (e.g. giving a guarantee for the benefit of the group), any doubt about whether this involves a breach of the director’s duties can be dealt with by the shareholders passing a resolution to approve the action proposed. However, because directors may incur personal liability for wrongful trading by the company if the company goes into insolvent liquidation and the director knew or ought to have concluded that there was no reasonable prospect of avoiding this and did not take every step to minimize the potential loss to the creditors, directors will be very careful not to prefer the interests of the group over the interests of the creditors of the company if the company may become insolvent.

Section 16(1) protects the managers of the subsidiary against liability, if they take a decision or apply an instruction contrary to the interests of the subsidiary by taking into account the interests of the group. However, in case an instruction violates Section 16(1), the issue must be addressed of whether subsidiary managers “must” obey or “may” refuse to obey ?

On the one hand, if the management of the subsidiary “must” obey, it is a relief for the directors, as they would be exempted from liability in such case. It also makes the functioning of the group more effective as instructions are always binding. On the other hand, there are severe drawbacks to this approach. First, it would imply a lower level of protection for creditors and minority shareholders, since the directors would not act as a shield in a case where they think that the instructions violate the interests of the subsidiary, even taking into account the interests of the group. This would leave the management of the subsidiary with the only choice to comply or to resign. Both alternatives are unfavorable to the minority shareholders, at the very moment where they most need protection. Second, if the parent is located in another Member State or in a foreign state, it might be difficult, complex and costly, for the minority shareholders to sue them in this other State, since the management of the subsidiary will be exempted from liability because the instruction was binding for them. This increases the risk of abuses by parent companies. Finally, even if the recognition of the interest of the group is a necessary and useful relaxation from the protection of the interest of the minority shareholders and of creditors at the level of the subsidiary, this recognition is not without risks. These risks should be mitigated by a cautious approach and any instruction must be given in respect of the law.

From the perspective of effective management of the group, this approach has the disadvantage of allowing the directors of the subsidiary, in certain circumstances, to resist the directions of the parent company. However, such situations where the subsidiary would refuse to execute a binding instruction from the parent company should also remain exceptional. In cases where the directors do refuse to act but do not resign, the issue could be settled swiftly by the removal of the directors concerned at the next general shareholders’ meeting, possibly following a judicial request of the parent company (see. Section 15 of Chapter 11 General Meetings and Principles of Minority Protection). Therefore, the parent will always have the last word. The opposition by the management of the subsidiary could also lead the parent company to reconsider its decision, possibly after a discussion with the management of the subsidiary or because of complaints by minority shareholders. The interests of the minority shareholders and creditors are better protected by this right to refuse to apply the instruction. The EMCA noted that under German company law, in the case of a contractual group (“*Vertragskonzern*”, § 302 AktG), the managers of the subsidiary “may” refuse to comply with instructions from the parent company in case of manifest (“*offensichtlich*”) violation of the interests of the parent company or of the companies affiliated with it (§ 308(2) AktG).

Therefore, the EMCA has decided that, if an instruction of the parent company violates Section 16(1), the management of the subsidiary is not obliged to comply. The approach of the EMCA seems to be more protective than the German approach since the right to refuse to apply an instruction is granted to the management even if the instruction is not a manifest (“*offensichtlich*”) violation of the interests of the parent company or of the companies affiliated with it. However, this is justified since the EMCA approach is more flexible and does not require an automatic compensation of disadvantages.

In case that the management of the subsidiary decides to apply an instruction which violates Section 16(1), they will remain liable.

The safe-harbor also applies to wholly-owned subsidiaries. However, in such case, Section 16(2) eliminates the requirement provided for in paragraph (b) that “the management may reasonably assume that the loss/damage/disadvantage will, within a reasonable period, be balanced by benefit/gain/advantage.” This is so because if the subsidiary is wholly-owned, the management of the parent and the subsidiary should have more freedom to manage the company and to transfer value as long as they do not place the continued existence of the company in jeopardy.

*Section 15.17*  
**Parent liability**

(1) Whenever a subsidiary company, which has been managed according to instructions issued by its parent in the interest of the group, has no reasonable prospect, by means of its own resources, of avoiding a winding-up (crisis point), the parent company is obliged without delay to effect a fundamental restructuring of the subsidiary or to initiate its winding-up procedure.

(2) If the parent company act in contravention of paragraph 1, it shall be held liable for any unpaid debts of the subsidiary company incurred after the crisis point.

(3) If the parent company has managed the subsidiary to the detriment of the subsidiary and in violation of the interest of the group, it shall be held liable for any unpaid debts of the subsidiary which are the consequences of the harmful instructions.

(4) The right to claim compensation provided for in paragraph 2 and 3 hereof can be invoked only by the liquidator/administrator/administrative receiver/receiver of the subsidiary. The liquidator is obliged to exercise such claim if creditors holding 10 % of the debts of the subsidiary request it. The insolvency court may itself initiate the said claim.

*Comments*

Section 17 is inspired by the concept of “wrongful trading” which originates in the UK (Section 214 Insolvency Act 1986) but presents a significant difference. However, instead of making the directors liable for “wrongful trading”, it makes the parent company liable. This difference is designed to cover situations in which the subsidiary would be subject to instructions while at the same time there would be no directors representing the company in the board of the subsidiary.

Section 17 is close to the Forum Europaeum proposal, but with some modifications. It is also influenced by the Report of the Reflection Group on the Future of EU Company Law (2011), which suggested that the “Rozenblum doctrine”, if applied at the European level, should distinguish two situations: “(i) where the subsidiary is not close to insolvency and (ii) where it is close to insolvency. In case the subsidiary has no reasonable prospect of, by means of its own resources, avoiding a winding-up (crisis point), directors of the subsidiary should protect creditors and therefore unbalanced transactions to the prejudice of the subsidiary should not be protected”. This is in effect the result reached by Section 17. Where a subsidiary reaches a crisis point, the parent company has the duty to start without delay insolvency proceedings of the subsidiary, in order to effect a fundamental restructuring or alternatively to liquidate the subsidiary.

It is not presumed that the parent knew or should have known that the subsidiary company had arrived at a crisis point because the parent is not always aware of the situation of the subsidiary, even if it issues instructions to it.

Section 17 establishes a link between the unpaid debts of the subsidiary and the instructions given by the parent company. Therefore, it is close to the French action for damages for insufficient assets (*action en responsabilité pour insuffisance d’actif*). Section 17 is not an action of “piercing the corporate veil” but is more an action for damages based on fault.

The formulation ensures the existence of a link between power and liability of the parent company in case of bankruptcy of a subsidiary. As a matter of fact, the default of a subsidiary may be caused by the control exercised by the parent company but may also emerge from purely fortuitous and unpredictable circumstances (e.g., natural catastrophes, strikes, financial crisis, insolvency of important subsidiary debtors, abrupt modification of market environment or legal environment). In such a case, to impute a special liability on the parent corporation would be too rigid a solution, creating a windfall protection for subsidiary creditors (which the creditors of independent companies do not enjoy at all). It might also force the adoption of centralized structures of governance of groups as a way to prevent liability for subsidiary defaults. By limiting the parent company duties in the event of bankruptcy of the subsidiary (restructuring or winding-up) to the case of those subsidiaries, which were consistently managed in the interests of the group, and not in its own interests, one could ensure a flexible system of imputation of such duties.

The Forum Europaeum proposal conditioned this protection to the fact that evidence of compliance would “be recorded in a continuous manner” and that the management would report the invocation of the provisions “to the next general meeting of the subsidiary”. This approach is not kept in Section 17, since it would be formalistic.



## **CHAPTER 16**

### **BRANCHES OF FOREIGN COMPANIES**

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## General Comments<sup>86</sup>

### 1. EU law

The primary source of secondary EU law regulating branches is the 11<sup>th</sup> Council Directive concerning disclosure requirements in respect of branches opened in a Member State by certain types of companies governed by the law of another State (Directive 89/666/EEC). The Directive was adopted in 1989 and had to be implemented in national law by the end of 1991. As the name indicates, the Directive is focusing on the disclosure requirements which branches have to fulfil, and therefore the Directive was closely linked to the 1<sup>st</sup> Company Law Directive which harmonizes the disclosure requirements that companies have to fulfil in the Member State in which they are incorporated (Directive 68/151/EEC now codified in Directive 2009/101/EC). The importance of the Directive lies in the fact that in the field of company law the law exhaustively regulates the disclosure requirements that Member States can impose on branches of companies (but not regarding branches from outside the EU/EEA) covered by the Directive. Furthermore, in regulating disclosure requirements the Directive also indirectly regulates certain substantial issues relating to the annual accounts, the powers of representatives of the branch etc.

Branches of credit institutions and financial institutions are governed by special rules laid down in Directive 89/117/EEC.

Branches are also protected by the freedom of establishment found in Article 49 and 54 TFEU. The Court of Justice of the European Union (hereafter the Court) has in several important judgments paved the way for the use of branches in the EU by making use of these provisions. These judgments can be grouped in different ways. Some of them are focusing on discrimination against branches. Here it will normally be natural to compare the regulation of branches to that of other companies in the Member State of establishment. But the Court has also been keen to examine non-discriminating restrictions on setting up a branch. The Court takes the position that requiring a company (which must comply with the rules of its place of incorporation) additionally to comply with the (company) rules in the Member State in which it sets up a branch may in itself be a restriction of the freedom of establishment.<sup>87</sup> If there are such company law requirements to branches, they may still be justified if the following four conditions are fulfilled: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the public interest; they must be suitable for securing the attainment of the objective which they pursue, and they must not go beyond what is necessary in order to attain it.

Finally, the Court has held in a line of important cases that the setting up of a branch is not an abuse of the freedom of establishment even if the company has no activities in the Member State in which the company is incorporated. It was established in Case C-212/97, *Centros* that even if a person chooses to set up his or her company in the Member State with the least restrictive company law rules and then proceeds to set up branches in other Member States, there will be no abuse of the freedom of establishment. In the same case the Court did allow that there could be situations where it can be established on a case by case basis that there is an abuse because the person is pursuing a different objective than those behind the freedom of establishment. However, subsequent cases show that there will be very few cases where the Member State is in a position to argue that the incorporation in a different Member State and the setting up of a branch are likely to be considered abuse of the freedom of establishment.

Following the decision in *Centros*, there was an increase in the number of branches registered in some Member States. Most likely the reason for this was that some business entrepreneurs chose to incorporate in other Member States and set up a branch instead of incorporating through a local company. However, in recent years the number of branches seems to have adjusted to a lower level indicating that such a use of branches is less frequent.

Whereas the freedom of establishment only applies to companies incorporated in the EU (and the EEA area), the 11<sup>th</sup> Company Law Directive regulates not only branches opened in a Member State by a company formed in another Member State but also branches set up by companies formed outside the EU/EEA.

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<sup>86</sup> The working group on Chapter 16 was chaired by Professor Karsten Engsig Sørensen (Aarhus University, Denmark).

<sup>87</sup> See the argument in ECJ Case C-167/01, *Inspire Art*, para. 101.

## 2. National law

The Member States have implemented the 11<sup>th</sup> Company Law Directive differently. Some Member States have implemented the regulation of foreign branches in the Companies Act. This is for example the case in Denmark and Greece. Others have implemented most of the rules either in a separate act focusing on branches (see for example Poland and Sweden), in an act dealing with registration of commercial enterprises (as for example Germany, where the rules are found in the HGB), or simultaneously in company law and registration law acts (such as Portugal and the UK). The issue of accounts for branches is often dealt with in the specific accounting acts.

Apart from the topics regulated in the 11<sup>th</sup> Company Law Directive the Member States have often regulated different aspects of branches. This would include a regulation of branch managers and their duties, a regulation of branch names, a regulation of how branches are deregistered in the register etc.

Some Member States impose more stringent requirements on branches of companies incorporated outside the EU/EEA. It seems that the stricter requirements are mainly focused on disclosure and are thus an implementation of the 11<sup>th</sup> Company Law Directive.

In some Member States the regulation of branches also includes the situation where a company incorporated in the Member States sets up branches in other regions of that Member State.

National regulation also touches upon issues which are not related to core company law. This would for example be issues dealing with the taxation of branches (including bookkeeping), issues dealing with choice of law in activities relating to the branch, and issues relating to the insolvency proceedings of such branches.

## 3. Considerations

The EMCA Chapter 1 contains a number of general principles. Among them is Section 13, which supports the Treaty's principle of freedom of establishment. As mentioned above, this freedom also includes the freedom to establish branches, and after the ECJ case law – Centros etc. – the number of branches has increased. The case law on freedom of establishment as well as the 11<sup>th</sup> Company Law Directive have imposed a framework for using branches in the EU. With respect to company law, the Group considers that there is a need to have rules which cover substantial issues relating to branches.

The 11<sup>th</sup> Company Law Directive imposes an exhaustive regulation on which disclosure requirements it is possible to impose on branches of companies from other EU/EEA Member States. These requirements as well as the boundaries set out by the right of establishment are respected in the EMCA.

The aim of the 11<sup>th</sup> Company Law Directive is to lower the costs and minimize the barriers to set up branches. The Model Law Group intends to minimize the cost and barriers not only in the areas covered by the Directive, but also in general.

As for branches of companies from outside the EU/EEA the Group has decided to keep the rules as close as possible to those applicable to branches of companies from the EU/EEA. However, in accordance with the 11<sup>th</sup> Company Law Directive the Group has decided that more stringent rules on the drawing up and auditing of accounts may be necessary where the account of the company does not correspond to the harmonized rules on accounts in the EU. Thus, the Group has chosen to make use of the rule in Article 9 of the Directive.

As mentioned above, some Member States have rules on setting up branches in regions of the Member States. Since such rules are not necessary in all States rules on regulation hereof are not included in this Chapter. However, the Group recognizes that some Member States, for instance due to a decentralized registration system, may have a need to adopt such rules.

The Group has decided that the issues relating to branches which are not core company law should not be dealt with in the EMCA. Several of these issues such as choice of law and insolvency proceedings are often harmonized on an EU level which makes it less important to include them in the EMCA.

The special rules applicable to financial institutions are not addressed in the EMCA.

*Section 16.01*

**Right to Have Branches**

Foreign public companies, private companies, and companies with a similar corporate form that are incorporated abroad may operate via a branch in the EMCA States.

*Comments*

Section 1 states that foreign companies have a right to establish branches in Member States. The rules do not distinguish between companies incorporated in other EU/EEA Member States and those incorporated outside the EU/EEA.

As the EMCA is limited to public and private companies, so are the rules on branches limited to these corporate forms. However, the 11<sup>th</sup> Company Law Directive also covers other corporate forms, and the rights for these to set up branches should be ensured elsewhere in national law.

For companies incorporated in the EU/EEA, Section 1 is in accordance with the rules on establishment in Article 49 of the Treaty, after which establishment can take place by setting up agencies, branches or subsidiaries.

*Section 16.02*

**Duty to Register**

- (1) A branch is deemed to exist where there is an actual pursuit of an economic activity through a fixed establishment that is staffed and set up for an indefinite period defined. A company which establishes an activity in accordance with this definition must register the branch with the Registrar.
- (2) Where a company is opening more than one branch, each should be registered with the Registrar.
- (3) Registration and the documents and items listed in Section 3 should be submitted to the Registrar before the economic activity is commenced.

*Comments*

The 11<sup>th</sup> Company Law Directive does not impose a duty to register when a branch is set up, but since the Member States have a duty to ensure that certain information about branches is disclosed such a duty is an implicit necessity. The law only applies to companies covered by the 1<sup>st</sup> Company Law Directive, e.g. those defined in Chapter 1, Section 3 of the law or for companies incorporated outside the EU/EEA companies of a similar type. The Statute on the European Company requires that branches of a SE company should be registered with the same register, but rules on SE companies are not covered by the EMCA.

Re 1) Section 2(1) imposes a duty to register if a company fulfils the definition in this paragraph. There is no definition of a branch in the 11<sup>th</sup> Company Law Directive, but it must be assumed that the concept of a branch must be interpreted along the same line as the concept of a branch in Article 49 of the TFEU. The wording chosen in the definition of a branch in Article 2(1) is partly taken from the Case C-221/89, Factortame II. Future case law from the Court could narrow down the definition. Thus, a branch is considered to exist where there is an actual pursuit of an economic activity through a fixed establishment for an indefinite period defined. There should also be some sort of staff who can act on behalf of the company, even though there is no requirement for a full-time presence at the place of business.

Re 2) Section 2 (2) is inspired by Article 5 of the 11<sup>th</sup> Company Law Directive.

Re 3) Registration should be conducted before the commercial activity is commenced. The activities can be commenced after registration has been requested and thus before the registration is completed and the information is disclosed in the register. The registration should be completed within reasonable time.

*Section 16.03*

**Documents and Items Subject to Disclosure**

(1) For branches established by companies incorporated in the EU or EEA the following documents and items should be submitted to the Registrar for disclosure in the register:

- (a) The address of the branch;
- (b) The activities of the branch;
- (c) The register in which the company file mentioned in Article 3 of Council Directive 68/151/EEC [now 2009/101/EC] is kept, together with the registration number in that register;
- (d) The name and legal form of the company;
- (e) The appointment, termination of office and particulars of the persons who are authorized to represent the company in dealings with third parties and in legal proceedings. These can either be a company organ constituted pursuant to law or as members of any such organ, or it can be other persons who are appointed as permanent representatives of the company for the activities of the branch. In the former case the company should disclose how the company organ and/or its members can represent the company in accordance with the disclosure by the company as provided for in Article 2 (1) (d) of Directive 2009/101/EC and in the latter case the company should disclose the extent of the powers of the permanent representatives;
- (f) The winding-up of the company, the appointment of liquidators, particulars concerning them and their powers and the termination of the liquidation in accordance with disclosure by the company as provided in Article 2 (1) (h), (j) and (k) of Directive 2009/101/EC;
- (g) Insolvency proceedings, arrangements, compositions, or any analogous proceedings to which the company is subject;
- (h) The accounting documents of the company as drawn up, audited and disclosed pursuant to the law of the Member State by which the company is governed in accordance with the Directives of accounting;
- (j) The closure of the branch;
- (k) The instruments of incorporation and the memorandum and articles of association if they are contained in a separate instrument;
- (l) An attestation from the register referred to in paragraph (c) of this Article relating to the existence of the company.

(2) For branches of companies incorporated outside the EU and EEA areas the following documents and items should be submitted and disclosed:

- (a) The address of the branch;
- (b) The activities of the branch;
- (c) The law of the State by which the company is governed;
- (d) Where the law so provide the register in which the company is entered and the registration number in that register;
- (e) The name and legal form of the company;
- (f) The appointment, termination of office and particulars of the persons who are authorized to represent the company in dealings with third parties and in legal proceedings. These can either be a company organ constituted pursuant to law or as members of any such organ, or it can be other persons who are appointed as permanent representatives of the company for the activities of the branch. The extent of the powers of the persons authorized to represent the company must be stated, together with whether they may do so alone or must act jointly;
- (g) The winding-up of the company, the appointment of liquidators, particulars concerning them and their powers and the termination of the liquidation;

- (h) Insolvency proceedings, arrangements, compositions, or any analogous proceedings to which the company is subject;
  - (j) The accounting documents of the company are drawn up, audited and disclosed pursuant to the law of the State by which the company is governed. Where these are not drawn up in a manner equivalent to those found in the EU directives on accounting the company should disclose accounting documents produced according to the directives covering the activities of the branch;
  - (k) The closure of the branch;
  - (l) The instruments of incorporation and the memorandum and articles of association if they are contained in a separate instrument;
  - (m) An attestation from the register referred to in paragraph (c) of this Section relating to the existence of the company if the law provides for such a registration.
- (3) The company should register amendments to the documents referred to in paragraph (1)(j) and (2)(k) as well as any changes in the other items listed above should be registered as soon as possible and within a period of one month after the changes have taken place. The accounting documents listed in (1)(h) and (2)(i) should be registered no more than one month after they have been finalized according to the applicable law.
- (4) The instruments of incorporation according to paragraph (1)(j) and (2)(k) as well as the account drawn up according to (1)(h) and (2)(i) should be translated into one of the official domestic languages or submitted in English.
- (5) If a company registers more than one branch and these are registered in different registers in the Member State, the registration of the documents listed in (1)(h) and (1)(j) as well as (2)(i) and (2)(k) should be listed in the register of the company's choice. Disclosure of the other branches shall cover the particulars of the branch register where the documents mentioned were disclosed as well as the number of the branch in that register.

#### *Comments*

According to Article 2 of the 11<sup>th</sup> Company Law Directive, certain information, the instruments of incorporation, the articles of association and the accounting documents must be disclosed. From Article 4 it appears that it may be required that the documents mentioned should be translated into one of the official domestic languages. National company law may not add further requirements to the lists in the Directive Articles 2(1) and 2(2).

Re 1) This provision is inspired by Article 2 and 3 of the 11<sup>th</sup> Company Law Directive. The list in Article 2(1) is compulsory whereas the list of documents and items in Article 2(2) is optional. The Group has chosen to adopt two of the four items listed in Article 2(2), as it does not think that it is necessary to ask for the disclosure of the signature of the persons who can represent the company nor an indication of the securities on the company's property situated in the Member State.

Re 1 e) Section 1(e) states which persons are authorized to represent the company.

It should be possible to list several persons as being authorized to represent the company. These can be either company organs or members of such organs or it could be persons who are given the power to represent the company in relation to the activities of the branch. For company organs and member of those it should be listed whether they have the power to represent the company alone or together with other members according to Article 9 of the 1<sup>st</sup> Company Law Directive. For permanent representatives the company may give these different powers and these may not be as far-reaching as the power to act according to Article 9 of the 1<sup>st</sup> Company Law Directive. The Registrar should accept and disclose such a limited authority. It should be mentioned that some Member States require that the permanent representatives have an unlimited power to represent the company, but this requirement infringes on Article 2(1)(e) of the 11<sup>th</sup> Company Law Directive.

Re 1 f) It is important to inform the Registrar where the branch is registered if the company is wound up etc. This is necessary in order for the Registrar to decide on the deregistration of the branch, see below in Section 7.

Re 1 g) Regarding insolvency proceedings etc., see comments to 1 f).

Re 1 h) The accounting documents have to be drawn up and audited according to the law where the company is incorporated. These accounts should be submitted as they are and additional requirements for special audit or special accounts for the branch activities cannot be required. This, however, does not affect the Member States' power to require tax accounts.

Re 2) Section 3(2) is inspired by Articles 8 and 9 of the 11<sup>th</sup> Company Law Directive. The list in Article 8 is not exhaustive, but the Group decided that the disclosure requirements should basically be the same apart from the rules on accounts where accounts drawn up and audited according to the rules' applicable to domestic companies can be applied where appropriate.

Re 2 e) Section 2(e) is inspired by Article 8(h) of the 11<sup>th</sup> Company Law Directive. Article 8(h) is compulsory. See also the comments to Section 1(e).

Re 2 i) The accounting documents of the company as drawn up, audited and disclosed pursuant to the law of the State by which the company is governed. Where they are not drawn up in a manner equivalent to the EU Directives on accounts, the company should submit accounting documents covering the branch activities drawn up and disclosure according to the rules applicable to domestic companies.

Re 2 l) Section 3(2)(l) is not compulsory according to Article 8 of the Directive.

Re 3) According to the 11<sup>th</sup> Company Law Directive changes to instruments of constitutions as well as accounting documents should be disclosed. This provision ensures that also other changes to the information register should be submitted, and clarifies the time limits within which registration should take place. Furthermore, the effect of not registering changes, including changes in whom can represent the company and their power is regulated in accordance with what is the case when domestic companies neglect to register changes.

Re 4) According to Articles 4 and 9(2) of the 11<sup>th</sup> Company Law Directive Member States may require translation into the official language used in the state of registration. The Group believes that it serves the purpose of disclosure if the accounts, and the corporate charter are provided either in the official language used in the register or in English. Thus the English translation of the document can be used in all jurisdictions where a branch is registered, which may lower the translation costs. The directive makes it possible to require a certified translation, and the Group recommends that a certified translator in any Member State or EEA State should suffice.

Re 5) This Section is inspired by Articles 5 and 9(2) of the 11<sup>th</sup> Company Law Directive. The provision is only relevant in the situation where branches are registered in different registers.

#### *Section 16.04*

### **Branch Names and Trading Disclosure**

(1) A branch must have a name and may have secondary names. The name of the foreign company must be included in the branch's name. If the company is under liquidation or under insolvency proceedings, information about the status of the company must be added to the company's name.

(2) The name of a branch should clearly indicate the corporate form of the branch and it should not be similar or likely to be confused with a domestic company form.

(3) The name of a branch should differ from other names already registered in the State where the branch is set up, and should not be likely to mislead. If the company is prevented from using its own name in regards to the branch, it can choose a different name for the branch.

(4) Letters and order forms, as well as webpages used by a branch shall state the register in which the file in respect of the branch is kept together with the number of the branch in that register. For branches of companies incorporated in the EU and EEA, the information prescribed by Article 4 of Directive 68/151/EEC should also be listed. For companies incorporated outside the EU and EEA, the register in which the company is entered and the registration number should also be stated given that the law of the State by which the company is governed requires entry in a register.

#### *Comments*

Re 1) A branch must have an individual name. If a foreign company has more branches, each branch can have a different name.

The background to the second sentence in Section 4(1) is that the company is liable for the obligations that the branch enters into. Therefore, it is significant for the contracting parties to be informed whether the company is wound up or involved in other kinds of reconstructions. See also Section 6 concerning deregistration.

Re 2) It should be clear to those dealing with the branch that it is not a domestic company. Therefore, the branch should not use an indication which could be confusing with one of the domestic company forms. If the name or abbreviation of the company type is similar to that of domestic companies, confusion should be avoided by requiring that the nationality of the company is added to the name.

Re 3) The name used by the branch should fulfil the same requirements as apply to domestic companies, see Chapter 2, Section 19. This may mean that a company cannot use its own name for the branch. This is a restriction of the right of establishment, but the Group is of the opinion that this restriction can be justified to protect the interest of those companies which already use the name and to avoid confusion among third parties dealing with the company. It should, however, be mentioned that some Member States have chosen either to relax the requirements for branch names or have taken the position that by making it clear that the branch is a branch of a foreign company, confusion is avoided.

Re 4) The provision is inspired by Articles 6 and 10 of the 11<sup>th</sup> Company Law Directive. The directive requires letters and order forms to contain the listed information and there is no definition of what that is. The Group has added that the webpage of the branch should include this information if the branch has a webpage. The 1<sup>st</sup> Company Law Directive was amended by Directive 2003/58/EC to make it clear that the information which should go on the letters and forms should also appear on the webpage of the company. The Group finds it appropriate to extend this to webpages used by the branch.

#### *Section 16.05*

#### **Branch Management**

(1) The company must list a branch manager. The branch manager should have the power to represent the company to some extent and as a minimum should be able to represent the company in legal proceedings.

(2) The branch manager must fulfil the same requirements as persons who are appointed as directors of domestic companies, see Chapter 8, Section 21.

(3) The branch manager is responsible for making the registration of documents and items according to Section 2 and ensuring disclosure according to Section 3. Furthermore, the branch manager should ensure that the branch is removed from the register in the situations specified in Section 6.

#### *Comments*

A branch management, however, is necessary to ensure that at least one person is able to represent the company in legal proceedings related to the branch as well as one person is made responsible for ensuring compliance with Section 2, 3 and 6. The consequences of a breach of this duty should be specified.

The branch manager should fulfil those conditions as to age and qualification that are required by directors of domestic companies, see Chapter 8, Section 18. If the person is disqualified from acting as a director under the law of the state in which the branch is situated, that person should also be barred from acting as a branch manager.

*Section 16.06*  
**De-registration**

- (1) A branch must be removed from the Register if;
- (a) The foreign company is dissolved;
  - (b) The company closes the branch;
  - (c) The branch has no branch manager and this defect is not remedied before the expiry of a time limit set by the Registrar;
  - (d) The branch manager has failed to file the accounting documents for the foreign company according to national accounting laws. This is in accordance with Section 2(1)(h) and 2(2)(h) within the time limit given in Section 2(3), and the defect is not remedied by the expiry of a time limit set by the Registrar; or
  - (e) The company is not incorporated in an EU or EEA Member State, and a branch creditor establishes that his claim cannot be satisfied out of the company's assets in the country.
- (2) If it appears that the matter that provided the basis for deletion from the system no longer exists after deletion, the Registrar may re-register the branch upon request from the foreign company. The Registrar may prescribe rules about the re-registration of branches.
- (3) In the circumstances referred to in paragraph (1), paragraph e, the foreign company may not conduct business through a branch before re-registration has been affected. The branch may not be re-registered, until the creditor has either been paid in full or has consented to the establishment of a new branch.

*Comments*

Re 1 a) When the Registrar receives information that the foreign company is dissolved, the Registrar must deregister the branch. In practice the information of the company being dissolved may not reach the Registrar where the branch is registered. As the registers will be interconnected according to Directive 2012/17/EU, it should be possible to set up a co-operation between the national Registrars to ensure that once a company is dissolved, information about this fact is sent to the Registrar where the branch was registered.

Re 1 e) If a company carries on business through a number of branches and only one of them is deregistered, the business can continue through the other branches, see in this way Section 6 (3). However, branches of companies from the EU/EEA countries cannot be removed as it would conflict with the EU rules on establishment and exchange of services. Therefore, Section 6 (1)(e) only applies to branches of companies from outside the EU/EEA. The provision contains a rule of creditor protection.

Section 6 (1)(e) is not based on EU law. It is inspired by the Danish Companies Act Section 350 (1)(4). See also comments to paragraph 3 below.

Re 3) Section 5 (3) is inspired by the Danish Companies Act Section 350 (3). It is not based on EU law.

The provision secures the creditors. Thus, the creditor may ask for deregistration of the branch according to paragraph 1 (e) and thereby put pressure on the company.