European Commission - Fact Sheet

Frequently Asked Questions: New Company Law Rules

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Today, the European Commission is proposing new company law rules to make it easier for companies to merge, divide or move within the Single Market.

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What are the company law rules about?

The European Commission is proposing new company law rules to enable companies to make the best of business opportunities in the EU's Single Market and ensure that cross-border operations (conversions, mergers and divisions) are accompanied by adequate safeguards against abuse. Under the new rules, it will be possible to create a company fully online, including across borders, and to move, merge or divide a company across national borders within the EU without incurring unnecessary burdens and costs, provided that the operation is not artificial or abusive and that the interests of stakeholders (employees, shareholders, creditors) are protected. The company law proposals includes two draft laws, one on adapting company law to the digital age, and one on the cross-border mobility of companies.

1. Cross-border mobility: proposal for moving and restructuring companies

Why has the Commission put forward this proposal?

The European economy needs a framework that allows companies to easily operate in the Single Market, including when they grow and restructure across borders to adapt to changing market conditions. In the Single Market based on the principle of free establishment, companies must be able to merge, divide or transfer their registered seat from one Member State to another ("conversion") without having to go through liquidation and losing their legal personality, as recognised by the Court of Justice in its *Polbud* ruling of October 2017. However, it is equally important to ensure that these possibilities are not abused. The proposal therefore sets up strong safeguards to protect the rights and interests of employees, shareholders and creditors, and to prevent these procedures being used to set up artificial arrangements, including those aimed at obtaining undue tax advantages. The initiative introduces common EU procedures for cross-border conversions and divisions and it updates existing rules on cross-border mergers.

How will it be ensured that companies move for genuine business purposes?

Whilst the vast majority of companies move for genuine reasons, there is a risk that cross-border conversions and divisions could be misused to set up fictitious structures for abusive ends, such as tax avoidance or undermining workers' rights. The proposals contain strong safeguards to prevent this risk materialising in the future. A crucial element of the conversion and division procedures is therefore that the Member State of departure of the company will have to prohibit operations that constitute an artificial arrangement aimed at obtaining undue tax advantages or undermining the legal or contractual rights of employees, creditors or shareholders. In medium and large companies where this analysis may be more complex, an independent expert will be involved in providing the factual elements for the assessment by the authority of the Member State of departure. The expert report would need to take into account the following: the characteristics of the establishment in the destination Member State, including the intent, the sector, the investment, the net turnover and profit or loss, number of employees, the composition of the balance sheet, the tax residence, the assets and their location, the habitual place of work of the employees and of specific groups of employees, the place where social contributions are due and the commercial risks assumed by the converted company in the destination Member State and the departure Member State.

Why is there a need for action at EU level in this area?

Some Member States have put in place procedures for cross-border conversions and divisions, but these procedures differ and raise issues of compatibility (between the procedure in the Member State of departure and of destination). In other Member States, such procedures do not exist. This situation leads to unnecessary burdens and costs, as well as uncertainty for stakeholders whose rights may be affected. Moreover, in the judgment of the Court of Justice of the EU in the case of *Polbud* (C-106/16), the Court has clarified that based on the principle of free establishment, the Member State of departure

must allow for cross-border conversions, and that it cannot require the transfer of the "real seat" of the company (i.e. the head office, as opposed to merely the "registered seat") However, the destination Member State may require the real seat on its territory if this forms part of its incorporation requirements. As the Court has stated, it is for the EU legislator to provide for a procedure for cross-border conversions. Moreover, the legal framework clarified by the *Polbud* judgment needs to be complemented by adequate safeguards with a view to protecting the rights of employees, shareholders and creditors, as well as preventing abusive use of the cross-border procedure in order to set up artificial arrangements, in particular aiming at obtaining undue tax advantages.

How would employees be protected?

The proposal strengthens employees' rights by promoting stronger information, consultation and participation rights. Each company carrying out a cross-border operation should provide employees with a report addressing the implications and impact that this operation may have on them. The employees will have the right to express their opinion which should be taken into consideration during the general meeting. Specifically for cross-border conversions and divisions, employees will also be invited to submit their views on the draft terms of the proposed operation and, where applicable, the report from an independent expert. Their views will in turn be taken into account by the authority of the departure Member State when deciding whether to issue the pre-conversion certificate.

As regards the protection of employee participation rights (i.e. presence of employees in the company's management or supervisory organs), specific rules already exist concerning mergers and will remain unchanged. The proposal will introduce rules on employee participation rights in cross-border conversions and divisions, in view of the risks of abuse these operations may raise. In principle, the company will have to follow the rules of the destination Member State. However, if the national law does not provide for the same level of employees' participation (in the company's management or supervisory organs) as the law of the departure Member State, the company will have to enter into negotiations with the employees to determine the modalities of participation. The negotiations will be obligatory, and will have to result either in a bespoke arrangement regulating the involvement of employees or, in case no agreement is reached within 4 months, the standard rules of employees' participation as laid down in Directive 2001/86/EC will apply. These standard rules refer, in principle, to the situation before a given cross-border operation, which would need to be replicated in the company resulting from that operation. In case of subsequent restructurings, the company will have to preserve the introduced employees' participation regime at least for three years.

How will the procedures work?

The procedure for a cross-border merger will remain as it is in the existing Cross-border Merger Directive with the exception of new fast-track rules (for "simple" mergers) and extra protection measures for shareholders and creditors, where discrepancies between Member States remain.

The newly created procedures for cross-border conversions and divisions will follow to a large extent the process established already by the cross-border merger directive, but will be adapted to take into account the risks for potential abuses. These procedures will include:

a) drafting the terms of a given cross-border operation that would be publically disclosed

b) preparing reports by the management for the shareholders and employees

c) an independent expert report (not mandatory for micro and small enterprises),appointed by the competent authority, not by the company, and

d) the final checks by the departure and destination Member States that all conditions have been fulfilled, including the incorporation requirements in the new Member States and the respect of employee participation rights

Role of Independent Expert

The role of an independent expert for conversions and divisions is partially different from the role of the expert in mergers. Whereas in mergers the primary function of the expert is to assess the exchange ratio for the shares, for conversions and divisions the expert will verify the accuracy of the information submitted by the company and will provide the factual basis for the assessment to be carried out by the authority as regards the risk of an artificial arrangement being created.

Role of the Responsible Authorities – both departure Member State and destination Member State

The role of the national authorities is to scrutinise the legality of the operation. This is divided between the authorities of the departure and destination Member States.

The *authority of the departure Member State* will examine whether the cross-border conversion is lawful. The authority will assess if all conditions for the cross-border conversion are fulfilled, i.e. whether the requisite majority of shareholders has approved the conversion at a general meeting and

employees, and minority shareholders and creditors are protected as prescribed by the Directive. It would also assess whether or not the operation constitutes an artificial arrangement. If the authority has no objections, it will issue a pre-conversion certificate. In case the conversion does not fulfil the requirements, the authority would refuse to issue a pre-conversion certificate. Should the authority have serious concerns that an artificial arrangement may be created, it may perform an in-depth examination, and, if this confirms that the arrangement is artificial, the authority would block the operation.

After receiving the pre-conversion certificate, the *authority of the destination Member State* would perform its legality check, including whether the company fulfils its own incorporation requirements. One of such requirements could be for the company to have its head office ("real seat") in the same place as its registered office, in case the destination Member State foresees such requirement as a general rule in its own incorporation requirements. The authority will also check whether the employee participation rights in case of a conversion or division have been respected and whether the required procedures are complied with. Once the legality check has been carried out, the conversion enters into force and a company is registered in the register of a destination Member State and de-registered in the register of a departure Member State. All contacts between the registers are done via the system of interconnection of business registers (BRIS) and the Commission is informed about them.

In which cases will simplified formalities apply?

The existing rules for cross-border mergers offer only limited possibilities to speed up the merger procedure. For example, it allows waiving an independent expert report if all shareholders of each of the merging companies agree. Moreover, it does not require an expert report or the approval by the general meeting in case of a merger between a parent company and its wholly-owned subsidiary.

The present proposal offers further simplifications that will also apply to conversions and divisions. In particular, companies will have the option to waive the requirement of a management report for shareholders in the event that all of the shareholders agree. Moreover, they will have the ability to waive the employee report in the event that the company or any of its subsidiaries do not have any employees.

How would employees be protected?

The proposal strengthens employees' rights by promoting stronger information, consultation and participation rights. Each company carrying out a cross-border operation should provide employees with a report addressing the implications and impact that this operation may have on them. The employees will have the right to express their opinion which should be taken into consideration during the general meeting. Specifically for cross-border conversions and divisions, employees will also be invited to submit their views on the draft terms of the proposed operation and, where applicable, the report from an independent expert. Their views will in turn be taken into account by the authority of the departure Member State when deciding whether to issue the pre-conversion certificate.

There will be specific rules concerning employee participation in the company's management or supervisory organs in cross-border conversions and divisions. In principle, the company will have to follow the respective rules of the destination Member State, unless the national law does not provide for the same level of employees' participation as the law of the departure Member State. In such cases, the company will have to enter into negotiations with the employees to determine the participation. The negotiations will be obligatory, and will have to result either in a bespoke arrangement regulating the involvement of employees or, in case no agreement is reached within 4 months, the standard rules of employees' participation as laid down in Directive 2001/86/EC will apply. In case of subsequent restructurings, the company will have to preserve the introduced employees' participation regime at least for three years

How would creditors be protected?

Creditor protection in cross-border situations will be upgraded and the legal framework will become clearer, more reliable and predictable. In particular, Member States may require that companies seeking to effect a cross-border operation should make a declaration stating that they are not aware of any reason why the company resulting from the merger should not be able to meet its liabilities. Creditors who would be dissatisfied with the protection offered to them as indicated in the draft terms shall have the right to petition the competent court.

How would minority and non-voting shareholders be better protected?

The members of the merging companies will be better informed about the impact of the operation on their rights and their position in the company in general. A report addressed to the shareholders of each of the merging companies should explain the implications of the cross-border merger on the future business and the management's strategic plan as well as the implications for certain shareholders. The report should explain the share exchange ratio and describe any special valuation

difficulties as well as remedies available to certain members.

Furthermore, an exit right will be conferred to those shareholders that oppose the merger. The company should acquire the shares of the shareholders exercising the exit right in exchange for adequate cash compensation. An independent expert shall review the adequacy of the cash compensation. In case shareholders consider that the offered cash compensation has been inadequately set, they are entitled to demand for its recalculation by the competent court. These safeguards will also be provided for the conversions and the divisions.

Can digital tools be used for these cross-border operations?

All necessary formalities, such as the issuance of the pre-operation certificate, may be completed in their entirety online without the necessity to appear in person before any authority in the respective Member State. For example, online filing of draft terms and the electronic exchange of relevant information through the business registers interconnection system (BRIS) will be part of the revised and modernised procedure.

What are the next steps?

The proposal will be submitted to the Council of the European Union and the European Parliament for their consideration and final adoption. Once adopted, the new Directive would have to be implemented into the laws of all EU Member States.

2. Commission proposal on the digitalisation of company law

What will companies be able to do online?

Company law sets a number of obligations as regards public authorities that companies have to comply with throughout their life-cycle. This applies to registering a company as a legal entity, filing documents to the business register or applying for publication in the national gazette. This proposal enables companies to register, file and update their data in the registers fully online, without the need of physical presence before a business registry or intermediary except where there is a genuine suspicion of fraud. As such, business registers and intermediaries will be required to integrate digital tools into their practices.

How will the online registration of a company and filing of documents to business registers work in practice?

The registration of a company and the filing of documents to the business register will be entirely carried out online without any physical presence required (unless fraud is suspected). Every required document can be uploaded online and the identification of company founders may be completed by the use of digital means such as e-ID, digital signatures or video-conferences. Registration of companies is allowed with all parties present in the digital space and the authorised person, such as a notary, completing the process online.

Member States will lay down detailed rules to this end including the conditions for recognition of documents and data received from another Member State and ensure that the online registration may be completed with the use of electronic documents, including electronic true copies and necessary availability of information from business registers from other Member States. Companies will be able to benefit from the use of e-IDs and trust services, including e-signatures, in accordance with the eIDAS Regulation.

Why has the Commission put forward this proposal?

There are only 17 EU Member States that provide for a fully online registration procedure of companies. In the other Member States the only way to create a limited liability company is to physically go in person to the registration authority or to another body which then submits the application for registration. This creates significant inefficiencies, unnecessary costs and delays.

In the 2017 public consultation on company law, stakeholders identified the differences between national laws and the overall lack of a legal framework as regards interactions with business registers via digital tools as an obstacle to the functioning of the Single Market. This proposal will contribute to the creation of a digital single market by promoting the use of digital technologies throughout a company's life-cycle.

Why is action at EU level necessary?

Member States' own rules for online registration and filing, even where they exist, will not be mutually compatible in cross-border situations without intervention at EU level. Moreover, it is also necessary to enhance transparency and enable Member States to be able to prevent fraudulent behaviour within their territory by refusing proposed directorships for persons who are currently disqualified from acting as directors in another Member State. Finally, third parties (investors, citizens, creditors and other companies) need to access company information in the registers. EU law lays down a minimum set of

data which must always be provided for free to all interested users, and this proposal increases the data which is made available and so enhances transparency.

Who benefits from this proposal and how?

Both companies and stakeholders benefit from this proposal. Online registration and filing will make the procedure of establishing a company more flexible. This will lead to a reduction of costs that the company may redirect to other needs or new investments. At the same time, stakeholders will benefit from safeguards against fraud and abuse, such as the obligatory identity control against bogus companies and the check against disqualified directors. Legal certainty will be reinforced, there will be greater transparency of company information, and the internal market will be a safer environment for creditors and potential investors.

Is it safe to do all of this online and what are the safeguards?

This proposal provides for safeguards in order to prevent abusive and fraudulent behaviour. In case the authority responsible for registration or filing of documents has genuine reasons to suspect a fraudulent use of identity for online procedures, physical presence of the applicants may be required.

What role would notaries play in the registration of companies under this proposal?

It is up to Member States to define the role of notaries. Member States may provide for a role from them in procedures related to online registration and filing, as long as company founders or representatives can complete the procedure fully online except for the cases of genuine suspicion of fraud.

In which way will the online access to company information held in business registers change?

It is already possible to search online for information from all EU business registers via one single European access point thanks to the EU interconnection of business registers (BRIS). However, only a very limited set of company data is available free of charge.

In order to further enhance transparency in the digital age and increase trust in the Single Market, this proposal expands the set of data to be provided free of charge by all business registers. The data that is available free-of-charge will include not only the company name, registered office, legal form, and company registration number, but also the legal status of the company, other names of the company, company website, object of the company and information on whether the company has any branches established in another Member State. The set of free data will also include the names of those who can act on behalf of the company.

What is the ''once only'' principle and how will it apply to EU Company Law rules?

The "once only" principle ensures that the company does not need to submit multiple times the same information in order to comply with the requirements set by Member States. For example, once the company information is filed with a register, it is the register that sends it electronically to the national gazette for publication if this is required by national law. Similarly, when the register receives certain data from the company, it should then send them to the register of the branch of the company in another Member State. This would be the case for the latest annual account that should be filed to the business register of the branch as well.

What will be the impact of the proposal on the creation of branches?

Although branches do not have a legal personality, they still need to be registered in the business register as the registration of a branch largely follows the same requirements as company registration. Therefore, branches will benefit from the provisions regarding online registration and filing of documents to business registers and the "once only" principle will also apply.

This way cross-border registration of branches can be performed in a much more cost-effective way through online means and information required will have to be submitted only once to the register of the company before it can be used by the register of the branch in another Member State.

In what ways is this proposal different from the proposal for the Single Digital Gateway?

The Commission proposal on the establishment of a Single Digital Gateway covers the general registration of business activity via online means, except for the constitution of limited liability companies and their branches, since the specific rules in this field need to be taken under a different legal basis, by means of directives, and have to fit into existing rules in company law that deal with disclosure and business registers.. This proposal fills the gap by providing for a comprehensive set of rules for the use of digital tools for the constitution of limited liability companies and their branches. The two proposals are therefore complementary and the online procedures set out in this proposal will be available through the websites of the Single Digital Gateway.

What about the previous proposals on this which were blocked?

As announced in the Commission Work Programme 2018, we will withdraw the previous proposal for a Directive on single-member private limited liability companies.

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