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*European Company Law: The
“Simpler Legislation for the
Internal Market” (SLIM) Initiative
of the EU Commission*

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Abstract

This paper reviews the main proposals made by a working party, set up within the framework of the SLIM (Simpler Legislation for the Internal Market) initiative of the European Commission, which aims at reducing administrative and regulatory burdens on industries through the simplification of European Community Legislation. The mission of the SLIM working party on company law was limited to the first and second company law directives. The conclusions of the working party are formulated as recommendations through the European Commission, and might possibly result in amendments to be proposed by the European Commission on the directives.

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EUROPEAN COMPANY LAW: THE "SIMPLER LEGISLATION FOR THE INTERNAL MARKET" (SLIM) INITIATIVE OF THE EU COMMISSION

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Introduction

The SLIM action (Simpler Legislation for the Internal Market) is based on an initiative of the Commission, taken in May 1996, aimed at analysing the fields in which the legislation relating to the internal market can be simplified. In several previous stages of the project diverse fields of legislation have been scrutinised, including, insurance regulations, social security, diplomas, ornamental plants, and many others.

The third and fourth phase, endorsed by the Amsterdam European Council of June 1997, extends the ambit to company law, along with rules on pre-packaging and dangerous substances. By choosing these subjects the Commission took into consideration the fear that the legislation might impose excessive administrative burdens on business as a result of over-complexity, while the SLIM methodology would bring added value¹.

The SLIM working party was formed by the Commission and composed of officials of the state administrations, company law practitioners and academics. Although not all member states were represented, all States were invited to submit written statements and several did. The working party met three times, for a one day meeting. Under time constraints, the working party did merely identify fields and orientations in which the present directives could be simplified.

The mission of the SLIM working party was limited to the First and the Second Company Law Directive. One may hope that the Commission will decide to extend this mission to the other directives both in the field of company law and of securities markets regulation.

The purpose of this paper is to comment on some of the proposals that have been made by the SLIM working party, the report of which is attached². These comments are not necessarily supported by the members of the SLIM working party, nor have they been so approved, but merely serve to stir the debate.

I - The First Company Law Directive

It was agreed that there was a clear need for updating the prescriptions of the first directive, which was drafted in the 1960's at a time when electronic data exchange, data processing and dissemination was not yet so widespread. In order to increase productivity and save expenses, the system of registration of company data should be updated, and included in the modern systems of information exchange, especially through the Internet.

Home state control and Europe-wide reliability were considered essential objectives for the simplification of the existing apparatus.

¹ See for further details about the Commission policies, *Simpler Legislation for the Single Market (SLIM) Extension to a Fourth Phase*, SEC (1998) 1444, dated 16 November 1998.

² See also DE VOS, C., "Het SLIM IV Project van de Europese Commissie Harmonisatie door Deregulering van het Europees Vennootschappenrecht", to be published in *T.B.H.*, available at www.law.rug.ac.be/fli/WP.index.html; see also GB, "Raccomandazioni della Commissione Europea per la semplificazione direttiva in materia societaria", *Rivista delle Società* 2000, 217).

A - mandatory disclosures

Several member states have already extensive experience in the field of electronic processing of company documents with a view of their dissemination. Therefore it was proposed to render electronic processing mandatory throughout the Union, with a transition period of five years. This would allow member states to organise themselves and further work out details.

Electronic filing, processing and dissemination are recommended. However these can take different forms and member states have already introduced interesting practises or experiments in this field. It can take the form of full electronic drafting of the company documents - provided the subject of the electronic signatures has been adequately dealt with - and distance filing of the documentation. However, filing under the form of scanned documents, or by way of transmission of the original electronic document, would equally be admissible: here the original would remain in printed form. After time, it is expected that all company documents to be officially published will be made available in electronic form, and if possible also will be filed at the company registry in electronic form. Whether the original would still have to be a printed is left to the member states.

Once electronic filing is fully in place this new mode of data processing will also affect the function of these official publications. While today, access is relatively limited and transmission processes have to be put into place (e.g. through specialised firms, or by banks or rating agencies), in the future direct general accessibility through the Internet can be secured. Several schemes could be devised, the traditional one being that the official registry would be open for electronic consultation and retrieval directly through the Internet.

A largely decentralised approach should be preferred rather than prescribing member states to collect the information at one central registry or by a single official body. Efficiency and subsidiarity point to decentralisation. A more advanced scheme might consist of limiting the role of the official registry to the organisation of the linkage between the websites which the individual companies themselves would make available for public consultation. The role of the registry would be to organise the access to the individual sites (a “website of websites”) while ensuring that the necessary information be disclosed in due time, and in reliable format. At present, in some states the court authenticates the information so disclosed: this role could be maintained, upon a decision by each individual member state. In other states where no vetting of the information is executed, an appropriate mention should be included.

This decentralised approach can be favoured as allowing for subsidiarity, for diversity and speed of implementation while limiting the burdens of the public administrations to that part of the process to which an official sanction should be attached. It also allows for new, voluntary initiatives in the field of corporate disclosure. Voluntary disclosures may have a considerable long term impact on company structure and functioning³.

On the background of these ideas, there will be a host of issues coming up for discussion: some states have already stated that the transition period is too short, while others have especially stressed the translation issue, especially if company data would be made directly accessible throughout the Union. The latter point is indeed a difficult one and has received due attention from the working party. In a multi-lingual European Union, adequate access cannot be guaranteed except by insuring appropriate translation. Computerised translation may one day take care of the problem. The idea adopted in the SLIM working party is based on the following reasoning: every member state decides in which language the information must be disseminated. But in addition, especially for companies that are active outside their language region, there might be a need for making the documentation accessible in other languages. Here the company should be allowed to translate voluntarily the data, and put the same information on its webpage. This translation should not be put in the hands of an official translator, as this is costly, time consuming and inefficient. The party best able to insure translation is the company itself, as it often has translators on its payroll. Only the information in the original language can be invoked against third parties. But one can image that

³ See for further analysis our contribution to FS Marcus Lutter, “Die Harmonisierung des Gesellschaftsrecht in Zeitalter von Internet”, to be published, available at www.law.rug.ac.be/fli.WP.

a member state, interested in promoting its export, would allow the company to apply for an official approval of its translation, by having the translation vetted by an official body, and mentioning the seal of approval of that body in the webpages concerned.

Third party effect of disclosed documents was dealt with in the directive: the basic rule that only the published items can be relied on by the company against third parties (art. 5.3 of the directive) would be maintained except that the precise moment would be the point as of which the information can be electronically consulted or retrieved. Third parties that have a specific interest in the company could be put on an alert page for any changes or announcements in the official documentation.

Companies establishing branches in other member states often are confronted with additional burdens flowing from the requirement to publish data at the commercial registry in the state where a branch is being established. The subject was dealt with in the Eleventh Company law Directive of December 21, 1989. The directive is based on the concept that disclosures for a branch should be mandated, but should not give rise to barriers to entry. In practice however, there are complaints about the length of the procedures, the administrative harassment caused at some of the registries, especially in terms of producing authenticated documents, the need to have each document translated by an official, often local translator, and the expenses involved in the registration procedure. Therefore the SLIM working party suggested to review the directive from a more radical European perspective: companies registered in one member state have made sufficient disclosure, provided that disclosure is accessible throughout the Union. Linking to the previous ideas, provided that the Union works out a system whereby the national registries are accessible throughout the Union, it would suffice to refer to the home state registration, where the information would be available and retrievable. There is no need for an additional disclosure at the host state registry. Here the question of translation comes in: the company should ensure that the disclosure is also made in the official language of the state where the branch will be established. The registry of the host state will intervene to supervise and authenticate the translation, and secure that the minimum content as determined by a future directive, will be disclosed.

B - Disclosure of company representatives

At present, the mandates of company representatives are published at the official registry. The factual situation in the different member states seems to be quite diverse. In most states only the company organs are published, while in other states, general representatives, appointed by contract, are also part of the official publication. This is especially the case in Germany, where the publication includes the beneficiaries of general powers of representation.

The SLIM working party proposed to invite the Commission to issue a clarification on this point: is it allowed that the companies publish the general powers of these representatives, or should this be limited to the official organs of the company. Limitations to their powers may, according to art 9.2 of the directive never be relied on against third parties. Would this apply to both categories?

Limited or specific powers should not be disclosed.

II - The Second Company Directive

Where the First Directive mainly deals with issues of disclosure, the second directive contains very far going rules of substantive law. These rules impose, as a common denominator, the requirement for companies with limited liability, to provide for a legal capital⁴. The rules are applicable to public companies limited only (of the AG or SA type), which may seem illogical as

⁴ For a comprehensive comparative overview of the Second Directive and its implementation, see SCHUTTE-VEENSTRA, J.N., *Harmonisatie van het kapitaalbeschermingsrecht in de EG*, Kluwer, 1991, 348 p.

private companies limited (of the GmbH or Sàrl type) or even co-operative companies in some jurisdictions enjoy similar privileges of limitation of liability for their shareholders. The philosophy relating to the legal capital mainly originates in German legal thinking of the 1950s and 60's, and was considered the most adequate safeguard against shifting the risk of trading under a regime of limited liability to the creditors. The directive is clearly "creditor-oriented".

In the meantime, the requirement for a legal capital has become the subject of criticism⁵. Some consider that the requirement has not prevented companies to fail, while the minimum capital - which has not been adapted since the 1970's - constitutes a mere optical safeguard for creditors. They further argue that American companies, and UK private companies limited function without any legal capital requirement. Creditors can be equally or even better protected by using other tools, based on financial disclosure by the debtor company, or by intervention of third parties.

Criticism is also being addressed to the specific rules contained in the directive. Some of these rules have been experienced as being particularly cumbersome and often unjustified. When shares of the company are actively traded, the need for external, "expert" valuations upon shares being contributed to form the capital will usually serve no economic purpose: the expert rightly will conclude that the market price is the right basis of valuation. Rules aimed at the protection of shareholders by granting preferential subscription privileges often work counterproductive: the company will suffer additional expenses (e.g. underwriting fees) and loss of financial value (as a consequence of a likely discount) if the shares can be placed directly at the market price⁶. Share repurchases are submitted to severe restrictions by the directive: however in today's financial markets they play a useful rule for returning excess cash to shareholders without a negative tax impact. These transactions should then be encouraged, rather than slowed down. The rules on financial assistance - introduced at the request of the United Kingdom in the 1973 negotiations of the directive - are something like a puzzle⁷: financial assistance to a third party to acquire shares in the company does not affect the situation of the company. The transaction may affect the company if the debtor is unable to repay the loan, but this is a matter of decision by the board. There may be issues of conflict of interests involved, but they should then be dealt with under that heading, not by an outright prohibition. The regulation, as it now stands, prevents useful MBO's to be realised. The cost of the prohibition is considerable and, as recognised in the UK, unjustified⁸.

The SLIM working party did not enter into the theoretical discussion whether the legal capital requirement should be maintained at all⁹. Many consider the capital requirement as a useful - although often insufficient - price to be paid for the privilege of limited liability. It also constitutes a break on frivolous formation of business enterprises with shareholders being protected against the consequences of their ill considered plans. It finally serves as a reference point for a certain number of decisions - especially limiting distributions to the undistributable net assets - see art. 15 of the directive - which contributes to protect the creditors against the directors siphoning off financial substance in favour of the shareholders. Ultimately, the discussion around the legal capital is

⁵ Mainly from KÜBLER, F., *Aktie, Unternehmensfinanzierung und Kapitalmarkt*, 62 e.s. and KÜBLER, F., MENDELSON, M., MUNDHEIM, R.H., "Die Kosten de Bezugsrechts Eine rechtsökonomische Analyse des Amerikanischen Erfahrungsmaterials", *Die Aktiengesellschaft* 1990, 461, WYMEERSCH, E., "Das Bezugsrecht der alten Aktionäre in der Europäischen Gemeinschaft, eine rechtsvergleichende Untersuchung", *Die Aktiengesellschaft* 1998, 382-393.

⁶ See for an analysis of some of the practices, WYMEERSCH, E., "Das Bezugsrecht der alten Aktionäre in der Europäischer Gemeinschaft", *Die Aktiengesellschaft* 1998, n° 8, 382-393.

⁷ See WYMEERSCH, E., "Article 23 of the second company law directive: the prohibition on financial assistance to acquire shares of the company", in: BASEDOW, K., HOPT, K.J., KÖTZ, H. (Eds.), *Festschrift für Ulrich Drobnig*, Mohr Siebeck, special issue.

⁸ See the Modern Company Law for a Competitive Economy, Company Formation and Capital Maintenance, October 1999, A Consultation Document, Company Law Reform, vol. 3.

⁹ The UK Company Law Review pointed out that "major creditors attach relatively little importance to the amount of a company's capital, compared with other indications of its creditworthiness; for many companies, the amount of share capital subscribed is in any case minimal" § 17.

essentially related to the question whether company law should protect the shareholder, rather than the creditor. It is well known that American company law essentially protects the shareholder, while European company law is more aimed at protecting the creditors. Whether this balance of interests is the right one, is the subject of a fundamental debate, in which the role of corporate finance, insolvency law, but also wider societal interests, such as the interests of the employees, and of the role of credit institutions, come into play.

In the light of these considerations the SLIM working party reviewed only some of the provisions of the Second Directive, limiting itself to those that were considered most cumbersome in actual practice.

The items singled out can be grouped under the heading of taking better account of the influences of the securities markets. The presence of active and reliable securities markets are indeed the major factor of difference between the times the directive was framed and today.

In case of contributions in kind, the requirement to have the assets contributed valued by an external independent expert has continued to receive support. However, the working party suggested that if the assets so contributed are regularly traded - especially securities traded on the market -, no additional valuation should be requested. The rule would be of special significance in case of an exchange take-over bid.

The rule could be broadened to other valuations: if assets have been valued in a recent financial statement of a company, is there a reason for proceeding to an additional valuation if these assets are being contributed, provided the valuation has been rendered in the same perspective ?

This approach also lies at the basis of the proposal to allow issues of additional shares without preferential subscription rights when the new shares have a listing, and therefore a regular valuation, and provided the shares are placed at the market price¹⁰. If the new shares are issued at the market price- or according to practice, slightly below - there is no need for shareholders to fear any dilution of the value of their shares. Objections based on the dilution of voting rights should be overcome by the fact that the authorisation to the board to issue additional shares is given by the general meeting, deciding with a supermajority. Minority shareholders who hold a stake that is worthwhile to be protected, will therefore be able to block the authorisation decision.

A similar reasoning lies at the basis of the rule allowing companies to repurchase their own shares at the market price¹¹: the present rule limiting the repurchases to 10% of the outstanding shares - which seems purely arbitrary - can better be justified, from a perspective of creditor protection, by allowing companies to repurchase, at market price, provided that the amounts used do not exceed the distributable net assets. But member states who prefer to be more restrictive could maintain the said threshold. For listed companies the procedure should be simplified, by allowing the board, upon authorisation from the general meeting, to repurchase for a five year period, at the market price. Disclosure is essential to avoid market manipulation.

With respect to financial assistance¹², the working party came to an intermediate position: it proposed to the Commission to review the provision and limit it to a minimum. Two more detailed indications were given. In the absence of a clear fiduciary standard applicable to board decisions, or other specific safeguards dealing with conflict of interest situations, it might be useful to limit financial assistance to that part of the assets to which creditors cannot assert any claim. These are the distributable net assets. This standard is also followed in certain member states with respect to financial assistance granted by private companies limited, that are not subject to the directive.

¹⁰ Art. 29 §4 of the directive.

¹¹ Art. 19 of the directive.

¹² Art. 23 of the directive.

Another avenue would be to limit the provision to the subscription of new shares, a rule that would come close to the prohibition for a company to subscribe to its own shares (art. 18.1 of the directive). One could argue that the shareholder who subscribes with company funds, acts as a dummy for the company itself. In fact, the criticism as formulated against the present article 23 would also apply here: the problem is due not to the origin of the funds, but to the decision of the board.

The working party reflected on the issue of shares with nominal value. These are still the prevailing type of shares in large parts of Europe. The introduction of the Euro has stimulated member states to reflect on the subject of maintaining this type of expression of the share capital. The directive assumes shares to have a nominal value, or, as was then the practice in Belgium, an “accountable par”, being the value obtained by dividing the nominal capital by the number of shares outstanding¹³.

These techniques for designating the value of shares are very confusing: the values allocated have no relationship with the economic or market value, that may be higher or lower. They often bear some relationship to the assets contributed, but only at the moment of incorporation of the company. Later on, capital movements of diverse nature will normally have cut the link with the assets contributed. The issue becomes significant if, as is the case in some jurisdictions, voting rights are established in relation to the nominal value or the accountable par. Changes in these values, due to incorporation of reserves, set-off of losses, mergers, or whatever other transactions may lead to highly intricate discussions. So e.g. under the “accountable par” regime, it has been argued that shares that are issued later under par have no voting rights, although the directive and the national law provided for an explicit procedure to issue below par (art. 8.2, second directive)¹⁴. An alternative opinion established voting rights according to historical par values, creating even more confusion.

Without entering into these Byzantine discussions, it is clear that there is an argument for getting rid of these - misleading - techniques of designating share value, which serve little economic purpose¹⁵. The issue at stake is not creditor protection, but only a technique for establishing the relationship between shareholders. Therefore, it might be useful to study the American approach, according to which the shares represent a fraction of the company, whatever that company is worth¹⁶. Shares are issued without reference to nominal value, or to accountable par, but merely as additional fractions of the same company¹⁷. The price is established in any case, not according to the amount of legal capital - that plays no role anyway - but according to the market value per share, if unlisted, maybe by taking into account the net asset value. By following this approach, there would be no need to establish intricate rules forbidding issuance under nominal value¹⁸, about issuing under accountable par, rules on share premiums¹⁹, while the use of different classes of shares could be made more flexible by a mere description of the rights attached to each of the classes, but without reference to the amount of capital represented.

The SLIM working party deemed that the suggestion to introduce shares without expressed value was worthwhile to be further studied.

¹³ Terminology may be confusing, as these shares are often referred to as “shares without nominal value”. But they use the “accountable par” as an equivalent, but not identical point of reference.

¹⁴ In fact the argument is more complicated: voting rights would be attached in relation to the lower accounting par, leading to reduce the voting power of the shares issued previously at a higher accounting par. In case of successive issues under accounting par, the situation might become unmanageable.

¹⁵ For an overview of the repeated attempts to change the UK law in this respect see FERRAN, E., *Company law and Corporate Finance*, O.U.P., at 84 e.s.

¹⁶ Apart from the US, Canada and Australia have also decided to abandon the stated value of shares.

¹⁷ This is also the proposal of the UK Company Law Reform with respect to private companies limited, as these are not subject to the second directive, n° 18 e.s. and § 3.12.

¹⁸ As prevented by art 8.1 of the directive.

¹⁹ Which has moreover a different meaning in the UK v. the continental jurisdictions: in the former it qualifies for capital maintenance rules, in the second it does not: see FERRAN, E., at 283.

Finally, the working party suggested to make the rules on the compulsory withdrawal shares more flexible. The need arises in jurisdictions where no squeeze out remedies have been adopted. Here the minority shareholder could be obliged to leave the company, by a decision of the company itself, and of course at a correct price. The proposal differs from the prior regulation in that it would allow companies to introduce the withdrawal right by a later decision of the general meeting, and not merely if the right has originally been provided for upon issue of the shares.

III - Follow-up of the SLIM activities

The Commission has started discussions on the mentioned proposals, and hopes to come forward, later in 2001 with amendments to the directives.

Annexed

Conclusion of the SLIM working party.