

What makes a good company?

Employee interest representation
in European company law:
reflections and legal provisions

Report 94

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European company law:
reflections and legal provisions**

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for Research, Education and Health and Safety (ETUI-REHS)

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Foreword

Currently, there is a battle over the character of the evolving European system of corporate governance. At issue is the fundamental choice between two different conceptions of the firm: the *shareholder model*, where the purpose of the firm is to maximise value in the interests of shareholders, and the *stakeholder model*, where the firm has responsibility to a broader range of stakeholders. Potentially, Europe could use its existing legal framework to develop a regime of corporate governance which anchors companies within the society. An important EU contribution to realising corporate social responsibility is the establishment and maintenance of a well-balanced corporate governance framework by legislation which respects different systems of worker involvement and, at the very least, safeguards existing provisions at national level.

National and cultural differences notwithstanding, worker participation has been an ever-present thread running through the process of creating the European Constitution. Article II-87 of the European Constitution will, if approved, legally establish information and consultation in the workplace as a fundamental workers' right. It could be argued that these fundamental rights make workers into workplace citizens, underlining the common political will throughout Europe to involve workers as key players in the shaping of Europe's economic and social future.

The legislation on worker participation in the European Company (SE) (2001/86/EC; 2157/2001), in force since October 2004, as well as the Directive on cross-border mergers (the so-called 10th Directive on European company law, which has to be transposed into national law by December 2007, 2005/56/EC) provide the protagonists on both sides of industry with the opportunity to set up a qualified transnational representation of workers and to realise a range of benefits by involving them in monitoring and influencing management decisions. In interaction with, at least, the relevant provisions of the other main EU Directives on information and consultation, the EWC Directive (94/45/EC) and the so-called information and consultation Directive (2002/14/EC), workers and their trade unions should take the opportunity to develop a joint European policy of interest representation which is at the same time reconciled with companies' economic objectives.

The so-called Bolkestein plan of May 2003 – 'Modernisation of European Corporate Governance' – which is currently under revision, and ETUI-REHS's so-called GOODCOM project ('What makes a GOOD COMpany?') examined the legal role of workers' participation within corporate governance. From a trade union point of view involvement of workers' representatives is crucial for sound corporate governance, promising both improved economic performance and fulfilment of the Lisbon strategy. Currently, the project provides monitoring and topical support with a view to influencing the debates of the European Corporate Governance Forum organised by the EU Commission. This may lead to the development of a workers' voice in corporate governance which stresses the potential for shaping (global) financial markets in the workers' interests. Thanks to Janja Bedrac's compilation trade unionists will find it easier to orient themselves and to identify legal reference points in this relevant and decisive debate. The report is the result of a collaboration lasting more than one year and closely connected to ETUI-REHS's SEEUROPE project (see www.seeurope-network.org). I would like to thank Stefan Clauwaert for his valuable advice.

Norbert Kluge

Senior researcher, head of GOODCOM and SEEUROPE project

Introduction¹

The European Union has laid down a strategy to become the world's leading economic power. However, in parallel with this, the EU is also enhancing its social role. Workers' participation in enterprise management and decision-making is one of the fundamental elements of a social economy.

For this reason the European Union is extending its legislation in this area, laying down minimum standards for employee information, consultation and participation. This is especially important at a time when establishing companies in other EU Member States is becoming easier, which could – without appropriate legal guarantees – be detrimental to workers' participation rights. On the other hand, for decades the European Union has been legislating on various aspects of company law, enabling the aforementioned freedom of establishment and protection of shareholders, creditors and other related parties.

The European Union is still divided between those Member States which guarantee strong participation rights, and those guaranteeing only weak or no participation rights in the enterprise's organisational structure. However, growing cross-border activities and mergers between companies from different Member States are increasing the complexity of employee involvement in the EU. Workers' representatives, therefore, especially those participating in management and supervisory boards, need wide knowledge of both European company law and European employee involvement rights, established both by EC secondary legislation and by the case law of the European Court of Justice in Luxembourg. This will improve their role as equal partners in company decision-making concerning both employees' rights and matters coming under company law.

The purpose of this report is to present an overview of European company law and its relationship to European law on employee involvement. The first section contains a short overview of freedom of establishment as regulated by the Treaty establishing the European Community (the Treaty). The second section presents (existing and proposed) EC legislation establishing supranational entities and legislation regulating employee involvement rights in their decision-making processes. The third section deals with social dialogue in the European Union and Commission initiatives in this area: the report emphasises directives already adopted which are most important for workers' participation. On this basis, in section 4 we analyse the basic features of European company law, emphasising European corporate accounting principles, aimed at safeguarding shareholders, creditors and employees (section 5). Section 6 provides an overview of the most important ECJ judgements in the area of European company law, dealing with the right of freedom of movement of companies throughout the EU. Section 7 presents the basic features of European corporate taxation as formed by legislation and ECJ case law in this area. Section 8 reviews three main directives intended to have an impact in the future (the already adopted 13th company law directive and the proposed 10th and 14th directives), which will also have a significant impact on employee involvement rights. Section 9 reports in detail on discussions on this issue in the new Member States (acceding in 2004), where the employee involvement situation is very heterogeneous and freedom of establishment on the Single European market is in its early stages. The final section presents the latest developments concerning employees' financial participation in the EU, which may be defined as a component of employee involvement in the wider sense. This is followed by a brief conclusion and presentation of a number of open questions.

¹ This report was completed in November 2005 and does not cover any developments after that date.

1. Freedom of establishment

Freedom of establishment is one of the four fundamental freedoms of the EU internal market. It includes **the right to take up and pursue activities as a self-employed person and to set up and manage undertakings** under the conditions laid down for its own nationals by the law of the country where such establishment is effected. To this effect, Article 43 of the Treaty prohibits all restrictions on the freedom of establishment of nationals of one Member State in the territory of another Member State. Also prohibited are restrictions on the setting up of agencies, branches or subsidiaries by nationals of one Member State in the territory of any other Member State. Accordingly, freedom of establishment includes freedom of primary and secondary establishment.

It is important to note that the Treaty puts **natural and legal entities on an equal footing**. It provides that companies formed in accordance with the law of a given Member State and having their registered office, central administration or principal place of business within the Community must be treated in the same way as natural persons who are nationals of Member States (Article 48).²

The provisions on freedom of establishment do not apply to the exercise of **official authority** in the state concerned (Article 45). The European Court of Justice has interpreted this **exception** very restrictively and has limited it to those functions which are closely related to the exercise of sovereign rights, which require special loyalty to the state. Another exception to freedom of establishment applies to provisions providing special treatment for foreign nationals on grounds of **public policy, public security or public health** (Article 46), where the proportionality test needs to be satisfied.

One of the main aims of European legislation by the Council and the European Parliament is to increase legal certainty and effectiveness. However, since the secondary legislation was very much delayed it was extremely important to establish whether it would be possible for natural and legal persons to rely directly on the EC Treaty provisions on freedom of establishment. Deriving from the *Van Gend en Loos*³ decision, which established the EC legal order as a new and autonomous legal order in its own right, the European Court of Justice confirmed that *‘the rule on equal treatment with nationals is one of the fundamental legal provisions of the Community. As a reference to a set of legislative provisions effectively applied by the country of establishment to its own nationals, this rule is, by its essence, capable of being directly invoked by nationals of all the other member states’* (*Jean Reyners v. Belgium*).⁴

² Where ‘companies’ means companies constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, except those which are non-profit-making.

³ Case 26/62, ECR 1963, p. 3.

⁴ Case 2/74, ECR 1974, p. 631.

2. Supranational (European) legal entities and employee involvement

2.1. European Economic Interest Grouping (EEIG)⁵

The EEIG is a legal entity based on Community law whose purpose is to facilitate and encourage cross-border cooperation among its members. It is not intended that such groupings should be profit-making. Any profits which do arise shall be apportioned among the members and taxed accordingly. EEIG activities must be related to the economic activities of its members, but cannot replace them (ancillary nature of the EEIG). It is important to stress that an EEIG cannot employ more than 500 persons and it is thus often emphasised that an EEIG is predominantly an instrument for the transnational cooperation of small and medium-sized enterprises. However, it is important to note that this limitation refers to those employees employed by the EEIG itself and does not represent a limitation on the total number of employees of the members. In practice, it is common that EEIGs have no or very few employees.

An EEIG can be formed by companies, firms and other legal entities governed by public or private law which have been formed in accordance with the law of a Member State and which have their registered office in the Community. It can also be formed by individuals carrying on an industrial, commercial, craft or agricultural activity or providing professional or other services in the Community. **An EEIG must have at least two members from different Member States.**

The contract for the formation of an EEIG must include its name, its official address and objects, the name, registration number and place of registration, if any, of each member of the grouping and the duration of the grouping, except where this is indefinite. The contract must be filed at the registry designated by each Member State. Registration in this manner confers full legal capacity on the EEIG throughout the Community.

When a grouping is formed or dissolved, a notice must be published in the Official Journal of the European Communities. A grouping's official address must be within the Community. **It may be transferred from one Member State to another**, subject to certain conditions.

Each member of an EEIG has one vote, although the contract for its formation may give certain members more than one vote, provided that no one member holds a majority of the votes. The Regulation lists those decisions for which unanimity is required. The EEIG must have at least two organs: the members acting collectively and the manager or managers. The managers represent and bind the EEIG in its dealings with third parties, even where their acts do not fall within the objects of the grouping. An EEIG may not invite investment by the public. An EEIG does not necessarily have to be formed with capital. Members are free to use alternative means of financing. The profits of an EEIG will be deemed to be the profits of its members and will be apportioned either according to the relevant clause in the contract or, failing such a clause, in equal shares. The profits or losses of an EEIG will be taxable only in the hands of its members. As a counterweight to the contractual freedom which is fundamental to the EEIG and the fact that members are

⁵ Council Regulation (EEC) No. 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG), Official Journal L 199, 31.07.1985.

not required to provide a minimum amount of capital, each member of the EEIG has unlimited joint and several liability for its debts.

In 1997 the Commission adopted a communication entitled '**Participation of European Economic Interest Groupings (EEIGs) in public contracts and programmes financed by public funds**'.⁶ While an encouraging number of EEIGs (more than 1,500)⁷ have been set up so far, the Commission has found that optimum use is not yet being made of the EEIG by firms wishing to cooperate at transnational level, particularly where they hope to participate in public contracts and programmes financed by public funds. Community Directives on public procurement do not contain any provisions which could impede the participation of EEIGs. However, the Commission stressed that **EEIGs are always entitled to apply to participate in Community programmes**, including those which require the participation of legal entities from several Member States. EEIGs can be regarded as constituting a 'consortium' since they must include at least two members from two different Member States who remain economically and legally independent throughout their cooperation.

An EEIG provides a means of increasing the borrowing potential of its members while reducing the cost of loans. The unlimited joint and several liability of the members can make it much easier to obtain credit. There is no reason to require that each member of an EEIG provide a personal guarantee. Credit institutions should be able to carry out an overall assessment of the solvency of groupings on the basis of the financial status of their members.

The EEIG Regulation does not contain any specific provisions relating to **employee involvement** in EEIG decision-making procedures. For this reason '*the laws of the Member States and Community law are applicable*'.⁸ The EEIG has thus avoided the employee involvement issue, made possible by the fact that EEIGs serve only as an ancillary instrument for transnational cooperation. In this regard, however, the limitation of 500 employees was set in order not to interfere with German provisions on *Mitbestimmung* which require board-level participation in companies with more than 500 employees.

2.2. Statute for a European company

The Statute for a European company (*Societas Europea* – *SE*) allows companies incorporated in different Member States to merge or form a holding company or joint subsidiary while avoiding the legal and practical constraints arising from the existence of fifteen different legal systems. It also arranges for the involvement of employees in the European company and recognises their place and role in the company.⁹

⁶ COM(97) 434 final, Official Journal C 285, 20.09.1997.

⁷ For up-to-date statistics see Libertas Institute EEIG Centre:
http://www.libertas-institut.com/uk/uk_Vorlage.htm

⁸ See Preamble.

⁹ The European Company is now a reality some 30 years after the initial proposal. The new legislation entered into force in October 2004.

For this purpose the Statute consists of a regulation determining company law aspects¹⁰ of the European company and of a directive guaranteeing employee involvement¹¹ in the formation and management of the European company.

2.2.1 Regulation on the Statute for a European company

The Statute provides **four ways** of forming a European company:

1. **merger**: available only to public limited companies from different Member States;
2. **formation of a holding company**: available to public and private limited companies with their registered offices in different Member States or having subsidiaries or branches in Member States other than that of their registered office;
3. **formation of a joint subsidiary**: available under the same circumstances to any legal entities governed by public or private law;
4. **conversion** of a public limited company previously formed under national law.

The SE must have a **minimum capital** of 120 000 euros. Where a Member State requires larger capital for companies engaged in certain types of activity, the same requirement will also apply to an SE with its registered office in that Member State.

The **registered office** of the SE designated in the statutes must be the place where it has its central administration, that is to say its true centre of operations. The SE can easily transfer its registered office within the Community without dissolving the company in one Member State in order to form a new one in another Member State.

The **registration** and completion of the liquidation of an SE must be disclosed for information purposes in the Official Journal of the European Communities. Every SE must be registered in the state where it has its registered office, in a register designated by the law of that state.

The **statutes** of the SE must provide for – as governing bodies – a general meeting of shareholders and either a management board and a supervisory board (two-tier system) or an administrative board (one-tier system).

Under the **two-tier system** the SE is managed by a management board. A member or members of the management board have the power to represent the company in dealings with third parties and in legal proceedings. They are appointed and removed by the supervisory board. No person may be a member of both the management board and the supervisory board of the same company at the same time. However, the supervisory board may appoint one of its members to exercise the functions of a member of the management board in the event of absence due to holiday. During such a period the function of the person concerned as a member of the supervisory board shall be suspended.

Under the **one-tier system**, the SE is managed by an administrative board. A member or members of the administrative board have the power to represent the company in dealings

¹⁰ Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European Company [Official Journal L 294 of 10.11.2001].

¹¹ Council Directive No. 2001/86/EC of 8 October 2001 complementing the Statute for a European Company with regard to the involvement of employees in the European company [Official Journal L 294 of 10.11.2001].

with third parties and in legal proceedings. Under the one-tier system the administrative board may delegate the power of management to one or more of its members.

In **tax matters**, the SE is treated the same as any other multinational, that is, it is subject to the tax regime of the national legislation applicable to the company and its subsidiaries. SEs are subject to taxes and charges in all Member States where their administrative centres are situated. Thus their tax status is not perfect as there is still no adequate harmonisation at European level.

Winding-up, liquidation, insolvency and suspension of payments are in large measure to be governed by national law. An SE which transfers its registered office outside the Community must be wound up on the application of any person concerned or any competent authority.

2.2.2. Council Directive complementing the Statute for a European company with regard to the involvement of employees in the European company

The directive has set up standards of employee involvement, guaranteeing autonomy of the social partners and at the same time a degree of existing rights of employees provided by the different regimes of participation rights.

Several participation models are possible: first, a model in which the employees participate in the supervisory board or the administrative board, as the case may be; second, a model in which the employees are represented by a separate body; and finally, other models to be agreed between the management or administrative boards of the founder companies and the employees or their representatives in those companies, the level of information and consultation being the same as in the case of the second model. The general meeting may not approve the formation of an SE unless one of the models of participation defined in the Directive has been chosen.

Employees' representatives must be provided with financial and material resources and other facilities such as enable them to perform their duties properly.

If the two parties do not reach a satisfactory arrangement, a set of standard principles set out in the Annex to the Directive becomes applicable.

With regard to a European company formed through a merger, the standard principles relating to workers' participation will apply where at least 25% of the employees had the right to participate in decisions before the merger. Here a political agreement proved impossible until the Nice summit in December 2000. The compromise adopted by the Heads of State or Governments allowed a Member State not to apply the Directive to SEs formed from a merger, in which case the SE could not be registered in the Member State in question unless an agreement had been concluded between the management and employees, or that no SE employee had the right of participation before the formation of the SE.

2.3. Social economy

2.3.1. *Promoting the role of voluntary organisations and foundations in Europe*

The EU has stated that it will encourage and develop civil dialogue by promoting the role of voluntary organisations and foundations in order to inform citizens about social policy developments, notably the implementation of measures designed to combat social exclusion and discrimination.¹²

The beginnings of a more structured and consistent civil dialogue date back to the Maastricht Treaty, which enshrined Declaration 23, stressing the importance of ‘*cooperation between [the European institutions] ... and charitable associations and foundations as institutions responsible for welfare establishments and services.*’

The social economy consists of three sectors:

1. cooperatives,
2. mutual societies,
3. voluntary organisations and associations.

In these sectors, voluntary organisations and foundations are becoming increasingly numerous. Over time they have begun to contribute to European integration. However, the voluntary sector has had to address fresh problems and challenges linked to the extension of its role, which the Commission and the Member States are trying to remedy.

2.3.2. *Statute for a European cooperative society*

The European Union believes it to be essential that companies of all types, whose business is not limited to satisfying purely local needs, should be able to plan and carry out the reorganisation of their business on a Community scale. For this reason the Council adopted regulations on EEIGs and SEs. These two instruments are not, however, suited to the specific features of cooperatives. **Cooperatives are independent organisations of individuals voluntarily associated to satisfy their common economic, social and cultural aspirations and needs by means of a collectively owned enterprise in which the members exercise power democratically.**

The Community therefore decided to provide cooperatives with adequate legal instruments capable of facilitating the development of their cross-border activities at European level. In 2003 the **Regulation on company law aspects¹³ of the European cooperative society** (*Societas Cooperativa Europea* – SCE) and the **Directive on employee involvement in SCEs¹⁴** were adopted.

Council Regulation on the Statute for an SCE

With the adoption of this Regulation, a genuine single-entity SCE was established. These legal acts permit the creation of a cooperative by persons residing in different Member

¹² Commission Communication of 6 June 1997 on promoting the role of voluntary organisations and foundations in Europe.

¹³ Council Regulation (EC) No. 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE).

¹⁴ Council Directive 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society with regard to employee involvement.

States or by legal entities established in different Member States. From August 2006 these new SCEs will be able to operate throughout the Single Market with a single legal identity, set of rules and structure.

The SCE is defined as a body with legal personality for which the capital subscribed by its members is divided into shares. Its registered office, which is to be specified in its rules, must be within the Community and must be in the same place as its central administration. The SCE is to have legal personality from the day of its registration in the state in which it has its registered office.

An SCE shall have as its principal object the **satisfaction of its members' needs and/or the development of their economic and social activities, in particular through the conclusion of agreements with them to supply goods or services or to execute work of the kind that the SCE carries out or commissions.**

Subject to this Regulation, the formation of an SCE is governed by the law applicable to cooperatives in the state in which it has its registered office. An SCE may be formed as follows:

1. by **five or more natural persons** resident in at least **two Member States**;
2. by **five or more natural persons and companies and firms** and other legal bodies governed by public or private law, formed under the law of a Member State, resident in, or governed by the law of, at least two different Member States;
3. by **companies and firms** and other legal bodies governed by public or private law formed under the law of a Member State which are resident in, or governed by the law of, at least two different Member States;
4. by a **merger between cooperatives** formed under the law of a Member State with registered offices and head offices within the Community, provided that at least two of them are governed by the law of different Member States;
5. by **conversion of a cooperative** formed under the law of a Member State, which has its registered office and head office within the Community if **for at least two years** it has had an establishment or subsidiary governed by the law of another Member State.

The **capital** of an SCE shall be represented by the members' shares, expressed in the national currency. It may not be less than 30 000 euros or the equivalent in national currency.

The **registered office** of an SCE may be transferred to another Member State without resulting in the winding-up of the SCE or in the creation of a new legal entity.

The Regulation provides for the SCE structure to be made up of a general meeting, and either a management board with a supervisory board monitoring its activities (the **two-tier system**), or an administrative board (the **one-tier system**), depending on which option is chosen in the SCE statutes.

Directive supplementing the Statute for an SCE with regard to employee involvement

In order to promote the social objectives of the Community, special provisions have been adopted by means of a Directive, particularly as regards employee involvement in the SCE, aimed at ensuring that the establishment of an SCE does not bring with it the

disappearance or reduction of practices of employee involvement existing within the entities participating in its establishment.

The Directive governs employee involvement in the affairs of SCEs. It is founded on the solutions adopted by the SE directive. The SCE directive aligns the laws, regulations and administrative provisions in force in the Member States so as to cater for employee involvement in the running of SCEs. The arrangements for employee involvement shall be established in every SCE in accordance with the negotiating procedure or the standard rules on employee involvement laid down in the Directive.

The special negotiating body

Where the management or administrative organs of participating legal entities draw up a plan for the establishment of an SCE, they shall as soon as possible take the necessary steps to start negotiations with employees' representatives on arrangements for employee involvement. For this purpose, a special negotiating body representing the employees of the participating legal entities and subsidiaries or establishments shall be created.

The special negotiating body and the competent organs of the participating legal entities shall determine, by written agreement, arrangements for employee involvement in the SCE. To this end, the competent organs of the participating legal entities shall inform the special negotiating body of the plan and the actual process of establishing the SCE, up to its registration.

The special negotiating body shall take decisions by an absolute majority of its members, provided that such a majority also represents an absolute majority of the employees. Each member shall have one vote. However, should the result of the negotiations lead to a reduction of participation rights, the majority required for a decision to approve such an agreement shall be two thirds of the members of the special negotiating body representing at least two thirds of the employees, including the votes of members representing employees employed in at least two Member States:

- in the case of an SCE to be established by merger, if participation covers at least 25% of the employees of the participating cooperatives;
- in the case of an SCE to be established in any other way, if participation covers at least 50% of the employees of the participating legal entities.

With the exception of an SCE established by way of transformation, the special negotiating body may decide by a majority of the votes of two thirds of the members, representing at least two thirds of the employees, not to open negotiations or to terminate them. In this case, these votes should represent employees employed in at least two Member States.

The special negotiating body shall be reconvened at the written request of at least 10% of the employees of the SCE, its subsidiaries and establishments, or their representatives, at the earliest two years after the above-mentioned decision, unless the parties agree to negotiations being reopened sooner.

The agreement on arrangements for employee involvement

This agreement shall be negotiated in a spirit of cooperation between the competent organs of the participating legal entities and the special negotiating body, in accordance

with the legislation of the Member State in which the registered office of the SCE is to be situated. Negotiations shall commence as soon as the special negotiating body is established and may continue for six months thereafter. The parties may decide, by joint agreement, to extend these negotiations up to a total of one year from the establishment of the special negotiating body.

Standard rules

The Member States shall lay down standard rules on employee involvement which must satisfy the provisions set out in the Annex to the Directive. As laid down by the legislation of the Member State in which the SCE has its registered office, these standard rules shall apply from the date of registration of the SCE where either:

- the parties so agree, or
- no agreement has been concluded between the competent organs of the participating legal entities and the special negotiating body within the deadline given and
 - the competent organ of each of the participating legal entities decides to accept the application of the standard rules in relation to the SCE and so to continue with its registration of the SCE, and
 - the special negotiating body has not taken a decision not to open negotiations or to terminate negotiations already opened with the competent organs of the participating legal entities.

Rules applicable to SCEs established exclusively by natural persons or by a single legal entity and natural persons

In the case of an SCE established **exclusively by natural persons or by a single legal entity and natural persons**, which together employ fewer than 50 employees, or employ 50 or more employees in only one Member State, employee involvement shall be governed by the following provisions:

- in the SCE itself, the provisions of the Member State of the SCE's registered office, which are applicable to other entities of the same type, shall apply;
- in its subsidiaries and establishments, the provisions of the Member State where they are situated, and which are applicable to other entities of the same type, shall apply.

2.3.3 Proposal on the Statute for a European association

To enable associations and foundations to operate throughout the Community, by providing for a legal form to be known as a European Association (EA) and to provide for the involvement of employees in the European Association so that they can play their proper part in the organisation, the European Commission issued a Proposal on the Statute and regarding employee involvement in the European Association.

Proposal for a Council Regulation on the Statute for a European Association

A European Association (EA) is to be a body whose members pool their knowledge or their activities either for a purpose in the general interest or in order directly or indirectly to promote the interests of particular professions or groups. An EA is to have legal personality from the day of its registration in the Member State in which it has its registered office.

An EA may be set up directly either by **two or more legal entities** formed under the law of a Member State, provided at least two of them have their registered offices and central administrations in different Member States, **or by at least 21 natural persons**, being nationals of and resident in at least two Member States.

An association which has been formed in accordance with the law of a Member State may set up an EA by converting into EA form if it has an establishment in a Member State other than that of its registered office. It must be able to show that it is carrying on a genuine cross-border activity. The EA's registered office, which is to be specified in its rules, must be within the Community, and must be in the same place as its central administration.

The rules of the EA must provide for a general meeting and for an executive committee. A general meeting is to be held at least once a year, no more than six months after the end of the financial year. The executive committee may convene meetings at any time either on its own initiative or at the request of at least 25% of the members; the rules may set a lower proportion. A member or members of the executive committee have the power to represent the EA in dealings with third parties and in legal proceedings. They are to be appointed and removed by the general meeting. Members of the executive committee are to be appointed for a period which may not exceed six years. They may be reappointed at the end of the six-year period.

Proposal for a Council Directive complementing the Statute for a European Association with regard to employee involvement

No EA may be registered until a model of participation or an information and consultation system has been chosen. The Directive refers back to domestic rules governing the participation of employees in the supervisory or administrative boards of domestic companies and societies in general. If the Member State in which the EA has its registered office has no rules on the participation of employees, or does not wish to apply such rules to the EA, it must nevertheless comply with the minimum requirements of the succeeding articles as regards the informing and consulting of employees. The Directive describes the procedure to be followed for the adoption of information and consultation arrangements in EAs with at least 50 employees.

In the event of direct formation by natural persons, the arrangements chosen must be submitted to the general meeting called to approve the formation of the EA. The executive committee must inform and consult the employees in good time; the Directive supplies a minimum list of areas in which information and consultation are required, including any proposals which might significantly affect the interests of the employees and any question concerning conditions of employment.

The Directive lays down certain basic principles concerning election procedures and the performance of their functions by elected representatives. Employees' representatives are to be elected, not appointed, and are to represent the employees of all the EA's establishments, plants and facilities, even if they are employed part-time.

2.3.4. Statute for a European mutual society

To facilitate mutual societies wishing to engage in cross-border business, taking account of their specific features and in particular of the fact that they operate in the general interest and to provide for employee involvement in the European mutual society (ME) so

that they can play their proper part in the organisation, the European Commission issued a Proposal for a Council Regulation on the Statute for a European mutual society and the Proposal for a Council Directive supplementing the Statute for a European mutual society with regard to employee involvement.

Proposal for a Council Regulation on the Statute for a European mutual society

A European mutual society (ME) is to be a grouping of natural or legal persons, or both, which guarantees its members, in return for a subscription, full settlement of contractual undertakings entered into in the course of the activities authorised by its rules (whether concerned with providence, insurance, health assistance, credit or otherwise). The ME is to have legal personality from the day it is registered in the state in which it has its registered office.

The Regulation does not affect obligatory social security schemes, which in certain Member States are managed by provident mutual societies, nor the freedom of Member States to decide whether and in what circumstances to entrust the management of such schemes to MEs. The ME's registered office, which is to be specified in its rules, must be within the Community and must be in the same place as its central administration. The ME is to have a formation fund of no less than EUR 100 000 or the equivalent in national currency.

The rules of the ME must provide for a general meeting of the members and either a management board, with a supervisory board monitoring its activities (the two-tier system), or an administrative board (the one-tier system).

Proposal for a Council Directive supplementing the Statute for a European mutual society with regard to employee involvement

The Directive refers back to the domestic rules governing employee involvement in the supervisory or administrative boards of domestic companies and societies in general. If the Member State in which the ME has its registered office has no rules on the participation of employees, or does not wish to apply such rules to the ME, it must nevertheless comply with the minimum requirements of the succeeding articles as regards the informing and consulting of employees.

The Directive describes the procedure to be followed for the adoption of information and consultation arrangements in MEs with at least 50 workers. The management board or administrative board of the ME must inform and consult the employees in good time; the Directive supplies a minimum list of areas in which information and consultation are required, including any proposals which might significantly affect the interests of the employees and any question concerning conditions of employment.

The representatives of ME employees are to be elected, not appointed, and are to represent the employees of all the ME's establishments, plants and facilities, even if they are employed part-time.

3. European law on employee involvement in decision-making

3.1. Social dialogue in the European Union

3.1.1. European social dialogue

Dialogue with the social partners is considered one of the cornerstones of the European social model. The European Commission's role, in accordance with Article 138 of the Treaty, is to '*develop the dialogue between the social partners at European level, which could, if the two sides consider it desirable, lead to relations based on agreement*'. Furthermore, the new title on employment in the Treaty gives the social partners a significant role in the coordinated strategy for employment.

The social dialogue has made possible some progress in the social field. In 1996 the Council adopted Directive 96/34/EC on **parental leave**, the first Directive to implement a European-level framework agreement between the social partners. In 1997 the Council adopted a second Directive, 97/81/EC, implementing an agreement between the social partners concerning **part-time work**, and in 1999 Directive 99/70/EC concerning **fixed-term work** was concluded in order to establish a general framework encompassing general principles and minimum provisions relating to fixed-term work and to ensure equal treatment of workers.

The Commission views the future of social dialogue both as a key to better governance of the enlarged Union and as a driving force for economic and social reform. This approach to social dialogue is based on the social partners' contribution to the Laeken European Council (December 2001) and the reflections of the High-Level Group on Industrial Relations. Following these reflections in 2002 the Commission adopted a Communication on 'The European social dialogue, a force for innovation and change'.¹⁵ The Communication is divided into three sections.

a) Social dialogue: a key to better governance

The Commission stressed the importance of **consultations with the social partners**. Article 138 of the Treaty provides for a compulsory two-stage consultation procedure:

1. before presenting proposals in the social policy field, the Commission is required to consult the social partners on the possible direction of Community action;
2. if the Commission considers that Community action is desirable, it must consult the social partners on the actual content of the envisaged proposal.

The social partners are also consulted within advisory committees, in the context of procedures aimed at garnering the views of interested parties, such as Green Papers, and systematically on the reports on transposition of Community legislation. The legitimacy and effectiveness of consultation of the European social partners is based on their representativeness.¹⁶

¹⁵ COM(2002) 341 final – not published in the Official Journal.

¹⁶ The requirements in respect of representativeness were set out in the 1998 Communication adapting and promoting the social dialogue at Community level, COM(1998) 322 – not published in the Official Journal.

The Communication also identified the need to strengthen the role of the social partners. The White Paper on European Governance highlights the need for **more interaction** between the European institutions, national governments, regional and local authorities and civil society, of which the social partners form part. At **European level**, the Commission considers that, with the development of consultations on the various aspects of the Lisbon strategy, it is necessary to consolidate joint training of representatives of the authorities and the social partners in order to foster exchanges and partnerships. At **national level**, the social partners play an important role in the implementation of directives by means of agreements at Community level, the adaptation of rules to take account of differences in national situations and the negotiation of responses to the goals set by directives. Innovative solutions to employment development, combating exclusion and improving the quality of life and work are to be found at **local level**. It is for this reason that the Commission, through various Community programmes and initiatives, supports information activities targeted at local and regional partners and dialogue at local level. Reinforcing European or **transnational dialogue** among firms is a fundamental challenge. Significant progress has therefore been made by the setting up of European works councils.

b) Social dialogue: a force for economic and social modernisation: increasing the social partners' involvement in the different aspects of the Lisbon strategy

Attainment of the **strategic goals laid down in Lisbon** – full employment and reinforced social cohesion – depends largely on the action taken by the social partners. They are best placed to take on the positive management of change, which can reconcile the flexibility essential to businesses with the security needed by employees. The open method of coordination, the main tool of the Lisbon strategy, applies to many fields of interest to the social partners (employment, social inclusion, pensions, and so on). The Commission suggested that the social partners be consulted on all these fields, both on the guidelines and on the content of measures to be taken, particularly regarding the drafting and implementation of the employment guidelines.

c) Social dialogue and enlargement

The Communication pointed out that a lot remains to be done to strengthen the capacities of the social partners in the Member States and involve them in the enlargement process. The system of social partnership and independent social dialogue in the new member states is relatively weak.

In summer 2004 the Commission adopted a Communication on '**Partnership for change in an enlarged Europe – Enhancing the contribution of European social dialogue**'.¹⁷ In this Communication the Commission emphasised that enlargement would reinforce the need for social dialogue and partnership. Enlargement creates new opportunities for EU economies and enterprises, but major adjustments are still necessary, particularly in the economies of the new Member States. Partnership will therefore be of particular

¹⁷ Communication of 12 August 2004, Partnership for change in an enlarged Europe – Enhancing the contribution of European social dialogue [COM(2004) 557 final]. There have also been some other Communications in this field: the Communication of 20 May 1998 adapting and promoting the social dialogue at Community level [COM(98) 322 final], the Communication of 18 September 1996 concerning the development of the social dialogue at Community level [COM(96) 448 final], the Communication of 14 December 1993 concerning the application of the Agreement on social policy presented by the Commission to the Council and to the European Parliament [COM(93) 600 final].

importance in managing the impact of continuing restructuring in these countries. However, according to the Commission the enlargement of the EU also presents a **challenge for the European social dialogue**. Social dialogue in the new Member States is characterised by the predominance of tripartism, relatively new social partner organisations and underdeveloped bipartite social dialogue at national and sectoral levels. The question of the technical capacity of the social partners is also important in this context. Enlargement will also challenge the technical capacity of the European social partner organisations. It will increase the variety of industrial relations traditions and require larger negotiating delegations, which may make it harder to reach agreement. Furthermore, the recent enlargement comes at a time when important qualitative developments are occurring within the European social dialogue.

The Communication stresses that social partners in different sectors – at the European, national and company levels – can learn a great deal from each other's experiences. The results of the European social dialogue could therefore be improved by enhancing the synergies between the various sectors, as well as between the European cross-industry and sectoral levels.

In addition to this, the Commission emphasised that the social partners could explore the possible synergies between the European social dialogue and the company level and exemplified this in terms of the link between the sectoral social dialogue and European works councils (EWCs). Increasingly, the range of issues being considered within EWCs is expanding beyond the core issues of company performance and employment to embrace subjects with a strong European dimension, such as health and safety, equal opportunities, training and mobility, corporate social responsibility and environmental issues. Where these and similar topics are being addressed by the social partners at the sectoral level there may be an opportunity for synergies between that level and the EWCs in the sector concerned.

The Commission also underlined that EWCs are adopting a growing number of agreements within multinational companies, which cover employees in several Member States. There is also a growing interest in cross-border agreements between social partners from geographically contiguous Member States, as well as agreements between the social partners in particular sectors covering more than one Member State. In view of this trend, the Commission is conducting a study of **transnational collective bargaining** and will make its results available to the social partners

3.1.2. Lisbon strategy and role of social partners

Social dialogue represents one of the cornerstones of the Lisbon strategy. In this regard it is important to note that in February 2005 the Commission launched its new Social Agenda 2005–2010 for modernising Europe's social model under the revamped Lisbon Strategy for Growth and Jobs.¹⁸

The new Agenda focuses on providing jobs and equal opportunities for all and ensuring that the benefits of the EU's growth and jobs drive reach everyone in society. By modernising labour markets and social protection systems, it will help people seize the

¹⁸ Communication on the Social Agenda, 9.2.2005, COM(2005) 33 final – not published in the Official Journal.

opportunities created by international competition, technological advances and changing population patterns, while protecting the most vulnerable in society.

The new Social Agenda has two key priorities:

1. employment;
2. fighting poverty and promoting equal opportunities.

These key priorities support two of the Commission's strategic goals for the next five years: prosperity and solidarity. The Agenda calls for partnerships between public authorities at local, regional and national level, employer and worker representatives and NGOs.

Under employment, the Agenda will focus on:

- creating a European labour market by enabling workers to **take pension and social security entitlements** with them when they work in a different Member State and by establishing an optional framework for collective bargaining across frontiers; the Commission will also **examine transitional periods for workers** from new Member States;
- getting more people into better jobs, particularly through the European Youth Initiative and supporting women (re-)entering the labour market;
- updating labour law to address needs created by new forms of work, for example, short-term contracts; a new health and safety strategy;
- managing the process of restructuring through the social dialogue.

Under poverty and equal opportunities, the Agenda will focus on:

- analysing the impact of ageing populations and the future of relations between the different generations, by launching a **Green Paper on demography**;
- supporting the Member States in reforming pensions and health care and tackling poverty;
- tackling discrimination and inequality; the Commission will examine minimum income schemes in the Member States and set out a policy approach for tackling discrimination, particularly against ethnic minorities such as the Roma;
- fostering equal opportunities between women and men, for example by setting up a **gender institute**;
- clarifying the role and characteristics of social services of general interest.

The social partners are now preparing a Social Policy Position. The **ETUC** has already prepared some **initial comments on the new Agenda**, noting that in contrast to previous Social Policy Agendas, this one is less detailed in terms of proposed measures. It is more programmatic in the sense that it identifies measures and issues requiring future action, but the measures are not yet identified. According to the ETUC the new approach makes evaluation at this stage more difficult. The ETUC also stressed that the use of green papers, communications and other instruments should not mean that social partners are not consulted in a proper way. On the contrary, the ETUC demands that the social partners be consulted on every new initiative. Furthermore, the ETUC considers that social policy must be considered as a productive factor and that it contributes to improving competitiveness

in the EU at all levels. The fact that this notion has been abandoned in the general principles may imply that the Agenda has abandoned the idea of interdependence between economic, social and employment policies. This is not in line with the Charter of Fundamental Rights enshrined in the Constitutional Treaty nor with the social cohesion objectives, including at the regional and local levels. In addition, the ETUC has drawn attention to the fact that while it is essential that citizens have more confidence it is also *important to keep their collective guarantees alongside their individual rights*.

By the end of 2005 a new Work Programme on Dialogue is expected. In this regard the ETUC is preparing a document in cooperation with the employers. For the ETUC, apart from some important issues, the main theme in the new programme should be a discussion on how to improve the quality of the social dialogue by improving its functioning, instruments and implementation, follow up and enforcement and by raising awareness and promoting better results

In January 2002 the Commission adopted the first stage of consultation with the social partners '**Anticipating and managing change: a dynamic approach to the social aspects of corporate restructuring**'.¹⁹ The paper advocated a positive approach to corporate restructuring balancing the interests of businesses faced with changes in the conditions governing their activity and those of employees threatened with the loss of their jobs. The social partners agreed to explore the possibilities of social dialogue on this issue and included it as an element of their work programme adopted in November 2002. Following a number of seminars exploring practical experience on restructuring, the social partners submitted to the Commission in October 2003 a joint text '**Orientations for reference in managing change and its social consequences**'.²⁰ The statement identifies a range of factors that can contribute to preventing or limiting the negative social impact of restructuring, including good social dialogue. The text addresses, inter alia, the issue of information and consultation in restructuring situations, saying that obligations arising from the legislative and contractual framework on information and consultation must be met.

In March 2005 the European Commission published the Communication '**Restructuring and employment – anticipating and accompanying restructuring in order to develop employment: the role of the European Union**'.²¹ In this Communication the Commission emphasises that the restructuring of enterprises often entails costs that can be very high, not only for the workers but also for the local or regional economy. The preservation of social cohesion, which is a distinctive characteristic of the European social model, requires the introduction of accompanying policies designed to reduce the social costs to a minimum and to promote the search for alternative sources of jobs and income. It is therefore essential to ensure that restructuring is well-managed so as to meet a twofold economic and social requirement. It is vital for enterprises to adapt to change: if enterprises conduct these operations rapidly, their competitiveness can be preserved and enhanced. The Communication invited the European social partners at cross-sectoral and sectoral level to respond to the Communication, which at the same time constitutes the

¹⁹ Accessible at:

http://europa.eu.int/comm/employment_social/news/2002/jan/corporate_restructuring_en.pdf

²⁰ Accessible at: http://europa.eu.int/comm/employment_social/social_dialogue/docs/orientations_en.pdf

²¹ COM(2005) 120 final; accessible at: http://europa.eu.int/comm/employment_social/news/2005/apr/com_restruct_en.pdf

second phase of the consultation on corporate restructuring and European works councils under Article 138(3) of the Treaty.

The **ETUC executive committee has adopted an initial position** regarding the latest communication on restructuring.²² The ETUC welcomes the fact that the Commission Communication puts back on the EU agenda the issue of restructuring, its links to employment and to other relevant policies, and social dialogue within companies, at both EU and national level.

According to the ETUC executive committee, restructuring is, amongst other things, closely linked to delocalisation, a concept which is high on the list of concerns of many EU countries, where we are seeing threats of delocalisation being used to wring concessions from workers and their representatives. The problem is just as important for the new Member States, which are currently experiencing substantial changes in employment structure. If the European Union is to respond successfully to the challenges posed by globalisation and the swift pace of change affecting society in general and the workplace in particular, it needs to develop a strategic and pro-active approach to restructuring. Anticipating, managing and accompanying restructuring processes require the active participation of all relevant actors and must be based on clear synergies between political, legislative, contractual and financial instruments. In addition, action must be taken at all relevant levels, including the European level.

The ETUC stresses that trade unions do not wish to play a role merely in managing the social consequences of restructuring. They also want to participate pro-actively in anticipating restructuring. To this end, workers and their representatives must be actively involved in the daily life of their companies so that they can influence any decisions taken and make sure that information and consultation procedures not only target restructuring issues, but also cover all areas of the company's activity, including its strategic choices and decisions, and anticipate their effects on employment.

In this respect, it is essential that the existing legal instruments on information and consultation are fully respected and made more coherent, and that companies which do not respect these instruments are sanctioned. However, the ETUC would also have liked to see a reference to participation, as well as information and consultation, as is the case in the 10th and 14th European company law directives. Furthermore, the ETUC regrets the absence of guidelines on how European companies should behave when they delocalise: the ETUC's view is that their actions should be in accordance with their country of origin and they should not simply adopt the culture of the destination country.

3.1.3. Role of the social partners in the Constitutional Treaty

Title VI of Part 1 of the Constitutional Treaty (Articles I-45 to I-52) contains provisions on the '**Democratic life**' of the Union. This title comprises eight articles on, respectively, representative democracy, participatory democracy, transparency, access to documents,

²² ETUC Executive Committee's meeting held in Brussels on 14-15 June 2005.

protection of personal data, the European Ombudsman, the role of the social partners and the role of the churches.²³

The Constitutional Treaty reaffirms the rights associated with European citizenship and defines the democratic foundations of the Union. These are based on three principles: (i) democratic equality, (ii) representative democracy and (iii) participatory democracy. Finally, Title VI also brings together certain provisions that were previously scattered throughout the Treaties, including those on transparency, access to documents and the role of the European Ombudsman.

The inclusion in the text of the principles of democratic equality and **representative democracy** does not confer new rights on European citizens but confirms principles corresponding to the spirit of the Treaties. Thus, citizens are directly represented at Union level in the European Parliament. In addition, national governments, which send their representatives to the European Council and the Council of Ministers, are accountable to national parliaments, which are themselves elected by European citizens.

Participatory democracy becomes one of the principles on which the working of the Union is founded. **The main innovation in this area is the inclusion of a right of citizens' initiative.** Article I-47 stipulates that a petition with at least one million signatures obtained from a number of Member States may be sent to the Commission inviting it to take a legislative initiative, provided the latter is compatible with the Constitution and, in particular, with the Charter of Fundamental Rights. This citizens' initiative does not affect the right of initiative of the Commission, which is itself free to decide whether or not to respond to the request to present a proposal. Nevertheless, it is a major innovation, which means that, for the first time, the idea of participatory democracy has been brought into the European political arena. It gives those European citizens who complain about the 'democratic deficit in Europe' a direct means of making their voices heard. This innovation goes hand in hand with the efforts to clarify the distribution of competences and to simplify legal instruments, whose ultimate purpose is to bring citizens closer to the Community institutions.

The concept of participatory democracy embraces other important aspects. The same article also requires the institutions to maintain an open, transparent and regular dialogue with representative associations and civil society, and to carry out broad consultations with the parties concerned.

Article I-48 states that the European Union recognises and promotes the role of the social partners, facilitating dialogue between them and respecting their autonomy. It also reiterates the role of the Tripartite Social Summit for Growth and Employment in contributing to social dialogue.

* * *

The increasing role of the social partners in the legislative process of the European Community has contributed to several directives which have already been adopted in this area (*on collective redundancies, on transfers of undertakings, on insolvency of the employer and on European works councils, together with the abovementioned directives*

²³ This title should be read in conjunction with Article I-10 on European citizenship, Articles II-99 to II-106 relating to the Charter of Fundamental Rights, which restate all the rights associated with European citizenship, and Articles III-125 to III-129, which also deal with this subject.

implementing statutes on the European company and the European cooperative society), while a number of other proposals have not yet been finalised (*European association, European mutual society*).

3.2. Directive 98/59/EC – Collective redundancies²⁴

Two main objectives for the adoption of the Directive were to approximate Member States' legislation concerning the practical arrangements and procedures for such redundancies and to afford greater protection to workers in the event of collective redundancies.

According to the directive, any employer contemplating collective redundancies must consult with workers' representatives, with a view to reaching an agreement. These consultations must at least cover ways and means of avoiding redundancies or reducing the number of workers affected and mitigating the consequences, in particular by recourse to accompanying social measures aimed at redeploying or retraining workers who are made redundant.

The directive does not apply to collective redundancies effected under contracts of employment concluded for limited periods of time or for specific tasks; to workers employed by public administrative bodies or by establishments governed by public law; and to the crews of sea-going vessels.

The directive provides that Member States may make provision for workers' representatives to call upon expert assistance in accordance with measures in force at national level. The employer is to provide workers' representatives with all relevant information and, in any event, is to provide the following information in writing:

- the reasons for their decision;
- the period during which redundancies are to be effected;
- the number and category of workers normally employed;
- the number to be made redundant;
- the criteria used to select those workers to be made redundant;
- the method used to calculate compensation.

The procedure for collective redundancies consists of three stages:

1. The employer **notifies the competent public authority** in writing of projected collective redundancies. This notification must contain all the relevant information concerning the projected redundancies and consultations held, except for the method used to calculate compensation. However, where the cessation of activity is the result of a court judgment, notification is necessary only at the express request of the authority.
2. The employer forwards a **copy of the notification to the workers' representatives**, who may send comments to the competent public authority.

²⁴ Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies. This Directive is a codified version of Directives 75/129/EEC and 92/56/EEC, which have been repealed.

3. Collective redundancies **take effect** at the earliest 30 days after the notification; the competent public authority uses this period to seek solutions.²⁵

Member States may apply or introduce provisions which are more favourable to workers.

3.3. Directive 80/987/EEC – Employer’s insolvency²⁶

The objective of this directive is to guarantee payment of outstanding claims to employees in the event of their employer’s insolvency. The Directive applies to employees’ claims arising from contracts of employment or work relations and existing against employers who are in a state of insolvency within the meaning of the Directive.²⁷ Member States may, by way of exception, exclude claims by certain categories of employee.

Guarantee institutions shall guarantee payment of employees’ outstanding claims relating to pay for the period prior to the onset of the employer’s insolvency, the date of the notice of dismissal or the date on which the contract of employment was discontinued on account of the employer’s insolvency. Member States have the option of limiting the liability of these institutions under specified conditions. Member States shall also take the measures necessary to ensure that non-payment of compulsory contributions due from the employer, before the onset of his insolvency, to their insurance institutions does not adversely affect employees’ benefit entitlements in respect of these insurance institutions in as much as the employees’ contributions were deducted at source. The interests of employees and persons having already left the undertaking at the date of the onset of the employer’s insolvency are protected as regards rights conferring on them immediate or prospective entitlement to old-age benefits, including survivors’ benefits, under supplementary company or inter-company pension schemes outside the national statutory social security schemes.

Member States may apply or introduce measures which are more favourable to employees. They have the option of taking measures necessary to avoid abuses or to refuse or reduce the liability or the guarantee obligation if it appears that fulfilment of the obligation is unjustifiable because of the existence of special links between the employee and the employer.

In 2000 the Commission adopted the Communication concerning the Directive on employee protection in the event of employer insolvency (80/987/EEC). The Commission re-examined the directive in order to decide whether it needed to be amended. One of the difficulties the group of experts identified included cases of transnational insolvency: in the event of a transnational insolvency, the group of experts raised the question of how it would be decided which guarantee institution would be responsible for paying claims. The group agreed that these problems must be addressed at Community level.

²⁵ Member States may grant the public authority the power to reduce this period or to extend it to 60 days following notification in cases in which the problems cannot be solved. This is not compulsory for collective redundancies following a cessation of activity resulting from a court judgment. Wider powers of extension may be granted. The employer must be informed of any extension and the grounds for it before expiry of the initial period.

²⁶ Council Directive 80/987/EEC of 20 October 1980 on the approximation of the laws of the Member States relating to the protection of employees in the event of their employer’s insolvency.

²⁷ It does not prejudice national law as regards the definition of the terms ‘employee’, ‘employer’, ‘pay’, ‘right conferring immediate entitlement’ and ‘right conferring prospective entitlement’.

3.4. Directive 2001/23/EC – Safeguarding employees’ rights in the event of transfers of undertakings

In 1977 the **Transfer of undertakings directive, 77/187/EEC**²⁸ was adopted by the Council. According to the preamble, the differences in employee protection among the Member States can have a direct effect on the functioning of the Single Market. The purpose of the Directive is (Article 1) to protect employees’ rights in case of a ‘*transfer of an undertaking, business or part of a business to another employer as a result of a legal transfer or merger*’. The basic idea behind the Directive is, according to the ECJ, to ensure that restructuring of undertakings within the common market does not adversely affect the workers in the undertakings concerned.²⁹ The Directive gave rise to a long series of different problems of interpretation and a large number of cases were referred to the European Court of Justice.³⁰ In 1997 the Commission published a **Memorandum on acquired rights of workers in cases of transfers of undertakings**, intended to serve as guidance on the application of Community law. With Directive 98/50/EC³¹ amending the original Transfer of undertakings directive, the Council mainly codified the abundant case law of the Court. These Directives were in turn repealed in October 2001 through the revised **Transfer of undertakings directive 2001/23/EC**,³² which was adopted ‘*[i]n the interests of clarity and rationality*’ but did not materially change the Directive or the scope of the original Transfer of undertakings directive which had been interpreted through ECJ case law.

The Directive is applicable when the undertaking to be transferred is situated within the ‘territorial scope of the Treaty’. Another prerequisite for the applicability of the Directive is that there is a transfer of employer. The ECJ stated in *Allen v. Amalgamated Construction*³³ that there can be a Directive-relevant transfer when there is:

a change in the natural or legal person responsible for carrying out the business, who by virtue of this acquires the obligations of an employer vis-à-vis employees of the undertaking, regardless of whether or not ownership is transferred. For instance, if a person acquires the stock of a company but the employer remains the same, the Directive does not become applicable.

The basic purpose of the Transfer of undertakings directive is to achieve partial harmonisation of the Member States’ legislation by extending the protection of workers to cover the case of transfer of undertakings. The aim of the Directive is to ensure, as far as possible, that the employment relation continues unchanged with the transferee and that

²⁸ Council Directive 77/187/EEC of 14 February 1977 on the approximation of the laws of the Member States relating to the safeguarding of employees’ rights in the event of transfers of undertakings, businesses or parts of businesses.

²⁹ Case 135/83 The Administrative Board of the Bedrijfsvereniging voor de Metaalindustrie en de Electro-technische Industrie.

³⁰ See O. Lundin, ‘Transfer of undertakings’, Master’s thesis, University of Stockholm, http://www.juridicum.su.se/jurweb/utbildning/master/ec_commercial_law/assignments/Olle%20Lundin.pdf

³¹ Council Directive 98/50/EC of 29 June 1998 amending Directive 77/187/EEC on the approximation of the laws of the Member States relating to the safeguarding of employees’ rights in the event of transfers of undertakings, businesses or parts of businesses.

³² Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees’ rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

³³ Case C-234/98, *Allen v. Amalgamated Construction*, para. 16.

the workers are not placed in a less favourable position solely as a result of the transfer. The aim is not, however, to establish a uniform level of protection throughout the Community on the basis of common criteria, thus prohibiting Member States from introducing more employee-favourable provisions than those of the Directive. As a result, the protection of employees' rights in these situations may differ amongst the Member States. However, the ECJ has delivered many decisions related to the interpretation of the Directive whereby the substantive provisions have often been given an extensive and flexible interpretation.

3.5. Directive 94/45/EC on European works councils³⁴

3.5.1. Objectives and principles of the Directive

The objective of the directive was to improve employees' rights to information and consultation in Community-scale undertakings and Community-scale groups of undertakings.

The directive lays down the establishment of a European works council or a procedure for informing and consulting employees in every **Community-scale undertaking**³⁵ and every **Community-scale group of undertakings**,³⁶ following agreement between the central management and a special negotiating body.

The **central management** is responsible for creating the conditions and means necessary for the setting up of a European works council or an information and consultation procedure and may start negotiations on its own initiative or at the written request of at least 100 employees or their representatives in at least two undertakings in at least two Member States.

The **special negotiating body** (SNB), comprising a minimum of three and a maximum of 18 members, has the task of determining, with the central management, by written agreement, the scope, composition, competence and term of office of the European works council(s) or the arrangements for implementing a procedure for the information and consultation of employees. The SNB may decide, by at least two-thirds of the votes, not to open negotiations or to terminate the negotiations already opened; such a decision would stop the procedure to conclude the agreement and would nullify the provisions of the Annex. Members of the special negotiating body and of the European works council, and any experts who assist them, may not reveal any information which has expressly been provided to them in confidence.

³⁴ Council Directive 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees.

³⁵ 'Community-scale undertaking' means any undertaking with at least 1,000 employees in Member States and at least 150 employees in each of at least two Member States.

³⁶ 'Community-scale group of undertakings' means a group of undertakings with the following characteristics:

- at least 1,000 employees in Member States,
- at least two group undertakings in different Member States, and
- at least one group undertaking with at least 150 employees in each of at least two Member States.

Community-scale undertakings and Community-scale groups of undertakings in which there is already an agreement, covering the entire workforce, providing for the transnational information and consultation of employees, are not subject to the obligations arising from the Directives. When these agreements expire, the parties involved may decide jointly to renew them. Where this is not the case, the provisions of the Directives apply.

Subsidiary requirements laid down by the legislation of the Member State in which the central management is situated will apply:

- where the central management and the special negotiating body so decide, or;
- where the central management refuses to commence negotiations within six months of the initial request to convene the special negotiating body, or;
- where, after three years from the date of this request, they are unable to conclude an agreement to establish a European works council or an information and consultation procedure, and the special negotiating body has not taken a decision not to open negotiations or to terminate the negotiations.

These **subsidiary requirements** must satisfy the provisions set out in the Annex, whereby the competence of the European works council is limited to information and consultation on matters which concern the Community-scale undertaking as a whole or at least two establishments or group undertakings situated in different Member States. The European works council is to have a minimum of three and a maximum of 30 members and, where its size so warrants, is to elect a select committee from among its members, comprising at most three members. Four years after the European works council is established, it must consider whether to open negotiations for the conclusion of the agreement on the arrangements for implementing the information and consultation of employees, or to continue to apply the subsidiary requirements adopted in accordance with the Annex. The European works council has the right to meet with the central management once a year in order to be informed and consulted, on the basis of a report drawn up by the central management, on the progress of the business of the Community-scale undertaking or Community-scale group of undertakings and its prospects. Where there are exceptional circumstances affecting the employees' interests to a considerable extent, particularly in the event of relocation, closure or collective redundancy, the select committee or, where no such committee exists, the European works council has the right to be informed and the members of the European works council are to inform the employees' representatives of the content and outcome of the information and consultation procedure.

The operating expenses of the European works council are to be borne by the central management; in compliance with this principle, the Member States may lay down budgetary rules regarding the operation of European works councils.

3.5.2. ECJ case-law on European works councils

The ECJ has so far dealt with three cases concerning the interpretation of the EWC Directive. All three cases originated in Germany and concerned different aspects of the Directive's obligation on employers to respond to requests by employee representatives for information about the number and distribution of employees and corporate structure in

order to prepare for the possible establishment of an EWC.³⁷ This series of ECJ judgments has sought to clarify the rules on transparency in the initial dealings between employee representatives and company management prior to any employee request for negotiations about establishing an EWC, and will serve to limit the scope for companies to refuse to disclose information in an attempt to avoid or delay negotiations.

Bofrost case, C-62/99

In March 2001, the European Court of Justice delivered its judgment in the first case concerning the EWC Directive: *Betriebsrat der bofrost* Josef H. Boquoi Deutschland West GmbH & Co. KG v bofrost* Josef H. Boquoi Deutschland West GmbH & Co. KG*. The ruling in the bofrost* case highlights the responsibility of undertakings which are part of a group to meet employee requests for information about the number and distribution of employees and the structure of the group, including the disclosure of documents if necessary, so that the employees can determine whether they have the right to seek negotiations about a possible EWC.

The bofrost* group's undertakings in Europe adopted an agreement intended to establish parity between them so that none should have a dominant influence over the others. The agreement entrusted the management of the group in Europe to a steering committee. It also established a shareholders' advisory council, whose agreement is necessary for the adoption of certain business-related decisions. A year later the works council applied to the local labour court for an order that the information should be supplied. The company contended that none of the undertakings within the group exercised legal or actual control of the bofrost* group, so it was not covered by the EWC legislation.

The ECJ stated in its judgement that on a proper construction of Article 11(1) and (2) of the EWC directive an undertaking which is part of a group of undertakings is required to supply information to internal workers' representative bodies, even where it has not yet been established that the management to which the workers' request is addressed is the management of a controlling undertaking within a group of undertakings. In addition, the ECJ emphasised that where information relating to the structure or organisation of a group of undertakings forms part of the information which is essential to the opening of negotiations for the setting-up of a European works council or for the transnational information and consultation of employees, an undertaking within the group is required to supply the information which it possesses or is able to obtain to the internal workers' representative bodies requesting it. Communication of documents clarifying and explaining the information which is indispensable for that purpose may also be required, in so far as that communication is necessary in order that the employees concerned or their representatives may gain access to information enabling them to determine whether or not they are entitled to request the opening of negotiations.³⁸

³⁷ M. Hall, 'European Court of Justice issues decision in EWCs case', <http://www.eiro.eurofound.eu.int/about/2004/09/feature/eu0409203f.html>

³⁸ See M. Hall, 'ECJ rules on employees' information rights prior to seeking establishment of an EWC', <http://www.eiro.eurofound.eu.int/about/2001/06/feature/eu0106218f.html>

Kühne & Nagel case, C-440/00

In January 2004, the European Court of Justice (ECJ) ruled in favour of a German works council in the case *Gesamtbetriebsrat der Kühne & Nagel AG & Co. KG v Kühne & Nagel AG & Co. KG*.

As a first step towards the establishment of an EWC, the German company works council had asked Kühne & Nagel in Germany to provide it with specific information about the average number of employees and their distribution across the Member States, undertakings and establishments, and about the structure of the company and the group of companies, as well as the names and addresses of the Kühne & Nagel group employee representatives within those Member States. While Kühne & Nagel did not dispute that it was under an obligation to provide the information, it stated that it was not able to fulfil its obligation because central management, located in Switzerland, was not subject to Community law and refused to supply it with the information. The German company works council took the case to the national courts, and several questions were eventually referred to the ECJ.

The ECJ found that the German works council had a right to be supplied with the necessary information to open negotiations, as prescribed in the EU directive on EWCs, even if the parent company of the undertakings concerned was not located in a Member State. In addition, the ECJ stated that where central management does not make certain information available to the management of the group establishment or undertaking which employs the largest number of employees in any single Member State – the so-called ‘deemed central management’ – so that the latter can fulfil its obligation to provide information to the employees’ representatives, it must request the information essential to the opening of negotiations for the establishment of a European works council from the other undertakings belonging to the group which are located in the Member States, and has a right to receive that information from them. The management of each of the other undertakings belonging to the group, which are located in the Member States, is under an obligation to supply the deemed central management with the information concerned where it is in possession of the information or is in a position to obtain it. The obligation to provide information deriving from Articles 4(1) and 11(1) of the Directive encompasses information on the average total number of employees and their distribution across the Member States, the establishments of the undertaking and the group undertakings, and on the structure of the undertaking and of the undertakings in the group, as well as the names and addresses of the employee representation which might participate in the setting up of a special negotiating body in accordance with Article 5 of the Directive or in the establishment of a European works council, where that information is essential to the opening of negotiations for the establishment of such a council.³⁹

ADS Anker case, C-349/01

On 15 July 2004, the European Court of Justice (ECJ) delivered its judgment in the case of *Betriebsrat der Firma ADS Anker GmbH v ADS Anker GmbH* (case C-349/01). At issue was the extent and practical implications of the Directive’s obligation imposed on management within transnational groups of undertakings to provide information on corporate structure, employee numbers and representation arrangements across the group,

³⁹ H. Dribbusch, ‘ECJ rules on German EWCs case’, <http://www.eiro.eurofound.eu.int/about/2004/04/inbrief/de0404202n.html>

where requested by employee representatives prior to seeking negotiations about establishing an EWC.

The works council at ADS Anker in Germany requested local management to provide it with information on employee numbers and corporate structure, and the names of the employee representatives in other group undertakings, with a view to seeking the establishment of an EWC. ADS Anker replied that it was not able to respond because both its parent company, Anker BV, and the parent company of the group, Anker Systems GmbH, refused to provide the information requested.

The ECJ delivered a judgement stating that Article 4(1) and Article 11 of the EWC directive must be interpreted as meaning that Member States are required to impose on undertakings established within their territory and constituting the central management of a Community-scale group of undertakings or the deemed central management (see previous section for definition) the obligation to supply to another undertaking in the same group established in another Member State the information requested from it by its employees' representatives, where that information is not in the possession of that other undertaking and it is essential for opening negotiations for the setting up of a European works council. However, it is for the national courts to ascertain, on the basis of all the evidence before them, whether the information requested is essential for opening the negotiations referred to in Article 5(1) of the Directive.

3.5.3. Reform of the EWC Directive

On 4 April 2000 the Commission adopted the **Report on the application of the Directive on the establishment of a European works council**.⁴⁰ The report deals only with the transposition status of Directive 94/45/EC. It emphasises the major effort made by most countries to meet the transposition deadline. Although it is still too soon for it to be possible to summarise the practical application of the Directive in depth, the report makes a number of non-exhaustive comments on this subject. Among other things it points out that, despite the number of agreements concluded, some of them seem to guarantee only a very low level of transnational consultation and information. Under operating rules, the report discusses the material and financial resources of SNBs and of European works councils (EWC) and it points out that the number of hours' paid absence granted to EWC representatives to perform their duties varies tremendously between Member States.

Four years later, in April 2004, the Commission published a document on '**European works councils: fully realising their potential for employee involvement for the benefit of enterprises and their employees**'.⁴¹ The European Commission has decided to consult the social partners on how European works councils can best respond to the challenges of a changing economic and social environment. In the document the Commission concludes that European works councils have proved instrumental in bringing management and employees together at the transnational level, where key decisions on the development of large enterprises are taken. Some 650 companies or groups have EWC agreements covering an estimated 11 million employees, with 10 000 employees' representatives directly involved. EWCs have been highly successful in providing access to information and consultation for employees in decision-making

⁴⁰ COM(2000) 188 final – not published in the Official Journal.

⁴¹ Accessible at: http://europa.eu.int/comm/employment_social/social_dialogue/docs/ewc_I_en.pdf

processes and obtaining their feedback on company development, especially in relation to managing change. However, the changed landscape since the Commission last reported on the Directive in 2000 and certain weaknesses identified in how EWCs operate mean that a new look is needed at how EWCs can fully develop. The Commission launched the consultation, in which the social partners have been asked their opinion on how to ensure that EWCs can realise their full potential, the possible direction of EU action and, most importantly, what role the social partners themselves can play in this process. Since the Directive was adopted, a number of changes have taken place. These include the setting out of the EU's Lisbon goals in 2000, economic changes such as the prevalence of large-scale corporate restructuring, the introduction of new Community legislation on employee involvement and development and dynamism within the EWCs themselves. EU enlargement will also have a major effect on EWCs since it will increase the number of companies affected by the Directive and the EWCs of companies which operate subsidiaries in new Member States will need to be expanded.

The European Trade Union Confederation has published a response document.⁴² The ETUC has carried out a consultation of all its member organisations. It agrees that European works councils have become important instruments of the European Union's social pillar and shares the Commission's view that they have clearly demonstrated their value. The ETUC has expressed its gratitude for the fact that the Commission's document acknowledged the important role played by European-level trade unions, especially the European sectoral federations, in this success. The ETUC also acknowledged the Commission's important role in supporting these efforts, particularly through the budget line promoting transnational cooperation between employee and employer representatives on employee involvement issues. However, some of the weaknesses that have been identified in the Directive must also be addressed. The ETUC agreed that 'the greatest challenge facing transnational enterprises and their employees over the last two to three years has been the issue of large-scale corporate restructuring' and it is 'in such situations that employees feel most at risk and most in need of the security provided by being genuinely involved in the process'. Unfortunately, the ETUC agreed that in some situations 'this has clearly, and sometimes dramatically, not been the case'. For this reason it finds it to be imperative that improvements to the Directive are made so as to better ensure that information and consultation take place in a serious and timely manner in all European works councils.

The ETUC shares the view that it is especially important that the improved definitions of 'information and consultation' in these more recent legislative instruments be reflected in a revised directive. The current EWC directive does not clearly define either the content or the means of exercising information and consultation rights. Community legislation is thus inconsistent since it defines information and consultation rights in different ways in several separate Directives. The ETUC finds that it is vital that information and consultation should be provided by companies in good time, in other words before any decisions are taken. Moreover, their content should provide workforce representatives with everything they need to proceed with an accurate assessment of the information received. By the same token, EWCs must have the right to a consultation procedure that enables them to draw up their own proposals in time for them, potentially, to be taken on board before the end of the decision-making process. Equally, with regard to the role of

⁴² See http://www.seeurope-network.org/homepages/seeurope/file_uploads/etucresponse0405.pdf

trade unions in EWCs, a revised directive must ensure the right to trade union coordination and support for workforce representatives, both in EWC negotiations and in their general duties. The participation of a member or representative of the sectoral federations in both Special Negotiating Bodies and EWCs must therefore be guaranteed in the legislation. Naturally, this demand is no substitute for either the presence of or services provided by experts. It is also absolutely essential to have a more closely specified procedure for renegotiating agreements. The current procedure set out in the Directive is unclear. This is particularly the case when EWCs are involved in restructuring or merger processes. It is vitally important that EWCs are fully able to carry out their important role while restructuring is taking place until any legitimate replacement is up and running.

The annex to the Resolution lists 26 points which in the ETUC's view would improve the functioning of the Directive, making it more effective in realising the goals set out in its preamble. Particular attention should be drawn to the importance of bringing in training provisions, shortening the period for negotiations, introducing effective sanctions, preventing abuses of confidentiality, improving recourse to experts, guaranteeing access to sites and introducing the right to preparatory and follow-up meetings.

3.6. Directive 2002/14 – general framework for informing and consulting employees⁴³

The objective of Directive 2002/14 is to establish a general framework for informing and consulting employees in the European Community in order to fill the gaps and counter the shortcomings in the provisions in force at national and Community levels.

In its **Communication on worker information and consultation**,⁴⁴ the Commission took stock of Community action in the field of information, consultation and participation of employees. Despite the existence of specific provisions on employee information and consultation, the Commission emphasised the need to redefine the Community legal framework in order to establish more binding rules. In its Communication, the Commission set out various options for the approach to be taken by Community action and encouraged the social partners to identify the arrangements for a general framework. Following this Communication the Commission presented a proposal for a Directive, the objective of which is to establish a general framework for employee information and consultation in undertakings located in the European Community.

Particular provisions applicable to undertakings which pursue directly and essentially political, professional organisational, religious, charitable, educational, scientific or artistic aims, as well as aims involving information and the expression of opinions, may be adopted on condition that, at the date of adoption of the Directive, such particular provisions already exist in national legislation. Member States may authorise the social partners to define freely, through agreement, the procedures for implementing the employee information and consultation requirements referred to in the Directive.

Employee information and consultation covers three areas in relation to undertakings:

⁴³ Directive 2002/14/EC of the Council and the European Parliament of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community [Official Journal L 80, 23.03.2002].

⁴⁴ COM(95) 547 final – not published in Official Journal.

1. economic, financial and strategic developments;
2. structure and foreseeable development of employment and related measures;
3. decisions likely to lead to substantial changes in work organisation or contractual relations.

Member States have the option of limiting the information and consultation obligations of undertakings with fewer than 50 or 20 employees, at the Member State's discretion.

Employees' representatives must enjoy adequate protection and guarantees to enable them to perform their duties.

The directive regards as **serious breaches** of the Member States' obligations:

1. a total absence of information and/or consultation of the employees' representatives prior to a decision being taken or the public announcement of such a decision;
2. withholding of important information or provision of inaccurate information rendering ineffective the exercise of the right to information and consultation.

In the event of a serious breach with direct and immediate consequences in terms of substantial change or termination of employment contracts or relationships, the decisions taken have **no legal effect**. This situation continues until such time as the employer has fulfilled his information and consultation obligations. If this is no longer possible, the employer must establish adequate redress in accordance with the arrangements and procedures in place in the Member States.

The provisions of the Directive do not prejudice Council Directive 94/45/EC on the establishment of a European works council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purpose of informing and consulting employees.

* * *

The increased role of social dialogue in companies doing business in the European Union requires that employee representatives involved in decision-making in these companies, especially those participating at board-level, be familiar with at least the basic principles and rules of European company law.

The latter has evolved not only through the process of establishing supranational legal entities, described in the previous section, but mostly through the harmonisation of company law principles of Member States, which brings legal certainty and guarantees for shareholders, creditors and employees in transnational business.

3.7. Aspects of European company law and employee involvement rights in the new EU Member States

The latest enlargement of the European Union has given a new dimension to the already existing diversity as regards employee involvement rights. In this area, however, it is not particularly helpful to draw a line between the employee involvement provisions in existing and in new Member States. On both sides, some systems have strong employees' rights and others have very weak rights. The relevant distinction lies in the fact that while it is fairly well known what the law on employee involvement is in the old Member States,

this cannot be said for the new Member States. In this regard, the ETUI is playing an active role in bringing the relevant information from ‘the East’ to the European authorities competent for building social dialogue throughout Europe.

What employee involvement rights in the new Member States have in common is that they started to develop as late as the early 1990s. However, the ways in which this process took place are extremely diverse. In this regard, Estonia, Latvia and Lithuania have the lowest obligatory level of employees’ rights, and the legal basis for the involvement of worker representatives in decision-making is only gradually being adopted. In other states involvement rights are, at least on paper, better regulated and in addition to information rights some form of board-level representation can be observed. Hence, in the Czech Republic, Hungary, Slovenia and Slovakia board-level representation is legally possible in both public and private companies, with a range of application criteria, mostly number of employees and company size. On the other hand, Malta and Cyprus guarantee board-level representation of employees in public sector companies only. Finally, in Poland employee involvement rights are mostly influenced by privatisation, whereby board-level representation is provided for employees in public sector companies and in privatised companies, while no general board-level representation right exists in genuinely private companies.

The accession of these ten states to the European Union in May 2004 gave this development new significance. The European legislation in the field of employee participation and social dialogue, which forms part of *acquis communautaire*, influences national employee involvement rights both in internal contents and international aspects. By accession, the EWC directive and some other directives on employee’s involvement rights had to have been implemented in all new Member States. There are further legislative acts to be adopted which will affect national legislation on employee involvement.

In addition to the employee involvement legislation, the new Member States have also been developing their company law in order to be compatible with new market circumstances. In this regard new company forms have been made available in respect of which it was necessary to ensure proper guarantees for shareholders and creditors. The social dimension of the European Union, however, put them under pressure to ensure appropriate employees’ rights.

4. Harmonisation of European company law

4.1. First company law directive – disclosure and the validity of obligations entered into by, and the nullity of, companies with limited liability⁴⁵

The objective of this Directive is to coordinate the regulations concerning:

- disclosure,
- the power of representation of company organs;
- the nullity of companies with limited liability.

The directive established the **principle of compulsory disclosure**. This concerns information of a legal nature, notably the instrument of constitution, the statutes if contained in a separate instrument, the amount of the subscribed capital, the balance sheet and the profit and loss account for each financial year, any transfer of the seat of the company, any declaration of nullity of the company by the courts, and any instrument or decision concerning the duration, winding-up or liquidation of the company.

Compulsory disclosure also extends to the appointment, termination of office and particulars of the persons who, either as a body constituted by law or as members of any such body, are authorised to represent the company in dealings with third parties and in legal proceedings. The same applies to persons who take part in the administration, supervision or control of the company. It must be clear from the disclosure whether the persons authorised to represent the company may do so alone or must act jointly.

The means of disclosure are threefold:

1. the opening of a file on every company in an official register;
2. publication in a national official gazette;
3. an indication, on all business documents, of the legal form and registered place of business of the company and the register in which the file on the company is kept, together with the number of the company in that register.

In the event of non-disclosure, the particulars omitted may not be relied on against third parties. This rule is qualified in two cases. First, if the company proves that the third parties had knowledge of the omitted particulars, the particulars may be relied on against them. Conversely, if third parties prove that it was impossible for them to have had knowledge of the published particulars during the first 15 days following publication, the particulars may not be relied on against them.

As a general rule **acts done by the organs or officers of a company** (its directors, and so on) may be relied upon by third parties. There are exceptions. Such acts are not binding if they exceed the powers which the law allows to be conferred on the organs. An act outside

⁴⁵ First Council Directive 68/151/EEC of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, Official Journal L 65, 14.03.1968. Amended by Council Decision 73/101/EEC of 1 January 1973, Official Journal L 2, 01.01.1973; European Parliament and Council Directive 2003/58/EC of 15 July 2003, Official Journal L 221, 04.09.2003.

the objects of the company may be relied on by a third party unless the relevant national law allows the company to prove that the third party in the case knew it was outside the objects of the company or could not have been unaware of that fact.

The Directive contains a set of **rules on nullity**. Nullity may not be automatic, a court judgment being required. An exhaustive list is given of the circumstances in which nullity may be ordered (for example, no instrument of constitution was executed or the requisite legal formalities were not complied with, the objects of the company are unlawful or contrary to public policy, or the rules concerning the minimum amount of capital to be paid up were not complied with).

Directive 2003/58/EC, which amended the first company law directive in the light of the so-called SLIM initiative of simplifications, facilitates and streamlines access by the public to company information and simplifies the disclosure formalities imposed on companies. It thus enables the benefits of modern technology to be exploited to the full since companies may now file the compulsory documents and particulars by paper means as well as by electronic means. Interested parties may also obtain a copy by either means. In addition, companies will continue to publish their documents and particulars in the language or in one of the languages of their Member State but will also be able to publish them voluntarily in other languages of the European Union in order to improve cross-border access to company information.

4.2. Second company law directive – The formation of public limited liability companies and the maintenance and alteration of their capital⁴⁶

The Second company law directive dates from 1976. It coordinates national provisions on the formation of public limited liability companies, minimum share capital requirements, distributions to shareholders and increases and reductions in capital. The Directive lays down the conditions needed to ensure that the capital of the company is maintained in the interest of creditors. Furthermore, it protects minority shareholders and states the principle that all shareholders who are in the same position should be treated equally.

It sets out information which must appear in the statutes or the instrument of incorporation of the company (type and name of the company, objects, and so on). The directive also lists certain other information which must be made public (registered office, types of shares, subscribed capital, and so on).

As regards company formation the directive determines the amount and composition of the minimum subscribed capital, rules governing the issue and the price paid for shares and the form of consideration acceptable. No distributions to shareholders may be made when on the closing date of the last financial year the net assets are lower than the amount of the subscribed capital and reserves. There is an exemption for investment companies with fixed capital. There is a definition of a serious loss of the subscribed capital, in which

⁴⁶ Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent. Amended by Council Regulation (EEC) No. 3308/80 of 16 December 1980 and Council Directive 92/101/EEC of 23 November 1992.

event a general meeting must be called. The directive also states principle and exemptions on subscription by a company of its own shares, and on loans made and security provided by a company, as well as increases and reductions in capital.

In **October 2004** the European Commission presented a **proposal** which would amend parts of the 1976 Second company law directive. The aim of the proposal is to make it easier for public limited liability companies to take certain measures affecting the size, structure and ownership of their capital. The new proposal would enable Member States, under certain conditions, to eliminate specific financial reporting requirements and to facilitate specific changes in share ownership. It would also bring into line across the EU the basic elements of legal procedures for creditors when capital is reduced.

The changes would include:

- limiting the need for an expert valuation of contributions in kind when a company establishes itself or increases capital;
- relaxing current rules on the limitation or withdrawal of pre-emption rights, to make the procedure of issuing new shares less burdensome, while maintaining shareholders' protection from dilution of their shareholdings;
- partially relaxing the prohibition on companies providing financial assistance for acquisition of their shares by third parties;
- introducing 'squeeze out' and 'sell out' rights (that is, the right of the majority shareholder, under certain conditions, to buy out minority shareholders at a fair price and the complementary right of minority shareholders to compel the majority shareholder to buy their shares);
- introducing a right for the company to acquire its own shares up to the limits of distributable reserves.

These modifications should enable companies to react more promptly and efficiently to market developments. Strong provision for protecting shareholders' interests is made in the proposed amendments.

4.3. Third company law directive – Domestic mergers of public limited liability companies⁴⁷

The directive lays down rules concerning mergers between public limited liability companies from the same Member State.

The Directive applies to public limited companies. Any Member State may choose not to apply it to cooperatives in company form or where the merger would result in the disappearance of a company which is the subject of insolvency proceedings.

To fall within the scope of the Directive a merger must result in:

- the full absorption of one or more companies by another, or
- the formation of a new company.

⁴⁷ Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies.

Whether the merger is by acquisition or by the formation of a new company, the process consists of **three stages**:

Stage one: the drawing-up of draft terms of merger, an instrument negotiated by the administrative or management bodies of the merging companies. The draft terms of merger must contain a required minimum of particulars, including the share exchange ratio and the new rights of shareholders. The draft must be published in the manner prescribed by the law of each Member State.

Stage two: a discussion, within each of the companies, by a general meeting of shareholders, ending in a vote on the merger decision. Once it has been taken, the merger decision must also be published.

Stage three: the actual merger. This involves the transfer, both as between the companies and as regards third parties, of all the assets and liabilities of the company being acquired to the acquiring company or of the merging companies to the new company.

Rules governing the nullity of mergers are laid down in order to protect members and third parties. The cases of nullity are limited to formal illegalities (for example, lack of judicial or administrative preventive supervision of legality, irregularity vitiating the decision of the general meeting). A series of restrictions are placed on the ordering and enforcement of nullity.

A number of specific provisions are laid down with a view to protecting the interests of members and creditors of the companies, whereas the protection of employees' rights in the event of transfers of undertakings, businesses or parts of businesses is referred to Directive 77/187/EEC on transfer of undertakings (see below).

4.4. Sixth company law directive – Division of public limited liability companies⁴⁸

The directive lays down rules concerning divisions of public limited liability companies from the same Member State and is usually referred to together with the third company law directive.

The Directive governs:

- **Division by acquisition:** this is an operation whereby, after being wound up, but without going into liquidation, a company transfers all its assets and liabilities to more than one company. The shareholders of the company being divided are allocated shares in the companies receiving contributions as a result of the division ('recipient companies').
- **Division by the formation of new companies:** this is an operation whereby, after being wound up, but without going into liquidation, a company transfers all its assets and liabilities to more than one newly formed company. The shareholders of the company being divided are allocated shares in the recipient companies.
- **Division under the supervision of a judicial authority:** this is a division operation subject to the supervision of a judicial authority having the power to call a general meeting of shareholders of the company being divided in order to decide upon the

⁴⁸ Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54(3)(g) of the Treaty, concerning the division of public limited liability companies.

division, or indeed to call any meeting of creditors of each of the companies involved, in order to decide upon the division. Where the judicial authority establishes that no prejudice would be caused to shareholders or creditors, it may relieve the companies involved in the division from applying certain rules applicable to divisions by acquisition and divisions by the formation of new companies.

As far as divisions by acquisition and divisions by the formation of new companies are concerned, draft terms of division, an instrument negotiated by the administrative or management bodies of the companies involved in a division, must be drawn up. The draft must contain a minimum of particulars, including the share exchange ratio and the rights conferred by the recipient companies on the holders of shares to which special rights are attached and the holders of securities other than shares. It must be published in the manner prescribed by the law of each Member State. A division requires at least the approval of a general meeting of each company involved in the division. The administrative or management bodies of a company being divided must supply certain information to the general meeting of that company and to the administrative or management bodies of the recipient companies. Strict safeguards ensure the protection of shareholders and, in particular, creditors. As regards the latter, the main safeguard consists in the joint and several liability of the recipient companies where one of them does not discharge an obligation transferred to it under the division. The Member States may provide that the recipient companies will be jointly and severally liable for the obligations of the company being divided.

4.5. Eleventh company law directive – Disclosure requirements in respect of branches⁴⁹

The eleventh directive lays down rules concerning the disclosure requirements imposed in a Member State in respect of branches of companies governed by the law of another state in order to provide an equivalent level of protection for shareholders and third parties.

The Directive applies to branches of public and private companies situated in a Member State other than that in which the company is established. Branches of companies from another Member State must publish documents which include the following information:

- the address of the branch;
- the activities of the branch;
- the company's place of registration and registration number;
- particulars of the company directors.

EC branches of public and private companies established in a non-EC country but having a legal form comparable to that of Community companies must publish documents which include the information required of branches of EC companies, together with the following particulars:

- the law of the state by which the company is governed;
- the company's memorandum and articles of association;
- the legal form of the company.

⁴⁹ 11th Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another state.

The branch must publish the annual accounts and annual report of the company. These accounting documents must have been drawn up either under Community legislation, or in such a way as to be at least equivalent to those so drawn up. They must also have been audited in conformity with the law which governs the company. In the event of non-conformity or non-equivalence, Member States may require that accounting documents relating to the branch's activities be drawn up and published.

4.6. Twelfth company law directive – Single-member private limited liability companies⁵⁰

The directive creates a legal instrument allowing the limitation of liability of the individual entrepreneur throughout the Community. The coordination measures prescribed by the Directive apply to Member States' provisions concerning **private limited companies**. Where Member States allow single-member companies in the case of **public limited companies** as well, the Directive applies, too.

A company may have a single member by virtue of **its being formed**, or by virtue of all its **shares coming to be held, by a single person** (single-member company).

Where a company becomes a single-member company because all its shares have come to be held by a single person, that fact, together with the identity of the single member, must either be entered in a register kept by the company and accessible to the public or be recorded in the file or entered in the register within the meaning of the first company law directive.

The single member exercises the powers of a general meeting of the company. **Decisions taken by the single member and contracts between him and his company as represented by him must be recorded in minutes or drawn up in writing.**

⁵⁰ 12th Council Directive 89/667/EEC of 21 December 1989 on single-member private limited liability companies.

5. EU corporate accounting

Following major scandals on both sides of the Atlantic which caused significant harm to shareholders, creditors and employees, corporate accounting became one of the most important areas of corporate law. European Community has to date adopted three directives, which are under process of modernisation. It is also significant that the Regulation adopting international standards of financial participation has been adopted.

5.1. Fourth company law directive – Annual accounts of companies with limited liability⁵¹

This Directive coordinates Member States' provisions concerning the presentation and contents of annual accounts and annual reports, the valuation methods used and their publication in respect of all companies with limited liability.

The annual accounts are to comprise:

- **A balance sheet:** the Directives provide for two balance sheet layouts, leaving it to the Member States to choose. It then lists the balance sheet items and comments on them.
- **A profit and loss account:** two layouts are proposed, from which Member States are free to choose. The Directives provide a commentary on certain items here too.
- **The notes on the accounts** should include the valuation methods applied to the various items, undertakings in which the company holds a certain percentage of the capital, the company's debts, financial commitments not included in the balance sheet, and so on.

The Directive states **general principles for the valuation of items** in the annual accounts, such as prudence, consistency in the application of the methods of valuation, and so on. It also supplies specific valuation rules. The annual report must include a fair review of the development of the company's business and of its position. It must also provide information on any important events that have occurred since the end of the financial year, the company's likely future development and activities in the field of research and development. The Directive lays down certain rules on publication and provides for a system of auditing under which companies must have their annual accounts audited by one or more persons authorised by national law to audit accounts. Such a person or persons must also verify that the annual report is consistent with the annual accounts for the same financial year.

Less severe rules are laid down for small and medium-sized companies. Member States may lighten their obligations in respect of the publication of annual accounts, or relieve small companies of the requirement that the annual accounts be audited.

The fourth company law directive has in recent years been amended so as to follow international developments in this area of law. In this respect special attention must be given to **Directive 2001/65/EC**.⁵² The Directive is aimed at modernising European accounting rules by permitting the method known as '**fair value accounting**' (*the 'fair value' usually being the*

⁵¹ Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies.

⁵² Directive 2001/65/EC amending Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions [Official Journal L 283, 27.09.2001].

current market value of a financial instrument, as opposed to its historical cost). European companies, banks and financial institutions will thus be able to compile financial statements which are understood and accepted worldwide. The text also amends the seventh directive, accordingly. Another important amendment of the fourth company law directive is **Directive 2003/51/EC**,⁵³ which sets out to harmonise the accounting rules applied to companies and other bodies not subject to Regulation (EC) No. 1606/2002 on the application of international accounting standards (there are around five million such companies).⁵⁴ This removes any discrepancy between the accounting directives and the Regulation on the application of the international accounting standards (IAS), since the IAS accounting options can now be applied to companies that retain the accounting directives as their basic legislation. The Directive also clarifies off-balance-sheet financing (debts and loans) and stipulates that in companies' annual reports risk analysis should not be restricted to just the financial aspects of the business. In addition, the Directive defines how audit reports must be presented.

5.2. Seventh company law directive – Consolidated annual accounts of companies with limited liability⁵⁵

This directive defines the circumstances in which consolidated accounts are to be drawn up. Any company (parent company) that legally controls another company (subsidiary company) is under a duty to prepare consolidated accounts. In most cases, legal control takes the form of the holding of a majority of voting rights. Member States may also require consolidated accounts to be prepared in other cases in which a parent company has only a minority shareholding but exercises de facto control. They may provide for exemptions from this obligation.

The Directive sets out the methods of drawing up consolidated accounts. Consolidated accounts comprise the consolidated balance sheet, the consolidated profit and loss account and the notes to the accounts. These documents constitute a composite whole. Consolidated accounts must give a true and fair view of the assets, liabilities, financial position and profit or loss of the companies included therein, taken as a whole. The book values of shares in the capital of companies included in a consolidation must be set off against the proportion which they represent of the capital and reserves of those companies. Such set-off must be effected on the basis of book values as at the date on which the companies are included in the consolidation for the first time.

5.3. Regulation 1606/2002 on international standards of financial reporting⁵⁶

In 2000 the Commission adopted a Communication entitled 'The EU's Financial Reporting Strategy: the way forward', in which it suggested that all listed companies should be required to prepare consolidated accounts in accordance with international

⁵³ Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings [Official Journal L 178, 17.07.2003].

⁵⁴ See below for more details.

⁵⁵ Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts.

⁵⁶ Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

accounting standards from 2005. On 17 July 2000 the Ecofin Council welcomed the Communication; it emphasised that the comparability, accuracy and transparency of European companies were an essential aspect of the integration of European financial markets and of their international competitiveness.⁵⁷ Furthermore, the harmonisation of these statements is considered essential for the Financial Services Action Plan (FSAP). The EU legislation on company accounting (fourth and seventh company law directives) was adopted in the 1970s and needed to be updated if it was to meet the needs of today's investors.

The International Accounting Standards (IAS) are adopted by the London-based International Accounting Standards Board (IASB), on which the Commission will be represented. These common rules are to be known in the future as 'International Financial Reporting Standards' (IFRS).

From 2005 all listed EU companies (including banks and insurance companies) must prepare their consolidated financial statements in strict accordance with IAS. Member States may also permit or require companies to apply the system to their annual accounts. Member States may also require application of the new rules in non-publicly traded companies.

Endorsement mechanism

The IAS require special endorsement in order to become applicable in the EU, which ensures that each IAS reflects the European public interest. In this regard the Commission is consulting with the Committee of the European Securities Regulators (CESR) to develop a common approach towards enforcing these rules. In this respect Regulation (EC) No. 1725/2003 and Regulation (EC) No. 707/2004 have been enacted in order to adopt certain international accounting standards.

5.4. Eighth company law directive – Qualifications of persons responsible for carrying out the statutory audits of accounting documents⁵⁸

The objective of this directive was to complete the series of directives concerning company accounts, defining the qualifications of persons responsible for carrying out the statutory audits of the accounting documents required by the fourth and seventh directives.

Persons responsible for carrying out audits of accounting documents may, depending on the law of each Member State, be natural or legal persons or other types of company, firm or partnership. The Directive applies to persons responsible for carrying out:

- statutory audits of the annual accounts of companies and firms and verifying that the annual reports are consistent with those annual accounts in so far as such audits and such verification are required by Community law;

⁵⁷ Big European companies were required to prepare a second set of accounts in order to be allowed to trade on international stock exchanges, above all in New York, because European regulations were not considered reliable. This fact was costly and put them at a competitive disadvantage in comparison to their global competitors.

⁵⁸ Eighth Council Directive 84/253/EEC of 10 April 1984 based on Article 54(3)(g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents [Official Journal L 126 of 12.5.1984].

- statutory audits of the consolidated accounts of bodies of undertakings and verifying that the consolidated annual reports are consistent with those consolidated accounts in so far as such audits and such verification are required by Community law.

Persons responsible for carrying out audits of accounting documents must be of good repute and may not engage in any activity incompatible with the auditing of such documents. A natural person may be approved to carry out statutory audits of accounting documents only after:

- having attained university entrance level;
- completing a course of theoretical instruction;
- undergoing practical training; and
- passing an examination of professional competence or university final examination organised or recognised by the state.

Member States may nevertheless approve persons who do not satisfy some of the above conditions if those persons can show either:

- that they have, for 15 years, engaged in professional activities which have enabled them to acquire sufficient experience in the fields of finance, law and accountancy and have passed the examination of professional competence; or
- that they have, for seven years, engaged in professional activities in those fields and have, in addition, undergone practical training and passed the examination of professional competence.

Member States must ensure that approved persons are liable to appropriate sanctions if they do not carry out audits honestly and independently.

In March 2004 the European Commission proposed a **new Directive on statutory audit in the EU**.⁵⁹ The objectives of the proposed directives are to ensure that investors and other interested parties can rely fully on the accuracy of audited accounts and to enhance the EU's protection against the type of scandals that recently occurred in companies such as Parmalat and Ahold. The proposed Directive would clarify the duties of statutory auditors and set out certain ethical principles to ensure their objectivity and independence, for example where audit firms are also providing their clients with other services. It would introduce a requirement for external quality assurance, ensure robust public oversight over the audit profession and improve cooperation between regulatory authorities in the EU. It would allow for swift European regulatory responses to new developments by creating an audit regulatory committee of Member State representatives, so that detailed measures implementing the Directive could be rapidly taken or modified. The proposal also foresees the use of international standards on auditing for all statutory audits conducted in the EU and provides a basis for balanced and effective international regulatory cooperation with third-country regulators, such as the US Public Company Accounting Oversight Board (PCAOB).⁶⁰

⁵⁹ Proposal for a Directive of the European Parliament and of the Council of 16 March 2004 on statutory audit of annual accounts and consolidated accounts and amending Council Directives 78/660/EEC and 83/49/EEC [COM(2004) 177 final].

⁶⁰ See press release IP/04/340 of 16 March 2004: Audit of company accounts: Commission proposes Directive to combat fraud and malpractice.

6. European Court of Justice case law on cross-border activities

The ECJ has issued several judgments about the scope of the freedom of movement of European companies defined by an interpretation of the provisions of the EC Treaty. In several decisions, the ECJ has emphasised the principle that companies registered in one Member State should be able to do business throughout the EU without being made subject to the specific incorporation requirements in other Member States. These decisions have progressively established a European theory of freedom of movement of companies.

6.1. Centros⁶¹

Two Danes established Centros Ltd under the laws of England and Wales. The company was to engage in business only in Denmark. The incorporators clearly stated that they established the entity under English/Welsh law only to avoid the minimum capitalisation requirement for Danish limited liability companies (approximately £25,000). The Danish commercial registry considered this to be an unlawful circumvention of the Danish minimum capitalisation rules and thus refused to register the company's branch office in Denmark.

The Centros case casts light on two main ideas. First, the ECJ ruled that where a company had exercised its right of establishment under the Treaty, the Member States are prohibited from discriminating against this company on the ground that it was formed in accordance with the law of another Member State where it has its registered office but does not carry on any business. Secondly, a State is not authorised to restrict freedom of establishment on the ground of protecting creditors or preventing fraud if there are other ways of countering fraud or protecting creditors. Besides, the Court points to the availability to Member States of the option of adopting EC harmonising legislation in this area of company law. In practice, it constitutes pressure for the adoption of the 14th directive.

6.2. Überseering⁶²

The ECJ went further in the Überseering case. All the shareholders of Überseering BV, a limited liability company organised under the laws of the Netherlands, were resident in Germany. Furthermore, the company's principal office was located in Germany. German courts decided that due to the location of the company's principal office German corporate laws apply to the company. The Dutch corporate entity was therefore dismissed from court proceedings in Germany.

In a judgement delivered on 5 November 2002, the European Court of Justice ruled that it was **incompatible** with the freedom of establishment guaranteed in Arts. 43 and 48 EC for a member state to deny legal capacity (and standing to sue or be sued in courts) to a company formed in a Member State which moves its central place of administration to another Member State. Against the expectations of many German legal commentators and the recommendation of the Advocate General, the ECJ also held that **where a company incorporated in another Member State exercises its freedom of establishment in another Member State, that other Member State is required to recognise the company's legal**

⁶¹ Case C-212/97; 9 March 1999.

⁶² Case C-208/00; 5 November 2002.

capacity (and capacity to be a party to legal proceedings) which it enjoys under the laws of its state of incorporation.

Following this ECJ judgement, a company incorporated in a EU Member State is entitled to rely on the principle of freedom of establishment to contest any refusal by a host state to recognise it as a legal entity with the capacity to enter into contracts and be a party to legal proceedings. As a matter of German law, this decision signals the end of the current practice whereby the legal capacity of foreign incorporated companies is not recognised, where the effective seat of administration is in Germany. It is also certain to provoke much academic discussion on the question of whether, and if so the extent to which, the accepted phenomenon of full recognition of the legal capacity of the ‘pseudo-foreign company’ within the single market will be extended to other areas of company law.

6.3. Inspire Art⁶³

A Dutchman established the company Inspire Art Ltd under the laws of England and Wales and requested the registration of the company’s Dutch branch office at the commercial registry in the Netherlands. The registry took the position that specific Dutch rules for foreign entities registered in the Netherlands were to apply to the company. As a consequence, Inspire Art Ltd would have been required, *inter alia*, to use a company name indicating its foreign origin, and comply with the minimum capitalisation rules for Dutch limited liability companies.

The European Court of Justice (ECJ) continued its tendency of deciding in favour of freedom of establishment by holding that rules submitting pseudo-foreign companies to the company law of the host state were inadmissible. It laid down that a foreign company is not only to be respected as a legal entity having the right to be a party to legal proceedings, but rather has to be respected as such, that is, as a foreign company that is subject to the company law of its state of incorporation. Any adjustment to the company law of the host state is, hence, not compatible with European law.

6.4. Hughes de Lasteyrie⁶⁴

In this case the French Conseil d’Etat decided to refer a question to the European Court of Justice as to whether French legislation which, in order to avert the risk of tax avoidance, established a mechanism for taxing increases in value where tax residence was transferred abroad, was compatible with the principle of freedom of establishment under the EC Treaty.

The Court began by underlining the fact that freedom of establishment is one of the fundamental provisions of Community law and recalled that, according to well-established case law, observance of that freedom precludes a Member State of origin from hindering the establishment of one of its nationals in another Member State, including by tax measures. In this case, **the Court took the view that the provision in question was likely to restrict the exercise of that right**, having at the very least **a dissuasive effect on taxpayers wishing to establish themselves in another Member State**, because they are

⁶³ Case C-167/02; 30 September 2003.

⁶⁴ Hughes de Lasteyrie du Saillant v. Ministère de l’Économie, des Finances et de l’Industrie, case C-9/02.

subjected, by the mere fact of transferring their tax residence outside France, to tax on a form of income that has not yet been realised, and thus to disadvantageous treatment by comparison with a person maintaining his residence in France. Such a hindrance can be allowed only if it pursues a legitimate purpose that is compatible with the Treaty and is justified by imperative reasons in the public interest. **This tax measure, inferring a general intention of tax evasion from the mere transfer of tax residence to another Member State, cannot be justified by imperative reasons in the public interest: it is disproportionate in relation to the objective sought.** This provision is aimed **generally** at any situation in which a taxpayer with substantial holdings in a company subject to corporation tax transfers his residence outside France for any reason at all, and thus presumes an intention to circumvent French tax law on the part of any taxpayer who transfers his residence outside France. Moreover, **the Court considers that the objective envisaged – to prevent a taxpayer eluding payment of the tax on increased value due in France – may be attained by measures that are less coercive or less restrictive of the freedom of establishment**, and which relate specifically to the risk of such a temporary transfer, for example by taxing a taxpayer who, after a short stay abroad, returns to France once his increased values have been realised.⁶⁵

⁶⁵ See also section 7.4 below: The role of the ECJ in the harmonisation of national corporate taxation.

7. EC corporate taxation and freedom of establishment

Unlike indirect taxes (for example, the sixth VAT directive), the EC Treaty does not specifically call for direct taxes (income and corporate taxes) to be harmonised. However, Article 94 of the EC Treaty provides for approximation of such laws, regulations or administrative provisions of the Member States which directly affect the establishment or functioning of the common market. As primary principle, national tax rules must respect the fundamental freedoms provided for by the EC Treaty. Since the founding of the European Communities, company taxation has received particular attention as an important element for the establishment and completion of the Internal Market. Accordingly, in July 1990 two directives were adopted following several decades of discussion: the Merger Directive 90/434/EEC and the Parent-Subsidiary Directive 90/435/EEC. Recently also Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments has been adopted.

7.1. Directive 90/435/EEC as amended by Directive 2003/123/EC – Common taxation of parent companies and their subsidiaries⁶⁶

The EU is establishing competition-neutral tax rules for groups of companies from different Member States. It is eliminating double taxation of profits distributed in the form of dividends by a subsidiary in one Member State to a parent company in another.

These Directives are applicable by each Member State:

- to distributions of profits received by permanent establishments situated in that state of companies of other Member States which come from their subsidiaries in a Member State other than that where the permanent establishment is situated;
- to distributions of profits by companies of that state to permanent establishments situated in another Member State of companies of the same Member State of which they are subsidiaries.

It does not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse. For the purposes of the Directive, the term ‘**company of a Member State**’ means any company which:

- takes one of the forms in the updated list in the Annex to Directive 2003/123/EC to which new legal entities have been added, for example, certain cooperatives, mutual societies, non-capital based companies, savings banks, provident funds and associations with commercial activity;
- according to the tax laws of a Member State, is considered to be resident in that state for tax purposes and, under the terms of a double taxation agreement concluded with a third state, is not considered to be resident for tax purposes outside the Community;
- moreover, is subject to corporate tax, without the possibility of an option or of being exempt.

⁶⁶ Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. This Directive has been amended by Directive 2003/123/EC.

The term ‘**permanent establishment**’ means a ‘fixed place of business’ situated in a Member State in which:

- the business of a company of another Member State is wholly or partly carried on;
- the profits are subject to tax in the Member State in which it is situated by virtue of a bilateral tax treaty or, in the absence of such a treaty, by virtue of national law.

The status of ‘parent company’ is attributed at least to any ‘company of a Member State’ that has a **minimum holding of 20% in the capital of a company of another Member State** fulfilling the same conditions. Such status is also attributed, under the same conditions, to a ‘company of a Member State’ which has a **minimum holding of 20% in the capital of a company of the same Member State**, held in whole or in part by a ‘permanent establishment’ of the former company situated in another Member State. From 1 January 2007 the minimum holding percentage will be 15% and from 1 January 2009 the minimum holding percentage will be 10%. ‘Subsidiary’ means a company whose capital includes a minimum holding of 20%.

Where a parent company or its permanent establishment, by virtue of the association of the parent company with its subsidiary, receives distributed profits, the state of the parent company and the state of its permanent establishment must, except when the subsidiary is liquidated, either:

- refrain from taxing such profits, or
- tax such profits while authorising the parent company and the permanent establishment to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid by the subsidiary and any lower-tier subsidiary (subject to the above conditions relating to the definition and minimum percentage holding).

The Directive also provides for the tax to be offset by the parent company to be determined in such a way (including the taxes paid by lower-tier subsidiaries) as to totally eliminate double taxation. In this way, even without a common system for double taxation, the Directive includes in the tax to be deducted from the parent company’s profits all the taxes paid by the subsidiaries in the different Member States. Member States retain the option of providing that any charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company. Profits distributed by a subsidiary company to its parent company are exempt from withholding tax. The Member State of a parent company may not charge withholding tax on the profits that such a company receives from a subsidiary.

On 22 December 2003, the Council adopted Directive 2003/123/EC⁶⁷ to broaden the scope and improve the operation of Council Directive 90/435/EEC. The new Directive, based on a Commission proposal of 8 September 2003, contains three main elements:

1. updating the list of companies that the Directive covers;
2. relaxing the conditions for exempting dividends from withholding tax (reduction of the participation threshold); and
3. eliminating double taxation for subsidiaries of subsidiary companies.

⁶⁷ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, Official Journal L7, 13.01.2004, str. 41-44.

7.2. Directive 90/434/EEC – Common system of taxation: mergers, divisions and contributions of assets⁶⁸

The Directive applies to mergers, divisions, transfers of assets and exchanges of shares in which companies from two or more Member States are involved. A merger or similar operation does not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes at the time of the operation in question but only when such gains are actually realised.

Member States are required to take the necessary measures to ensure that provisions or reserves partly or wholly exempt from tax may be carried over by the permanent establishments of the receiving company which are situated in the Member State of the transferring company. The allotment of securities representing the capital of the receiving or acquiring company to a shareholder of the transferring or acquired company must not give rise to any taxation of the income, profits or capital gains of that shareholder. Where the assets transferred in a merger, a division or a transfer of assets include a permanent establishment of the transferring company which is situated in a Member State other than that of the transferring company, the latter state must renounce any right to tax that permanent establishment. The taxation of capital gains derived from cross-border company restructuring carried out in the form of mergers, divisions, transfers of assets or exchanges of shares is deferred until a later disposal of the assets.

7.3. Directive 2003/49/EC - Taxation of cross-border interest and royalty payments in the European Union⁶⁹

In this context it is worth mentioning that on 3 June 2003 the Council adopted Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (the 'I+R' Directive) based on a proposal from the Commission.⁷⁰

The I+R Directive is designed to eliminate withholding tax obstacles in the area of cross-border interest and royalty payments within a group of companies by abolishing withholding taxes on royalty payments and on interest payments arising in a Member State. These interest and royalty payments shall be exempt from any taxes in that state, provided that the beneficial owner of the payment is a company or permanent establishment in another Member State.

7.4. The role of the ECJ in the harmonisation of national corporate taxation

The ECJ provides the main impetus for EU legal developments in the field of corporate taxation. Member states have to date been relatively reluctant to reach a broad consensus

⁶⁸ Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States.

⁶⁹ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, Official Journal L 157, 26.06.2003, str. 49-54.

⁷⁰ COM(1998) 67 final of 04/03/1998.

in adopting direct tax legislation at EU level.⁷¹ That vacuum has allowed the ECJ to forge ahead in issuing rulings and developing principles that are radically affecting key building blocks in Member States' corporate tax systems.

The ECJ has exerted jurisdiction over direct taxation matters on the basis that, **although direct taxation falls within the competence of Member States, Member States must nonetheless exercise that competence in accordance with EC Treaty (Single Market) principles, including freedom of establishment, free movement of capital and payments, and free movement of services.**

The rate at which the ECJ has ruled on direct tax issues has increased exponentially in recent times.⁷² Finally, litigation working its way through national courts is bound to lead to the ECJ considering further areas of national tax systems.

The ECJ has developed a number of radical propositions in its rulings to date:⁷³

i) Discrimination between residents and non-residents

It has ruled that residents and non-residents can in certain circumstances be in a comparable position, so that Member States can be found by the ECJ to have unlawfully discriminated against non-residents. For example, in *Commission v France* (270/83), the ECJ ruled that the French branch of a non-French (EU resident) company, since it was subject to French corporation tax, was in a comparable position to a French resident company. Accordingly, the denial of an imputation credit to that branch in respect of dividends received from French companies when such credit would have been available to a French resident company breached what is now Article 43 of the EC Treaty (freedom of establishment).

ii) 'Barriers' doctrine

The ECJ more recently introduced the 'barriers' doctrine into the direct tax sphere as a further way of circumventing the international tax principle that residents and non-residents are not generally in a comparable position. The ECJ asks: Does a national tax law rule make it less attractive for, say, a UK resident to transact across the EU rather than on a purely domestic basis? If the answer is yes, then the rule is a barrier to cross-border trade within the Single Market, and therefore is a *prima facie* breach of the EC Treaty. For

⁷¹ One recent notable exception is the Interest and royalties directive (Council Directive 2003/49/EC) of 3 June 2003 (see above).

⁷² The Commission has provided a helpful list of ECJ decisions in the field of, or of particular interest for, direct taxation: (http://europa.eu.int/comm/taxation_customs/publications/taxation/documents/court_cases_direct_taxation_en.pdf). This list shows only five decisions before 1990, around 40 decisions over the course of the 1990s, and more than 35 decisions since the beginning of 2000 alone. Furthermore, this trend is likely to continue: 19 cases relating to direct taxation are pending. These cases will consider the validity of some critical areas of national tax law, such as cross-border loss relief (Marks and Spencer (C-446/03); Ritter (C-152/03)), dividend taxation (Manninen (C-319/02)), exit taxes (de Lasteyrie (C-9/02)) and double taxation agreements (DTAs) (D v Rijksbelastingdienst (C-376/03)). (It is not surprising that many of the areas which will be considered by the ECJ coincide with those identified by the Commission as obstacles to the Single Market!)

⁷³ See for more details: P. Cussons and M. Frankland, 'Why the ECJ is the most powerful tax force in Europe', *International Tax Review*, 2003, vol. 14(1), str. 39; M. Gammie, 'The role of the European Court of Justice in the development of direct taxation in the European Union', *Bulletin for International Fiscal Documentation* 2003, 57(3), str. 86–98; E. Henson, 'The European Court of Justice: a powerful EU tax force', *International Tax Report* 2003 (November), str. 1–4.

example, in *Verkooijen* (C-35/98), the ECJ ruled that the inability of Mr Verkooijen, a Dutch portfolio shareholder in a Belgian company, to claim a particular exemption from Dutch taxation on receipt of dividends, when he would have been able to claim such an exemption had he received dividends from a Dutch company, constituted a breach of the rules on free movement of capital. More recently, in *Bosal* (C-168/01), the ECJ ruled that the Netherlands had infringed Article 43 (freedom of establishment) by denying a Dutch parent company deductions for the costs of financing investments in subsidiaries, the profits of which were not subject to Dutch tax, when such deductions were available to Dutch companies for financing investments in subsidiaries, the profits of which were subject to Dutch tax.

iii) Rejection of justifications

Third, the ECJ has rejected a whole host of defences that have been put forward by Member States. In particular, the ECJ has rejected the notion that Member States may justify breaches by reference to the need to protect their tax bases. Notably, the ECJ has effectively neutered the fiscal cohesion defence and has laid down very exacting conditions before it will accept a defence based on the need to prevent tax avoidance.

Observers amazed by the audacity of the propositions outlined above will be staggered if, as is possible, the ECJ develops a further set of principles that could render Member States' corporate tax systems even more vulnerable to attack under EU law.

8. Future development of European company law and its influence on employees' rights

The future development of European company law will have further consequences for employee involvement rights. Workers' representatives must therefore closely monitor developments in the area of corporate governance. The report emphasises some of the crucial legal documents having the most direct effect on employees' involvement rights.

8.1. Corporate governance in the EU: the Commission's Action plan on company law

In 2003 the Commission presented an Action Plan on 'Modernising Company Law and Enhancing Corporate Governance in the EU'.⁷⁴

The main objectives of the Action Plan are:

- to strengthen shareholders' rights and protection for employees, creditors and the other parties with which companies deal, while adapting company law and corporate governance rules appropriately for different categories of company;
- to foster the efficiency and competitiveness of business, with special attention to some specific cross-border issues.

The Plan is based on a comprehensive and prioritised set of proposals for action, covering several years. The Action Plan devotes special attention to a series of corporate governance initiatives aiming at boosting confidence on capital markets. Simultaneously with the Action Plan, the Commission has published ten priorities for improving and harmonising the quality of statutory audit throughout the EU. The Action Plan provides a clear and considered framework combining new law where necessary with other solutions. It will help deliver the integrated and modern company law and corporate governance framework which businesses, markets and the public are calling for.

The growing trend for European companies to operate cross-border in the Internal Market, the continuing integration of European capital markets, the rapid development of new information and communication technologies, the enlargement of the EU by 10 new Member States, and the damaging impact of recent financial scandals are the reasons that dictated the modernisation of the European regulatory framework for company law and corporate governance.

The Action Plan is based on a comprehensive set of legislative and non-legislative proposals, under the following headings:

a) Corporate governance

The Commission considers that a self-regulatory market approach, based solely on non-binding recommendations, is not sufficient to guarantee sound corporate governance. In view of the growing integration of European capital markets, the European Union should

⁷⁴ The Action Plan is the Commission's response to the Final Report, presented in November 2002, of the High Level Group of Company Law Experts appointed by Frits Bolkestein and chaired by Jaap Winter.

adopt a common approach covering a few essential rules and should ensure adequate coordination of national corporate governance codes.

The Commission considered the following initiatives as the most urgent ones:

- introduction of an Annual Corporate Governance Statement;
- development of a legislative framework aimed at helping shareholders to exercise various rights (for example, asking questions, tabling resolutions, voting in absentia);
- adoption of a Recommendation aimed at promoting the role of (independent) non-executive or supervisory directors;
- adoption of a Recommendation on Directors' Remuneration;
- enhancing directors' responsibilities for financial and key non-financial statements;
- offering to listed companies the choice between the one-tier and two-tier board structures.

b) Capital maintenance and alteration

The Commission considered a proposal to amend the Second company law directive a priority for the short term (see above).

c) Groups and pyramids

Groups of companies, which are common in most Member States, are a legitimate way of doing business, but they may present risks for shareholders and creditors. More transparency can help minimise those risks. Initiatives aimed at improving the financial and non-financial information disclosed by groups are priorities for the short term. Such initiatives would aim to ensure better information on the group's structure and intra-group relations, as well as on the financial situation of the various parts of the group.

d) Corporate restructuring and mobility

European companies need to be able to do business across national borders more easily within the EU. The Commission intends to present in the short term a new proposal for a **Tenth company law directive** facilitating mergers between companies from different Member States, as well as a proposal for a **Fourteenth company law directive** on the transfer of the 'seat' (a company's centre of activities and/or registered office) from one Member State to another. Both proposals are presented in more detail below.

e) Other matters

These include the possible introduction of a European private company statute, which would primarily serve the needs of SMEs active in more than one Member State, and the introduction of several European legal forms (European cooperative, European association, European mutual society), and in the medium term the development of a European foundation.

8.2. Thirteenth company law directive – Takeover bids⁷⁵

Following the Action plan on company law the European legislator soon – in April 2004 – adopted the Thirteenth company law directive on takeover bids.

⁷⁵ European Parliament and Council Directive 2004/25/EC of 21 April 2004 on takeover bids.

According to the directive, a **takeover bid** is a public offer (other than by the offeree company itself) made to the holders of the securities of a company to acquire all or some of those securities, whether mandatory or voluntary, which follows or has as its objective the acquisition of control of the offeree company in accordance with national law.

The Directive sets out to establish minimum guidelines for the conduct of takeover bids involving the securities of companies governed by the laws of Member States, where all or some of those securities are admitted to trading on a regulated market.⁷⁶ It also seeks to provide an adequate level of protection for holders of securities throughout the Community by establishing a framework of common principles and general requirements which Member States are to implement through more detailed rules in accordance with their national systems and their cultural contexts. Member States are required to transpose the Directive no later than 20 May 2006.

The Member States must ensure that the following principles are complied with:

- all holders of securities of the offeree company (a company whose securities are the subject of a bid) must be given equal treatment; if a person acquires control of a company, the other holders of securities must be protected;
- the addressees of the bid must have sufficient time and information to be able to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, the conditions of employment and the locations of the company's places of business;
- the board of the offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid;
- false markets must not be created in the securities of the offeree company, of the offeror company (any natural or legal person governed by public or private law making a bid) or of any other company concerned by the bid in such a way that the rise or fall in the prices of the securities becomes artificial and the normal functioning of the market is distorted;
- an offeror must announce a bid only after ensuring that he can fulfil in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.

Member States are to designate the authority or authorities competent to **supervise bids**. They must ensure that those authorities exercise their functions impartially and independently of all parties to a bid.

⁷⁶ The Directive is a key component of the Financial Services Action Plan. The Lisbon European Council (March 2000) placed it among the main priorities as regards the integration of EU financial markets by 2005. The previous proposal for a directive on takeover bids was rejected by Parliament in July 2001, after twelve years of negotiation. A conciliation procedure between Parliament and the Council had produced a compromise text but, when this was put to a plenary sitting of Parliament, an equal number voted for and against, and the compromise text was therefore rejected. One of the reasons for this vote was the belief that the protection which the Directive would afford employees of companies involved in a takeover bid was insufficient.

Where a natural or legal person, as a result of his own acquisition or the acquisition by persons acting in concert with him,⁷⁷ holds securities of a company which give him a specified percentage of voting rights in that company, giving him control of that company, Member States must ensure that such a person is required to make a bid (**mandatory bid**) as a means of protecting the minority shareholders of that company.

Right of squeeze-out

The Directive provides for a 'squeeze-out right' enabling a majority shareholder to require the remaining minority shareholders to sell him their securities. Member States must ensure that an offeror is able to require all the holders of the remaining securities to sell him those securities at a fair price.

Right of sell-out

The right of squeeze-out is combined with a 'sell-out right' enabling minority shareholders to require the majority shareholder to buy their securities following a takeover bid. Member States must ensure that a holder of remaining securities is able to require the offeror to buy his securities from him at a fair price.

Employees' rights relating to takeover

The Directive requires that employees or representatives of the offeree company must be informed in detail in the event of a takeover bid. It even extends the obligation to inform or consult staff to the employees of the offeror company. It also expressly stipulates that information for and consultation of employees must be in line with the relevant national provisions and with the various Community provisions adopted in this field, such as Directive 94/45/EC on European works councils, Directive 98/59/EC on collective redundancies and Directive 2002/14/EC on informing and consulting employees.

8.3. Tenth company law directive – Cross-border mergers

In November 2004 the Council of Ministers reached an agreement on its political stance regarding the Directive on cross-border mergers, proposed by the Commission in November 2003.⁷⁸ The European Parliament voted in favour of this directive on 10 May 2005 and the proposal has been adopted by the Council in September 2005.⁷⁹ The aim of this proposal is to create an appropriate Community legal instrument which will enable all types of companies with share capital to carry out cross-border mergers under the most favourable conditions. In particular it will tend to benefit mergers of small and medium-sized companies (SMEs), which, since they do not want to operate in all Member States,

⁷⁷ Persons acting in concert: natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid.

⁷⁸ Proposal for a Directive of the European Parliament and of the Council on cross-border mergers of companies with share capital COM(2003) 703. On 14 December 1984 the Commission adopted a proposal for a tenth Council Directive on cross-border mergers of companies [COM(1984) 727]. This proposal has been deadlocked since 1985 because of disagreement between Parliament and the Council on the consultation of employees. In 2001 the Commission withdrew this first proposal for a tenth Directive with a view to presenting a fresh proposal based on the latest developments in Community law.

⁷⁹ Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies, Official Journal, 25.11. 2005, L 310.

have no interest in adopting European company status (which is more appropriate for large companies, which have greater capitalisation and operate throughout the Community).⁸⁰

The Directive as agreed by the Council covers all limited liability companies except undertakings for collective investment in transferable securities (UCITS, or mutual funds). Given the very diverse types of cooperatives in the EU, Member States may exclude them from taking part in cross-border mergers.

The aim of the proposal is to identify the law applicable, in the event of a cross-border merger, to each of the merging companies. Except when provided for reasons otherwise to do with the cross-border nature of the operation, each company remains subject to its national law on domestic mergers. Consequently, verification of the pre-merger procedures is the responsibility of the competent national authorities in the individual Member States. The interests of creditors, debenture holders, holders of securities (other than shares), minority shareholders and employees, and so on, of each company are thus protected by the applicable national law. Once the new entity resulting from the merger has been set up it will be subject to the national law of only one Member State – that in which it is established.

Rights of employees of the company created by the cross-border merger

One of the main issues at stake in the Council discussions was the **provision on employee participation**. Member States have widely differing worker participation (codetermination) systems. This raised the question of how to deal with cross-border mergers which could lead to a loss or a reduction of employee participation. The proposal provides that the rules on employee participation must be governed by the national law applicable to the company created by the merger. Where at least one of the merging companies is governed by rules on employee participation and the company created by the merger establishes its head office in a Member State where such rules do not apply, the new entity must hold negotiations on an employee participation system. In such cases, the negotiation procedure laid down for the European company will apply. This allows the interested parties to reach agreement on an employee participation system or to decide not to provide a scheme of this kind for the new company. In case of failure of negotiations, standard rules on employee involvement would apply, stipulating that the higher standard of workers participation existing among the merging companies will apply to the merged entity if at least one third of the total number of employees before the merger were covered by a workers' participation scheme.

All obligations (existing employment contracts or relationships) must be transferred to the new management of the merged company. All acquired rights agreed under a collective agreement, and rights to old age, invalidity or survivor's benefits, are likewise fully protected.

8.4. Fourteenth company law directive – Cross-border transfer of the registered office of limited companies

In September 2004 the European Commission launched a public consultation on facilitating the exercise of shareholders' rights in company general meetings and solving

⁸⁰ This proposal for a directive forms part of the Financial Services Action Plan (FSAP) and the Communication on modernising company law and enhancing corporate governance.

problems in the cross-border exercise of such rights, particularly voting rights. The deadline for responses is 16 December 2004. Responses will be taken into account in a forthcoming proposal for a Directive – part of the Commission Action Plan on Corporate Governance.

The Commission's consultation paper gives first indications as to the possible future EU regime on shareholders' rights in listed companies. The Commission considers that this should be based on a Directive, since the effective exercise of such rights requires solving a number of legal difficulties. The main issues on which the Commission is seeking responses are:

- the entitlement to control the voting right – investors in shares are often not recognised as shareholders, in particular in cross-border situations, and are in practice deprived of their right to vote as they wish;
- the dissemination of information before the general meeting and the possible need for minimum standards to ensure that all shareholders, irrespective of where they live, get information in time;
- the criteria for participation in general meetings, and the removal of overly cumbersome criteria, such as share blocking requirements;
- possible minimum standards for the rights to ask questions and table resolutions;
- possible measures to enable shareholders to vote by post, electronically, or by proxy;
- the dissemination of information following the general meeting and the possible need for confirmation that votes have been executed.

Under point 10, the consultation document states that employee participation rights should be governed by the legislation of the host member state. Only where these rights were stronger in the home member state, should they be maintained, or renegotiated.

* * *

The ETUC has adopted a position on the 10th and 14th company law directives.⁸¹

The ETUC stressed its full endorsement of the compromise which was reached in respect of the European company directive concerning participation rights. For this reason the ETUC has urged all EU institutions to comply fully with this historic compromise in respect of all legal provisions related to cross-border company structures. Therefore, the **10th directive on cross-border mergers**, as well as the envisaged **14th directive on the transfer of registered offices**, must not lag behind this compromise.

Since the ETUC sees workers' participation at board level as an important element of corporate governance systems, it stated that it can only endorse the proposal for the 10th company law directive on condition that it does not reduce but instead fully reflects workers' rights to participation, as well as to information and consultation. The ETUC has welcomed the fact that the draft Directive **on cross-border mergers** embodies a provision (Article 14) aimed at safeguarding rights to board-level participation which the workers of the companies being dissolved by the merger could exercise before the merger. However, in its position it urged the EU institutions that there should be no falling back behind the

⁸¹ March 2004, http://www.seeurope-network.org/homepages/seeurope/file_uploads/etuc-190304_cross-bordermerges_positionfineng.pdf

level of protection already reached in the Directive concerning participation in European companies. It stated that the draft Directive should recognise the role of the workers' representatives of the companies taking part in a merger (within the meaning of the Directive) throughout the decision-making process with regard to a planned merger on the basis of the Collective redundancies directive, the Transfer of undertakings directive, the General framework on information and consultation directive and the EWC directive or, if it guarantees a higher level of protection, Member State legislation implementing them. Furthermore, information about the draft terms of the merger should be complemented by information regarding workers' rights to information and consultation in the company created by the merger, as well as their other rights insofar as they are not yet covered by the Transfer of undertakings directive (for example, pension schemes) and should also be delivered to the workers (Articles 3 and 4). Finally, the expert report should also be made available to the workers' representatives of the companies taking part in the merger (Article 5).

The ETUC also emphasised, in relation to the envisaged Coordination directive relating to transfers of registered offices, that it is of the utmost importance that the same rules apply as in the case of the European company (SE) directive 2001/86/EC in respect of safeguarding workers' participation. Transfers should not be used as a means of reducing, undermining or even getting rid of acquired workers' rights.

9. Employees' financial participation in the European Union

Employee involvement in a wider sense also includes workers' financial participation. This is understood as an important area of social democracy in Europe for the future and has thus become a new area of European Commission interest. As such it deserves a short presentation in this report.

In 1991 the Commission published the **PEPPER I Report** on the 'Promotion of participation by employed persons in profits and enterprise results', which summarised the situation concerning financial participation in Europe at the time. On the basis of this report, the Council adopted a **Recommendation** in 1992,⁸² which invited the Member States to acknowledge the benefits of a wider use of financial participation, taking into account the responsibilities of the social partners, in accordance with national law and/or practice.

The **PEPPER II report** on the application of the Council Recommendation⁸³ underlined the fact that financial participation schemes are associated with a number of important benefits, especially in terms of higher productivity levels, employment and workers' involvement. It further stressed that the development of financial participation was strongly influenced by government action, in particular through the availability of tax incentives. However, it also concluded that the general approach of Member States' policies to Pepper schemes had not greatly changed and that there was little exchange of information.

In 2002 the Commission adopted a **Communication**⁸⁴ which reflects the outcome of an extensive consultation process, which involved all key stakeholders and in particular the social partners.

Employee financial participation in enterprise profits or enterprise results can take many different forms. The Pepper reports and the Council Recommendation identified two main categories of financial participation schemes: profit-sharing and employee share-ownership. **Profit-sharing** implies the sharing of profits by providers of both capital and labour by giving employees, in addition to a fixed wage, a variable part of income directly linked to profits or some other measure of enterprise results. **Employee share-ownership** provides for the indirect participation of employees in enterprise results either through receiving dividends and/or through the appreciation of employee-owned capital. **Share options** constitute a further form of employee financial participation which is closely related to employee share-ownership but which also has a number of features of its own. Share options give employees the right to buy company shares at a set price for a specified period of time. They are similar to share-ownership schemes insofar as they can ultimately lead to the ownership of shares. However, unlike share ownership schemes they do not necessarily imply the actual ownership of a stake in the company. Related to profit-sharing are so-called '**gainsharing**' schemes. Such schemes are not linked to the financial

⁸² Council Recommendation of 27 July 1992 concerning the promotion of participation by employed persons in profits and enterprise results (including equity participation) (92/443/EEC).

⁸³ Report from the Commission Pepper II COM(96) 697.

⁸⁴ Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions – On a framework for the promotion of employee financial participation, COM/2002/0364 final.

performance of an enterprise, but to other criteria such as increases in productivity, cost reductions or certain qualitative objectives. They are therefore in general closer to performance-related pay than to financial participation. However, to the extent that such schemes are based on relatively broad performance measures and that these measures are applied at a collective level gainsharing can serve the function of financial participation. This is of particular relevance with regard to the public or non-profit sector, where standard forms of financial participation may not be applicable.

In practice, a wide variety of financial participation schemes exists, which are not confined to those just described but which may also combine different elements of different approaches. Financial participation schemes may thus also include asset accumulation or employee savings plans, provided that contributions to these schemes are related to enterprise results and/or that these schemes contribute to establishing some form of employee share ownership.

Financial participation can bring about substantial benefits for organisations, for employees and for the national economy.⁸⁵ From the organisation's point of view, financial participation should improve operational efficiency and reduce the need for close supervision because it gives employees an incentive to work harder and more effectively. Furthermore, the incentives created by financial participation may lead to reduced staff turnover and lower recruitment and training costs.

Financial participation should also benefit employees. Most obviously, it should reward them for their contribution to improved performance. In addition, however, financial participation is claimed to enhance job satisfaction and quality of working life. For one thing, it encourages management to share information more fully with employees, thus engendering a spirit of greater openness and transparency in the enterprise. Moreover, it may lead to greater team working and cooperation among employees because, by definition, financial participation incentivises group rather than individual performance.

Finally, in addition to the micro-level benefits for organisations and their employees, it is argued that financial participation can contribute to favourable macroeconomic outcomes. These include lower unemployment levels, reduced inflation and higher economic growth. **Both theoretical and empirical studies thus highlight the important benefits employee financial participation can bring. This underlines the need for enhanced efforts by all actors at all levels to make financial participation available on a larger scale and to extend its coverage.**

Two main features characterise the development of financial participation schemes in Europe:

1. The overall use of employee financial participation is limited. While profit-sharing is more developed, share ownership in particular is not very widespread.
2. In addition, financial participation is very unevenly developed in different Member States. While some Member States have a long tradition in promoting employee financial participation, in others it is used only on a very limited scale.

⁸⁵ The IDEAS Institute, Dublin – John McCartney, Richard Croucher and Ivan Svetlik, 'Benchmarking financial participation in Slovenia', 2004.

According to a study by the European Foundation for the Improvement of Living and Working Conditions (covering 10 Member States) 72% of enterprises did not have any financial participation scheme at all in 1997. Share ownership schemes in particular were very rare and existed only in 9% of companies. Financial participation schemes were most common in France and the UK, with more than 50% of companies having such schemes.

Employee financial participation is even less developed in the 10 new Member States. The privatisation process brought about a certain surge in schemes for employee ownership and management and/or employee buy-outs in a number of countries. Even in these cases, however, the importance of employee ownership has in the meantime tended to decline again.

The discussion so far has clearly underlined the need for further action in the field of financial participation. In this respect the Commission has proposed **eight important principles** as regards effective financial participation:

i) Voluntary participation

Financial participation schemes should be voluntary for both enterprises and employees. The introduction of financial participation schemes should meet the actual needs and interests of all parties involved, and should therefore not be imposed.

ii) Extending the benefits of financial participation to all employees

Access to financial participation schemes should in principle be open to all employees. While a certain differentiation may be justified in order to meet the different needs and interests of employees, financial participation schemes should aim at being as comprehensive as possible and treating employees on similar terms.

iii) Clarity and transparency

Financial participation schemes should be set up and managed in a clear and transparent way. This is important for the acceptance of such schemes and allows employees to assess fully the possible risks and benefits involved.

iv) Predefined formula

Rules on financial participation in companies should be based on a predefined formula clearly linked to enterprise results. This is a major element in ensuring the transparency of such schemes.

v) Regularity

Financial participation schemes should be applied on a regular basis and should not be a one-off exercise.

vi) Avoiding unreasonable risk for employees

Compared to other 'investors' employees tend to be more exposed to adverse economic developments affecting their enterprise. For them, it is not only their investment that is at stake, but potentially also their income and their very job.

vii) Distinction between wages and salaries and income from financial participation schemes

A clear distinction has to be made between income from financial participation on the one hand and wages and salaries on the other. In general, financial participation cannot be a substitute for pay and fulfils different, complementary roles.

viii) Compatibility with worker mobility

Financial participation schemes should be developed in a way that is compatible with worker mobility both internationally and between enterprises. Policies towards financial participation in particular should avoid creating barriers to the international mobility of workers.

The Commission has highlighted transnational problems relating to financial participation. Financial participation schemes and policies towards financial participation in Europe are extremely diverse. These differences can imply severe obstacles to the use and development of employee financial participation at **transnational level**. Differences in terms of tax systems, social security contributions, the general legal framework and also culture often make it impossible for enterprises to develop and apply a common financial participation scheme across Europe. Where enterprises introduce schemes that are open to all their employees in different Member States, this normally involves substantial costs and a huge administrative burden.

The Commission thus wants to promote financial participation by encouraging information transfer between the Member States, and has earmarked resources from the European Social Fund for this purpose.

The member organisations of the ETUC have negotiated many agreements on different forms of financial participation. The ETUC therefore considers it less helpful to indiscriminately lump together a multitude of actors in a field in which the social partners and the Member States have the key roles. The ETUC gives priority to wage negotiations and safe and transparent remuneration. Any European action plan should be designed in such a way as to afford the greatest latitude for adaptation to national specificities. The ETUC can support such a plan only if the following prerequisites are met:⁸⁶

- The ETUC underlines that financial participation will have a positive impact only if it is **embedded in a whole system of worker involvement** at all levels.
- In a profit participation scheme wages could be made to vary with the amount of bonuses. The ETUC firmly states that **profit participation**, as indeed all forms of financial participation, **should provide an additional income** and should under no circumstances constitute an alternative to wages. Financial participation is equally not an alternative to public pensions or to collectively agreed pension schemes. Negative effects of the fiscal or para-fiscal status of financial participation in national systems of social security have to be compensated.
- The ETUC believes that all the modalities of financial participation should be **introduced through negotiations between the social partners** and that collective

⁸⁶ Employee Financial Participation, Resolution adopted by the ETUC Executive Committee, 19–20 November 2002, Brussels, 156.Ex./11.02/05.

agreements should set the framework for financial participation. Participation in any type of scheme must always be voluntary.

- Financial participation should under no circumstances strengthen inequalities of income, either within companies or in the society in general. Special attention must be given to the impact on gender equality. The ETUC therefore insists that financial participation schemes must **cover all workers within companies** where they are adopted.
- The purposes and objectives of financial participation are many and varied. The ETUC stresses the need for the Commission in its action plan to **avoid a one-sided interpretation** of financial participation.
- The ETUC believes that **collective funds** are a safer form of financial participation than others. A fund is less vulnerable in the event of insolvency. Provisions for insolvency should be established in any system of financial participation.
- Financial participation schemes should be **transparent** and be accompanied by a long-term policy on corporate social responsibility. Financial participation schemes should be subject to prior consultation and agreement with worker representatives and trade unions.

Conclusions

The social partners have been given an important role in developing European legislation affecting employees' rights. They have made good use of it, achieving important results, culminating in the Directive on the European company (the SE directive). This directive postponed the adoption of the SE statute for thirty years, during which time social rights in the European Union developed up to the point at which the principles enshrined in the SE directive represent the optimal model of employee involvement in the participatorily diverse European Union.

The European Commission has put forward plans enhancing the transnational cooperation of enterprises and in this regard new European company entities are foreseen. This will have an important impact on employees' rights, creating a special responsibility for their representatives to follow developments and act as strong defenders of the achievements of the SE directive, which should be retained in future legislation.

In this regard the report has not perhaps sufficiently emphasised the question of the **European private company**, which is planned to be available to small and medium-sized enterprises. Clearly, in SMEs employees have very different, often much poorer involvement rights than in larger companies. When the proposal for a European private company finally emerges, that might be a good time to assess employee involvement rights in SMEs in general.

The extreme diversity of management structures under company law often serves as a barrier to the comparative analysis of the strength of employee involvement rights. In this area of law a few years ago there was a proposal to harmonise management structures (the so-called Fifth company law directive),⁸⁷ but so far no agreement has been reached. However, following the SE statute, many commentators believe that there is still a possibility that this directive will become a reality. This would give new impetus to discussions on employee involvement.

Finally, it is no less important to regularly monitor the implementation and application of the existing legislation. In this regard it is very important – especially in the new EU Member States – that employees' representatives are properly informed. This can also prevent so-called '*benefit tourism*', which harms employees in both EU-15 and new Member States.

⁸⁷ Proposal for a Fifth directive (structure, powers and obligations of the organs of the public company) [1972] OJ C 131; amended proposal [1983] OJ C 240, further amended [1991] OJ C 7 and C 321.