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The European Private Company*

In the various discussions on the European Private Company, promoters of the EPC have been frequently regarded as persons who want to sell a product nobody wants to buy. I would therefore, *firstly*, like to give you a few ideas as to what purposes the European Private Company might be useful for before, *secondly*, talking about the characteristics of this legal entity and, *thirdly*, the regulatory method we will have to apply in order to meet the intended practical use as set out in the first section.

I. Practical use of the EPC

1. Setting up a network of subsidiaries

As Madame *Simon* has already pointed out, it was business people who first asked for an EPC. It could be useful for various purposes. The EPC could, for instance, be used in the case of a joint venture. It would offer a neutral legal form in which both partners enjoy the advantage of better legal knowledge and each can be advised by its trusted legal advisor. Personally I expect, however, that an EPC will be mainly used for another particular operation: setting up subsidiaries in other member states. As of now, businessmen face the difficulty that for each country they have to invent the wheel again. For France, they need a French lawyer, for Germany, a German lawyer, for Poland a Polish lawyer and for Greece a Greek lawyer. And, as we all know, legal counselling does not stop after incorporation of the company. It continues during the whole life cycle of the company: how to call a shareholders' meeting, how to pass the relevant resolutions, how to give valid instructions to the directors? – For each company law issue you have to take recourse to local lawyers, multiplied by the number of subsidiaries established in the different member states.

If you think this is only a problem of large companies, you are wrong. There is an incredible number of small and medium sized enterprises whose competitive advantage is that they are highly specialised. They produce one single item, but in this small segment of the market they are amongst the world leaders. Which means they have to sell their product cross-border since the local market will soon be saturated with their product.

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Let us take one example: *Schunk GmbH&Co KG* from southern Germany which recently presented its case in a hearing before the legal affairs committee of the European Parliament (see ECL 2006, 275). With roughly 1,300 employees, they produce clamping tools for the metal-cutting industry and are represented in more than 40 countries. Each time they start setting up a subsidiary, one in-house employee will be occupied for three months. In addition, lawyers of the relevant jurisdiction will have to be paid. When the subsidiary is finally incorporated, up to six months will be gone by.

It is true, company law is only one of the problems. There is social security, tax and accounting law, public authorities work slowly in one country and fast in another. The EPC could only do away with the stumbling block of having to comply with 27 different company law systems. Let us be modest and assess that this saves only three days out of the three months the in-house employee spends on each subsidiary. Multiplied by the number of subsidiaries of Schunk, this totals almost two or three months. If we multiply the two or three months by the number of companies all over Europe which are engaged in cross-border business, we are talking about millions of working hours being saved. And this does not even take into account the lower cost of regular legal advice after incorporation of the subsidiary.

It follows from this quick look at the practical use of an EPC, that the main interest of small and medium businesses lies neither in a merger with foreign companies (they would thereby lose their independence) nor in a cross-border transfer of registered office (they want to stay where they are and establish wholly owned subsidiaries in other countries). Contrary to the opinion of some experts, the directive on cross-border mergers (tenth directive) and the directive on the transfer of the registered office (fourteenth directive) do not, therefore, provide an answer to the current needs of SMEs.

2. For comparison: The use of national companies

In order to establish a network of subsidiaries, one can also consider the use of purely national legal forms, since the freedom of establishment allows the foundation of companies in states other than that in which their management centre is situated. The use of national legal forms, however, has the following disadvantages:

- The foreign legal form will appear on the market as a “letter-box company” (pseudo foreign company). This raises mistrust in the minds of business partners. The unspoken question of whether there are dubious reasons for not using the local national legal form is always in the air.
- And what is more, to refer businesses to the use of national forms results in a hidden discrimination against small and new entry member states. Their legal forms are unknown in other member states which means they will have to take recourse to legal forms of member states whose legal system is not their own. The small and medium-sized enterprises of small and new entry member states are therefore at a competitive disadvantage in being practically compelled to use a legal form of one of the “old” member states.

- It is accepted, as a matter of principle, by the European Court of Justice (ECJ) that member states may impose restrictions on a foreign company in the interests of creditor protection or employee protection, provided they are appropriate and necessary. There is not, however, sufficient case law from the ECJ in order to exactly determine the boundary between the domestic law of the company and the jurisdiction where the company actually operates. The risk of the domestic law being overlaid with various national protective regulations is, in any event, real and results in legal uncertainty.

- Even if foreign courts respect and apply the domestic law of the company, it remains to be seen whether they do so correctly. A court interpreting foreign law is always liable to make a wrong decision. The actual outcome of litigation is therefore very uncertain and unpredictable. It is even less likely that the courts in all member states would reach the same conclusion on the same question. There is no legal remedy against possible erroneous interpretation of foreign law. No recourse to the courts of the home state exists. Neither can the ECJ be called upon, because it has no jurisdiction to interpret national law.

As far as the Europe-wide use of the UK limited is concerned, Germany seems to be the member state where the UK limited has proven to be most successful. As far as we know, however, most of these UK limiteds are established by Germans who use the company for an exclusively national activity. No international group can be seen organising its network of subsidiaries exclusively by one national type of company. Those who prefer legal certainty and a good reputation for their subsidiary follow the golden rule: "In Rome do as the Romans do" and they incorporate a German "GmbH". Which means they still have the problem that they need different national forms for establishing subsidiaries in different member states.

II. Characteristics of an EPC

Small and medium sized companies, which seek a reliable legal jurisdiction with the reputation of having a positive attitude to European law, still require an alternative in the competition between jurisdictions. The EPC can be this alternative, if it is successfully equipped with an original European and self-contained statute. If we want to achieve the effect of saving money for cross-border business, we need an EPC with the following characteristics:

- It has to be a supranational legal entity based on a European Regulation.
- It should offer a reliable set of European rules for the establishment and the internal management of the company.
- In those core areas of law, national law should not be allowed to step in.

These three core features of an EPC cannot be overestimated. We do not need a European Private Company Regulation regardless of its content. We need a supranational legal entity with European rules for its internal affairs not to be interfered with by national law.

In order to guarantee uniformity, the statute for an EPC should be provided in a European Regulation, which applies automatically in all member states and therefore ensures that the same legal text applies everywhere. The ECJ can be consulted if interpretation problems arise.

The European Regulation should deal only with company law. Other matters, such as labour law or tax law, cannot be unified at the present time because the differences between the member states are too great. A legal form, the internal structure of which is the same everywhere, would itself be a first major step in facilitating the cross-border business of small and medium-sized companies.

The principle of contractual freedom should apply to the internal structure of the company. The founders could, therefore, freely regulate internal matters and at the same time create a network of subsidiaries throughout Europe each having the same structure. Such internal matters are the relationship between shareholders (e.g. calling shareholders' meetings, resolutions) and the relationship of the shareholders to the managing directors (appointment and removal of directors, right to issue directives on management issues).

III. Regulatory methods to apply

1. Advantages in comparison to the European Company (SE)

In the light of the above mentioned characteristics, it is not surprising that reactions of the European Commission are still hesitant. They cannot avoid this feeling of "déjà-vu". Didn't we have the same story a long time ago? Didn't we want to create a truly European company and didn't we achieve a European Regulation that contains so many references to national law, it does not really deserve the label "European". Would it not be the same old story when we start discussing an EPC? I don't think so. I give you three reasons for that:

- The law on public companies is over-regulated in many countries and it is mostly mandatory law. This is one of the main reasons why it was almost impossible to reach common ground in the case of the European Company which is, in fact, a European Public Company. Compared to that, private companies are far less regulated in the national systems.
- The basic agreement we will have to achieve in the case of the EPC is contractual freedom for the internal affairs of the company such as shareholders' meetings, shareholders' resolution and the relationship between the shareholders and the directors. If we offer contractual freedom for its internal affairs, the EPC will be a success. With regard to the European Company, this solution could never be taken into account since many member states cannot think of the law on public companies otherwise than as mandatory law.
- Co-determination of employees was the stumbling block for the SE. It is less important in private companies. The intended use of the EPC – a network of small distribution and marketing subsidiaries – would not affect co-determination (cf. also III.4. below).

It follows, that the concept of an EPC has decided advantages over the SE: it is only intended for a small circle of shareholders, who can regulate their legal relations autonomously. This is not the case with a public company with its widely spread numerous shareholders. The individual shareholders in fact have no influence on the drafting of the articles. In order to protect shareholders, therefore, many legal jurisdictions enact very detailed regulations for public companies. This complexity of national laws is one of the main reasons why there was for so long no agreement at European level. For the EPC, contractual freedom is a priority. Agreement on this principle should be easier to achieve than that on the detailed provisions to unify public company law.

2. How to achieve a complete EU Regulation

The question of regulatory genius will be: how to achieve a complete company law system in one European Regulation? The trick is: the Regulation can be complete without being complete. If we offer contractual freedom, it is the shareholders who take care of themselves. It must, therefore, be ensured that the shareholders make provision in their articles for typical points of conflict in a small company. There are various regulatory tools which could help them with the drafting of their articles of association in a way that most internal conflicts known in company law will be solved by the articles.

- One tool would be that "drafting tasks" are imposed by the Regulation. Let me give an example: the proposal drafted by the international group led by MEDEF and CREDA contains the provision: "The articles of association shall determine the decisions which must be taken collectively by the shareholders." This rule helps the drafting of the articles without limiting the freedom of the shareholders to write down whatever they want. If there is no provision at all to be found in the articles, the register will ask the shareholders to provide one. No restrictions as to the content of such clause may, however, be imposed by the Registrar. All such drafting tasks imposed by the Regulation together constitute a checklist for the commercial register, which checks whether the articles contain provisions on each point when the company is being registered. This is not a uniformity check because the content of the provisions can basically be freely chosen.
- There is another tool for all those who do not have the time or the money to draft such tailor-made articles. They will find assistance in model articles to be attached to the Regulation. They can be taken as a whole or modified according to the needs of the shareholders. The choice of model articles offers a high degree of legal certainty, because it will provide information on the issues which have to be regulated. Furthermore, the authority of European law ensures that no national court can place the legal admissibility and validity of the provisions of model articles in doubt.

3. Creditor protection

Let me mention a few aspects which cannot be left to free choice by the shareholders, one example being creditor protection where the member states still apply significantly different concepts. The EPC may achieve a higher degree of protection by applying a combination of existing creditor protection rules. This is not a disadvantage, because the benefit of the EPC lies in its uniform application throughout Europe, not in a lower level of creditor protection. Such combinations could look like this:

- The EPC has a minimum capital, the amount of which should not be too high, and which is payable in cash. Further contributions can be in kind, which will not be valued, because the fact that the minimum capital is in cash is adequate. The European Parliament proposed another compromise: there will have to be minimum capital in the sense of a personal contribution to be required from the shareholders, but it will not have to be paid-in prior to incorporation.
- Distributions to the shareholders may be admissible on a balance sheet test, provided that the minimum capital is not affected. The shareholders and managing directors thereby gain sufficient and reliable protection from personal liability (safe harbour). On the other hand, the setting of a fixed capital is sometimes criticised because it permits of no flexibility in the case of distributions. Distributions by the EPC could, therefore, be additionally allowed on the basis of a solvency test. The distribution is then, however, linked to managing directors' personal liability if the solvency test result is erroneous or ignored. Shareholders and managing directors can therefore choose whether they adopt the safer path of relying on the capital and the balance sheet test, or whether they wish to make a distribution flexibly if they have good grounds for believing that the company will remain solvent.
- Limited liability will be tested ultimately in the case of insolvency. The European Regulation on the EPC must therefore conclusively deal with the exceptional case of personal liability of the managing directors or shareholders in insolvency cases. Otherwise, national provisions on liability would apply precisely in the event of insolvency through the European Insolvency Regulation. A possible model is the English "wrongful trading", which is, however, onerous in its requirements and controversial in its practical application. It would also possibly be adequate to provide for liability only in cases in which the managing directors or shareholders have contributed to the insolvency by withdrawing assets. Mere management errors should not trigger liability.

4. Involvement of employees

Finally, there is employees' co-determination which blocked the negotiations on the SE for so many years. The SE, however, is formed out of active companies, in which co-determination already exists and should not be lost in the course of the formation of an SE. The EPC is, in both its main applications – subsidiary and joint venture – a new formation. Hence, there are no existing employees who need protection. In the formation formalities, therefore, no employee participation procedure is necessary. After incorporation, it will be subject to national labour law, and to co-determination – to whatever extent that may exist in the different member states. This should be clarified by a reference in the EPC Regulation. In this manner, national labour law remains undisturbed by the EPC, and, on the other hand, does not impede the formation of the EPC.

5. Common law and continental law: different approaches to law making

In discussing the EPC, doubts have been raised as to whether it would be possible to draft a complete regulation of company law for private companies. Recent examples of the difficulties faced in this respect are the reform bills in England and Ireland which required many hundreds of provisions in their attempts to offer a rather complete legal framework for private companies. Germany at the same time is about to start the most important reform of private company law for more than one hundred years. The provisions to be introduced or amended in the course of this reform can be easily written down on ten pages.

There is, obviously, a different approach to law-making in common law countries as opposed to civil law countries. In England and Ireland, statutes are regarded as being an exception to judge-made common law and therefore need to be interpreted in a restrictive way; which means that legislation needs to be detailed and all-embracing if common law is to be replaced by statutory law. In civil law countries, judges tend to base their decisions not only on the letter of the law but also on its spirit, they use general clauses included expressly in the law or derived from it as implicit principles. It is this tradition which allowed Germany, for instance, to get along since the year 1892 with less than one hundred articles in its statute on private companies ("Gesellschaften mit beschränkter Haftung"). Nowadays, roughly one million private companies live in the legal framework of this act.

This tradition of continental law led the members of the international working group coordinated by MEDEF and CREDA, including two common law representatives, to conclude that it will be possible to offer a complete legal framework for the EPC. As *Bob Drury*'s presentation given to the EP's legal affairs committee pointed out (ECL 2004, 270), this technique will pose some problems for judges from common law jurisdictions. But if the European Regulation clearly instructs the judge to seek a solution in a particular way, they will rise to the challenge. English and Irish judges have done so in the past and there is no doubt that they will continue to manage to interpret Community law in the future – even if it were to be enriched by a Regulation on the European Private Company.

Further reading:

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