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Ref: Consultation Paper on Future Priorities for the Action Plan on Modernising Company Law

Sir,

the German Notaries' Association thanks for the opportunity to comment on the realization of the Commission's Action Plan. We would like to answer the questionnaire included in the consultation paper on future priorities as follows:

Question 1

Does the Action Plan address the relevant issues and identify the appropriate tools to enhance the competitiveness of European business? If not, please give your reasons and indicate which measures are not appropriate and/or would be desirable. What are your views on the balance of legislative/non-legislative measures proposed?

Are you facing particular obstacles in the conduct of cross-border activities to which, in your opinion, the Action Plan does not provide any satisfactory remedy? Please give your reasons.

In many aspects the Action Plan meets the needs of European economy to enhance its competitiveness. However, sometimes the approach of the Action Plan seems to be purely academic or seems to be too much committed to the needs of big business (instead of SME) as well as too obedient to the interests of big law firms and accountancies wishing to in-

crease the share of the markets of legal and financial consulting in the gross national product of the EU Member States[1].

This assertion may be proved by the following examples:

(i) The mainstream discussion on the pros and cons of legal capital focuses mainly on the requirement of a minimum capital and not on the economic efficiency of the diverse means of investor and creditor protection. A lot of comparative work is still left to be done, involving studies of economic efficiency of many different legal means such as subordination of shareholders' claims, the impact of financial covenants, of rating, of transparency of financial statements, of law of torts, of solvency tests and of insolvency law. In our view, the failure of the Commission's call for tender of a comparative study on legal capital might partly be due to biased and path dependent approaches having a deterrent effect on every serious tendering party. Hence taking the effort to submit a tender was considered useless for many stakeholders considering that such tenders are often given to consultancy firms without legal expertise but promising to deliver the desired results[2]. Such conclusion might also have been drawn from the *Rickford* report[3].

(ii) Due to lobbying of big law firms and accountancies, the highly competitive price-earning ratio of notarial services especially for SME seems to be ignored completely.

(iii) Both in favouring solvency test and wrongful trading the Commission's concepts do not address transaction costs as well as practical importance of these concepts in legal practise in their country of origin.

(iv) Ignoring the aspects mentioned above sub (iii) aligns with the Commission's approach in capital market and accounting law. This approach again prefers the economic interests of big law firms and accountancies over the interests of European economy, especially SME. Hence the Commission's approach proves to be a true copy of the US approach – the same accounting firms having given reason to enacting *Sarbanes Oxley* have come out as its winners.

(v) As the making of the cross-border merger directive showed, there is only insignificant interest in addressing several questions of high practical relevance, such as harmonization of the procedures and effects of a cross-border merger (e.g. creditor protection, time of effectiveness of a merger, conversion of options granted by the absorbed companies or the effects of merger general, especially with regard to assets in third countries). The discussion focussed on the issue of worker's participation – a matter

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1 This consequence is considered as advantageous for European economy by the Commission, cf. the Research Report on the impact of regulation in the field of liberal professions of Institut für Höhere Studien on the liberal professions of January 2003 (http://europa.eu.int/comm/competition/publications/prof_services/executive_de.pdf). The underlying concept of such economical analysis is not fully understandable to us.

2 Recent examples: the study of London Economics on which the Greenbook of 19 July 2005 (COM(2005) 327) was based (http://europa.eu.int/comm/internal_market/finservices-retail/docs/home-loans/2005-report-integration-mortgage-markets_en.pdf) or the Research Report on the impact of regulation in the field of liberal professions of Institut für Höhere Studien on the liberal professions of January 2003 (http://europa.eu.int/comm/competition/publications/prof_services/executive_de.pdf).

3 Reforming Capital. Provisional Report of the Interdisciplinary Group on Capital Maintenance, ed. by John Rickford, The Company Law Centre, British Institute of International and Comparative Law, January 2004.

of minor relevance for the vast majority of SME affected by the directive. Instead of simplifying the merger process the delicate issues are still left to the legal practitioners and therefore only a minor reduction of transaction costs is achieved.

Question 2

Do you have comments on the proposed application of better regulation principles in the area of corporate governance and company law? Are there other ways in which, in your view, the Commission should be seeking to improve its actions in this field?

Better legislation is a process adapting the legislator's responses to the needs of society. This implies addressing these needs empirically. Biased approaches as well as obedience to influential pressure groups should be avoided. Empirical research, relying on different independent means, should be emphasized. Fields of empirical research could be:

- transaction cost analysis;
- field studies of legal and financial practise;
- studies of cases tried at court;
- feasibility (e.g. impact assessment using game theory).

Empirical research could be carried out following the model of the double blind test in drug design. When calling for tenders of a study, it may be sometimes of advantage to commission two study groups with different methodical approaches. As a side effect the two groups would also assess each other.

In our view, in particular the Commission's approach in preparation of the proposed shareholders' rights directive is a fairly good start with regard to the concept of better legislation. Especially publishing the results of consultation has enhanced transparency and has favoured inherent control of the legislative process considerably.

Of course, empirical research must be monitored constantly. E.g. it must not taken for granted that comments of an association of stakeholders on an EU-document reflect the actual needs of its members. Factors such as the groups represented by and in these associations should be taken into consideration as well.

For sure impact assessment is imperative, whereas simplification of law is not a value for itself. Some laws must and may be simplified (e.g. the system of capital maintenance), some laws must but cannot be simplified (e.g. stock option programmes) and some laws must not be simplified for other reasons (e.g. prevention of money laundering by formation of companies).

Question 3

What would be the added value of addressing the issue at EU level?
What would be the appropriate form for any EU instrument? Please give your reasons.
Are there, in your view, specific elements which any such instrument should cover?

Addressing the „one share one vote" principle at EU level would enhance transparency of „Corporate Europe" as a whole. It would set a reliable standard for investors and foster the market of corporate control. A harmonization in this area would impede unfair competitive practises of several Member States to protect their domestic markets. The instrument of the directive would be adequate to enforce the principle of "one share of the same class of

shares – one vote". "Golden Shares" should be limited to rare exceptions of paramount public interest.

The issue of different classes of shares (e.g. giving rights to veto resolutions on specific topics) should rather be addressed by harmonized regulation of the Stock Exchanges encouraged by the Commission. If this fails, the issue may be addressed indirectly by an EU legislative instrument (e.g. a directive) on how to calculate the weight of the shares of a Company in a given stock index (e.g. by only counting common stock with equal rights of vote).

Question 4

What would be the added value of addressing these questions at EU level? Please give your reasons.
Which instrument would be best designed to deal with these matters? Please give your reasons.
Are there, in your view, specific elements which any such instrument should cover?

Addressing special investigations on an EU-level would facilitate corporate control by institutional investors. It would reduce costs for shareholders to inquire what to do in a given Member State. Hence it would have a deterrent effect on a board otherwise prone to unfair practises with regard to minority shareholders.

A minimum harmonization of the procedures for tabling a resolution on a special investigation, for the nomination of the investigator, its competences and the accessibility of the investigation report could be preferably achieved by a directive. Insofar the proposed shareholders' rights directive takes the first and decisive step.

Question 5

Is there a need for this issue to be addressed at EU level? What would be the added value of addressing the issue at EU level? Please give reasons for your reply.
What would be the appropriate form for any EU instrument? Please give your reasons.
Are there, in your view, specific elements which any such instrument should cover?

We already commented on this issue in the Commission's survey during the preparation of the proposed directive on shareholders' rights. We still oppose any regulation on this subject on EU-level. Whether an institutional investor chooses to play an active role as shareholder in a company or not should be left within its discretion.

Anyway, the practise of general meetings shows that institutional investors typically do not follow investment policy rules formulated by themselves and specifically adapted to the company subject to their voting right. They usually follow general recommendations given by consulting firms which do not have anything to do with the situation of the company *in concreto.* These consultants impose policy rules without assuming responsibility for their consequences. A good example for these methods are the generalized rules for capital measures (e.g. percentages of increase of share capital in consideration of contribution in kind or issuance of convertibles excluding shareholders' pre-emption rights) which are imposed on every company without regard to its entrepreneurial strategy or its specific needs.

So far we do not see any better impact of an EU regulation on institutional investors' voting policy.

Question 6

Do you consider that
a) the question of the wrongful trading rules and
b) the issue of directors' disqualification
should be addressed at EU-level? Please give your reasons.
Which instrument would, in your opinion, be most appropriate? Please give your reasons.
If so, are there, in your view, specific elements which any such instrument should cover?
Do you consider that any additional measures are needed to enhance transparency for legal entities and/or legal arrangements (e.g. trusts)?

To begin with, a EU-wide harmonization of director's disqualification is paramount for a level playing field for the competition of different legal entities. It is intolerable that a director disqualified under UK law may become director of a Dutch BV or of a German GmbH or *vice versa.* There is a need for harmonized disqualification standards as well as for a common basis for EU-wide information exchange on this topic between the authorities competent for disqualification.

Before addressing the concept of wrongful trading at EU-level, its practical relevance should be assessed empirically. Practical experience seems to show that in most cases in the UK the directors go away from court mainly because of the non-interventionist approach of British jurisdiction. The decision of a director "to keep on going with the company hoping for better times" is widely respected ("right or wrong, my company"). In comparison with the number of insolvencies in the UK, the percentages of directors actually held liable even for small amounts seems relatively small. It might well result from such a survey that the relevance of the wrongful trading concept has been grossly overestimated in the discussion of mainly German academics.

However, in the US-jurisdiction the concepts of wrongful trading and of fraudulent transfer (another concept offering interesting perspectives for regulation) are of considerably greater relevance. Probably this is due to the litigious character of US-society with judges much more prone to interfere in past business decisions.

Question 7

In the light of existing instruments, is there still a need for a directive on the transfer of registered office? Please give your reasons.
Are there, in your view, specific elements which any such Directive should cover?

Whether the European Court of Justice gave up the principle formulated in 1989 in the „Daily Mail" case in its recent rulings (see the cases „Centros", „Überseering", „Inspire Art" or „SEVIC Systems") or not is subject to an intensive academic discussion. We hold it highly probable that in SEVIC the Court actually abandoned the Daily Mail doctrine.

Like SEVIC overruled the EU directive on cross-border merger, a directive on transfer of registered office might be overruled by the ECJ again. However, difficult issues of law on conflict of laws should be addressed. The ECJ did not judge on protection of shareholders' or on third party's rights due to forum shopping implied by a cross-border merger or a transfer of registered office. The rights of option holders may have to be adapted to the new jurisdiction as well. Addressing these issues by cumulative application of the laws of the state of the former and of the new registered office is complicated, over-regulated, costly and leads to

frictions and contradictions. Hence harmonization of law of conflict of law in this area is a desire of legal practitioners.

The COMI-principle of the European Insolvency Regulation could be a model for these cases. Applying this principle, upon registration of the transfer of registered office only the rules of the Member State of the new office should be applicable.

Question 8

Should the question of the choice of board structure be addressed at EU level? Please give your reasons.
Which instrument would be best designed to deal with this matter? Please give your reasons.
Are there, in your view, specific elements which any such instrument should cover?

This issue belongs to the topics of legislation which should but cannot easily be simplified. The EU-legislator offered this choice in the SE Regulation. However, e.g. in the German law transforming the EU-regulation, the one-tier model was so highly regulated that it became impracticable for implementation of anything complying with good Corporate Governance. There are actually no options for adapting the one-tier system to the needs of a company, e.g. by instituting an audit committee with competences consistent with CG-standards. Considering these consequences, the value of a general option between the two systems granted by EU-legislation becomes questionable.

The solution could lie in deeper harmonization of the two systems both offering a wide range for possibilities in the Articles of Incorporation of companies and restricting the possibilities for the Members States to impose restrictive regulation. However, this would not match with the aims of simpler legislation.

Question 9

Do you think that a squeeze out and a sell out right should be introduced at EU-level? Please give your reasons.
If so, should these rights be limited to companies which shares are traded on a regulated market ("listed companies")? Please give your reasons.
Which instrument would be best designed to deal with this matter? Please give your reasons.

Traditionally, EU-legislation focuses on listed companies, leaving the issues of closely held corporations to the national legislator. This seems to be wise in this area as well, for squeeze-out and sell-out have major impact on the shareholders' property rights granted by the respective constitution of the Member States. In case of listed companies, at least the value of a shareholder's interest in the company may be assessed much more properly than in case of an SME. For investors of any size, a harmonization of the rules on squeeze-out and sell-out (especially in case of a takeover bid) would facilitate their investment decisions. These rules should address the thresholds triggering the squeeze-out and sell out rights, the procedure of assessment of the company (as to appraisal rights), and the legal remedies of the shareholders affected by squeeze-out and sell-out. To avoid the need of constant assessment of a company, a sell-out should be restricted to specific cases, such as a successful takeover bid or surpassing a threshold majority.

A directive for listed companies setting minimum and maximum standards for the above seems to be the appropriate instrument. Stock corporation law of the Member States not

being harmonized yet in full, the impact of a “Squeeze-out-Regulation” on EU level would have too harmful side-effects on the remaining parts of corporate law.

Question 10

Should the issues of framework rules for groups and abusive pyramids, in your view, be addressed at EU-level? Please give your reasons.
Which instrument would be best designed to deal with this matter? Please give your reasons. Are there, in your view, specific elements which any such instrument should cover?

Issues raised by groups and pyramids may be addressed in the following branches of law:

- consolidated accounting;
- shareholder’s liability for measures taken which are not in the interest of the affected company (group or pyramid member) or which are detrimental to minority shareholders;
- conflict of interest of board members and/or of officers of group or pyramid members;
- piercing the corporate veil if a group or pyramid member is acting for the “group” as a whole (e.g. by referring to group membership in letterhead stationery);
- transfer prices within the group or pyramid and its effects in tax law as well as unfair competition law;
- impact of groups and pyramids in antitrust law.

Any regulation (i) should start from an analysis of the existent *“acquis communautaire”*, (ii) should then compile the different regulatory approaches of the Member States to the phenomenon of groups and pyramids, (iii) should then try to develop a common notion of “group” and “pyramid” and – as the last step, (iv) should identify fields in which these phenomena impede the aim of a common market. Attempts to regulation may will have a start from mere harmonization of the existent *acquis*, e.g. in accounting law and antitrust law, before proceeding further.

Before having achieved a wider basis of empirical knowledge, we are not in a position to advise which way to go.

Question 11

How useful do you judge the ECS to be in practice? Do you consider any modifications are appropriate and desirable? Please give your reasons.

The ECS Regulation has not yet been accompanied by legislation of the Member States. Thus there is no data available on the ECS in practise. Probably, question 11 in connection with the foregoing text refers to the SE instead.

After almost 18 months of practical experience with the SE, it is too early to give a final judgement on the practicability of this new legal form. Some hints must do:

(i) An SE may be the appropriate acquisition vehicle for a corporate deal, offering an “European Corporate Identity” primarily to the staff of the target companies.

(ii) An SE may also be the appropriate legal form for a company longing for a “European CI” with regard to its customers as well.

In Germany the former has lead to the formation of “off-the shelf”-SE, the latter has been the motive for the planned, begun or completed changes of legal form of several big companies, such as Allianz AG, MAN B & W Diesel AG or STRABAG in Austria.

The cases sub (i) show that the process of formation of an SE pursuant to the regulation is too slow for the needs of M & A business. Hence the legal practitioners have resorted to ready-made SE. However, the disadvantage of a ready-made SE is that it is unclear whether the same procedures to achieve an agreement on employee’s participation by a special group of negotiation (after having closed the deal) are applicable or not. The cases sub (ii) show that the commitment to European identity is still a task for the management as well as for the other employees of an European company. Every group has to give up part of their interests in the process – which often mirrors the process of the European Council. The price of enlargement of boards, councils and committees for an SE (the typical common denominator of a settlement) – often proposed as an easy solution – would not be appropriate and would not meet the needs of a company committed to best practise of CG.

Moreover, the SE-regulation offers too much room for national regulation. Under the camouflage of creditor or shareholder protection, barriers still may be erected. A good example is the German regulation of a monistic SE which impedes the implementation of state-of-the-art CG already referred to in this questionnaire.

Question 12

Do you see value in developing an EPC Statute in addition to the existing European (e.g. Societas Europaea, European Interest Grouping) and national legal forms? Please give your reasons.
If so, are there, in your view, specific elements which any such statute should cover?

Yes, we do. Such statute should be more autonomous than the SE Regulation. Formation, registration, amendment of articles, transfer of shares etc. should remain subject to the incorporation state so as to make use of the existing legal infrastructure. However, in the matters of shareholders and directors rights and duties, jurisdiction and venue, it should set the framework for a true European corporation, not being coloured by the national law of the incorporation state.

Question 13

Do you consider it useful to carry out an examination on the feasibility of a European Foundation Statute? Please give your reasons.

Presently international foundation law is marked by forum shopping. Making use of the possibilities of Austrian or Luxembourg law, the need for a foundation in European colours does not seem as obvious as in the case of companies in commercial law. We therefore advise to postpone this project in favour of issues of more importance for European economy. Anyway, foundations do not seem to be covered by Art. 48 of the European Treaty.

Question 14

Do you agree that there would be added value in modernising and simplifying European Company Law? Please give your reasons.

Are there, in your view, areas of actual or potential overlap between the Action Plan and other initiatives or measures in related sectors? What, if anything, should be done in order to ensure coherence between the various fields of action? Please give your reasons.
What should be the extent of simplification in the interests of improving the regulatory environment and rendering the text more user-friendly? Please give your reasons.

Modernising and simplifying European Company Law (if possible) would add considerable value to European economy. Cost of legal and financial advice as well as litigation costs might be reduced. The notary's profession trying to achieve legal certainty by solutions understandable to the average businessman, this issue is of major importance in our view.

Company Law is both part of the law of financial markets as well as of civil law in general. Coherence with this two fields is paramount. The alignment of Company law with the emerging Common Frame of Reference in Contract Law should be in the principal focus.

Simplicity is not a value by itself. One should try to simplify things, but not to make them simpler than they actually are. The conflicts between majority and minority shareholders, between shareholders and stakeholders, between entrepreneurial freedom and the legitimate rights of others may not be solved easily. Notarial advice is one possible solution, for umpire advice to every shareholder has less impact on personal freedom than mandatory law, offers the possibility to avoid future conflicts and is – as the practise shows – achievable at very competitive prices. Authentic instruments as the outcome of this advice offer both legal certainty for the parties involved as well as conclusive evidence for third parties.

We look forward to further progress of the Commission's project and to play an active part in shaping the future European Company Law.

Yours truly

Dr. Stefan Zimmermann
President