

ETUC position paper The new company law package 2018: A missed opportunity for more democracy at work

Adopted at the Executive Committee on 25-26 June 2018

- **The ETUC has been asking for some time for a 14th company law directive on the cross-border transfer of company seats with meaningful worker's participation.**
- **Such regulation is even more necessary to fill the vacuum left by the Polbud ruling.**
- **However, the company law package as it now stands needs substantial improvement in terms of a) linking the main place of business and the registered office and b) transnational information, consultation and board-level representation rights.**
- **The real seat principle is necessary to avoid the spread of letterbox companies.**
- **Workers' voice is a cornerstone of sustainable corporate governance and needs to be anchored in the package.**
- **The fully online registration of companies without any checks will lead to an explosion in the numbers of letterbox companies.**
- **Both proposals must be kept bundled.**

On 25 April 2018 the European Commission published its Proposal for a Directive amending Directive (EU) 2017/1132 regarding cross-border conversions, mergers and divisions and its Proposal for a Directive amending Directive (EU) 2017/1132 regarding the use of digital tools and processes in company law.

The Commission's proposal would enable companies to convert cross-border by changing their legal form in one Member State into a similar legal form in another Member State, to merge and to divide.

The Commission underlined its intention to protect the social dimension, but the primary objective is to promote company mobility. There is no change of paradigm from the shareholder value principle towards the stakeholder approach.

The starting point was the same for the business and workers' side: There are European rules for mergers (CBM Directive) and there are European rules for information and consultation (Framework Directive; EWC Directive). However, there are only national rules on conversions and divisions and in most Member States no rules at all. There are national rules on board-level representation in 18 Member States and in the others no rules at all. A double-track approach would have been logical (as in the case of the European Company Statute SE with a Regulation and in parallel a Directive on workers' involvement), but the Commission chose a unilateral approach delivering on conversions, mergers and divisions for the business side and not delivering for the workers' side.

For the first time, the Commission proposes to adopt harmonised rules for cross-border conversions, transfer of seat and divisions. The proposal as it stands now could facilitate circumvention of social security obligations, taxation and workers' involvement and would create even more uncertainty. It is far too easy to get around it. The Commission neither

anchored the one seat principle as in the European Company Statute (SE) nor an EU horizontal framework for information, consultation and board-level representation rights.

In the view of the ETUC, two elements, among others, are of particular importance: to put an end to the establishment of so-called letterbox companies¹ and to improve transnational information, consultation and workers' representation rights.

Major shortcomings need to be fixed

The ETUC has serious concerns about the recent Polbud ruling (of 25 October 2017). The Court ruled that relocating registered offices to enjoy more favourable legislation does not constitute abuse. Polbud is a case of judges making the law. In a context of a legislative vacuum (i.e. lack of harmonised EU regulation) the ECJ stated that regime shopping is allowed as well as the setting up of letterbox companies and circumvention of taxation, social security and workers' rights. A Member State is not allowed to impede companies from moving their registered office even if such transfer would lead to the creation of a letterbox structure or regime shopping or circumvention. There is no obligation to connect the location of the registered office to the location of economic activities. Mobility of capital seems to be a higher good than fundamental social rights or other values anchored in the treaty. Against this background it is clear that the Commission was challenged to come up with a proposal to correct the bias of Polbud which is not in the interest of workers. The ECJ referred to the lack of EU regulation and due to this vacuum a case like Polbud became possible. Unfortunately, the Commission was not able to develop a clear and convincing European vision embedded in a social vision to fill the space adequately. The Commission felt partially obliged to respect Polbud instead of completely revising it. The problems linked to Polbud were not fully resolved but mirrored in the Commission's ambiguous company law proposal.

The Commission foresees as safeguard a report to tackle risks of abuse for conversions: the report should be applicable for mergers and the report must be fully published. From the Commission's viewpoint establishing a company "for the purpose of enjoying the benefit of more favourable legislation does not (!), in itself, constitute abuse". The competent authority will have to make an assessment and an independent expert will assess the accuracy of information. The independent expert's role has to be better defined and the financial authorities, the social insurance fund, the workers' representation body as well as the trade unions in the Member State of departure must be involved. The definition of "artificial arrangement" does not look watertight and leaves a lot of room for interpretation. It will be important to develop clear indicators or criteria to make the term "artificial arrangement" meaningful and to prevent the set-up of more letterbox companies. It is important to add a mandatory reference to the real seat principle as laid down in the European Company Statute, however the real seat principle alone would not fill the gap; substantive requirements linking the registered office to the place of economic activities must be added as cumulative conditions. Micro and small enterprises (up to 10 and 50 employees respectively) will be exempted from the requirement of the expert report. This omission is not justified.

The Commission proposes that a "competent authority" of the departure Member State shall conduct an assessment of whether the operation constitutes an artificial arrangement "aimed at obtaining undue (!) tax advantages or at unduly (!) prejudicing the legal or contractual rights of employees, creditors or minority members". Apparently simply moving to take advantage of more advantageous legal or tax regimes is not to be considered as an artificial arrangement. The ETUC asks to maintain the notion of artificial arrangement, but to remove the references to "undue" and "unduly". The pre-conversion certificate will be transmitted to the destination Member State. The departure Member

¹ According to recent estimations, currently 500 000 letterbox companies exist in Europe.

State shall not give an authorisation if the assessment is negative. The conversion cannot take place until the Member State of departure has completed all checks.

The starting point of the Commission on mergers was the harmonised procedure laid down in 2005 with the Cross-Border Merger (CBM) Directive which led to an increase in mergers of 173% (between 2008 and 2012) (figures from Commission).

Information, consultation and board-level representation rights are needed

As a majority of Member States do not allow conversions and divisions, it is quite logical that no rules for workers' involvement are foreseen for such cases. As the Commission wants to make conversions and divisions possible, it should have introduced in parallel the necessary rules for workers' involvement. Such an omission is unfair, as rules for transnational information, consultation and board-level representation are needed also in Member States where divisions and conversions are not foreseen.

However, the Commission does not propose rights to transnational information and consultation. Nothing specifically is foreseen for national level workers' representations or European Works Councils. The ETUC demands that when the EP and the Council consider accepting the company law package, rules on transnational information and consultation as well as board-level representation should be added as proposed in the EU horizontal framework for information, consultation and board-level representation rights (including the escalator approach). It is essential that the right to information, consultation and board-level representation be consistently provided for across all three proposed cross-border instruments.

It is important to distinguish between two dimensions of information and consultation in the Company Mobility Package. The first is the right to information and consultation about the proposed corporate reorganisation itself, and the second is with respect to the future arrangements for workers' involvement in the entity or entities that emerge from the corporate reorganisation.

Board-level representation at European level is foreseen in the European Company Statute (2001), the European Cooperative and the CBM Directive. Beyond these provisions no further provisions for board-level representation exists at European level. The provisions of the SE Directive are founded on the before-and-after principle. As the proposal stands no, the lack of a dynamic element leads to a loss of workers' rights in the case of employment growth beyond the threshold without triggering the obligation to introduce (stronger) board-level representation.²

The Commission proposes an article on workers' involvement in order to protect rights to board-level participation (in case of conversion, but not for merger). At the very least, the standards set by the SE Directive should provide the benchmark: this would not only support coherent rules, but would also reverse the trend of downward degradation of standards and foster upwards convergence.

The Commission proposes that where the number of workers exceeds four-fifths of thresholds set out in national law of the country of origin, the company will have to enter into negotiations to determine participation forms. However, the negotiations which would take place before the applicable thresholds have been reached would not have the benefit of the fall-back position. Experience has shown that these kinds of negotiations are useless unless there is a clear fall-back solution. New negotiations must be initiated as

² Board-level representation can contribute to economic efficiency and avoid extreme social inequalities: Companies without it spend significantly more money for the highest remuneration packages than companies with it. Companies with it have higher net sales or revenues than companies without it. (Workers' Voice in the 100 largest European Companies. MBF-Report no. 31, 04/2017, p. 4-5)

soon as the threshold of the Member State of departure is crossed. The Commission proposal is a tiny step forward but only transposes the freezing problem to a lower level. It contains no dynamic element. The ETUC considers these provisions as insufficient and asks for a European approach so that workers are treated equally in the case of company conversions, mergers, divisions.

The company will have to preserve the participation rights for only three years. This provision offers a time-limited protection of country of origin provisions. Such a sunset clause is clearly insufficient. The protection of participation rights for at least 10 years is a minimum. The ETUC rejects the option for Member States to allow to skip negotiations and choose directly the legislation of the Member State of destination. Member States should not be allowed to reduce workers' board level representation to a third. The Commission proposal as it stands would facilitate life for the companies but offers no steps forwards towards 'more democracy at work' for the workers, which is quite one sided.

Digitalisation of company law and the ETUC strategy for more democracy at work

Currently only 17 Member States allow the full online registration. The Directive on the use of digital tools and processes in company law makes online establishment of companies obligatory. The founder of a company is not obliged to go to an authority or notary but can do the establishment through online tools. The ETUC is quite concerned that the proposed Directive could reduce the quality and trustworthiness of information in company registries. Some form of ex-post monitoring should also be foreseen.

The proposal could increase the potential for fraud as the "gatekeeper" function of third parties such as notaries and courts (to detect fraudulent documents, disqualified directors) are being wiped out. The ETUC warns against the risk of an increase in fraud. A preventive check by notaries would be a tool to prevent such an increase. Online establishment should be allowed only to natural persons. The ETUC demands an involvement of notaries not only for founding but during the entire lifecycle of companies. The identity control should be mandatory. An interconnection of business registers would make more sense when there are strict minimum standards. As the Impact Assessment of the Commission rightly underlines, there are risks of diminished tax incomes³.

Fraudulent use of legal entities should not be facilitated. An in-depth risk assessment for sensitive sectors (transport, construction) is needed. Furthermore, Member states should have the right to exclude business sectors, which are prone to fraud, from the online establishment. The Member State of destination as well should have a word in determining whether there is an "artificial arrangement".

The ETUC is actively campaigning in favour of more and stronger democracy at work⁴. The campaign will run until the European elections in May 2019 and the hearings of the incoming new commissioners in Autumn 2019. An element of this campaign is a European Appeal which collected more than 650 signatures and was published in several newspapers.

The ETUC asks its affiliates to step up efforts to collect more signatures (at <http://european-appeal.org/>) with a view to handing the appeal to the President of the European Parliament and the President of the European Commission in the autumn.

³ "The facilitation of creation of companies by digital tools together with the facilitation of cross-border operations (mergers, divisions, conversions) could negatively impact tax revenues in some MS (as a consequence of de-localisation of companies)." COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT Brussels, 25.4.2018 SWD(2018) 141 final, p. 92 (https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-239_en)

⁴ Strategy for more democracy at work. ETUC Resolution adopted at the Executive Committee Meeting of 7- 8 March 2018 (<https://www.etuc.org/en/document/etuc-resolution-strategy-more-democracy-work-0>)

The campaign should strengthen the visibility of ETUC demands on a horizontal EU framework, on the revision of EWCs and related to the company law package, in particular to put a definite end to letterbox companies and to strengthen substantially workers' involvement.

The company law package is a missed opportunity for more democracy at work. The ETUC asks the EP and the Council to transform the unbalanced and one-sided proposal into a win-win situation for both business and workers.

The ETUC, having strong doubts about the need for divisions, sees no valid grounds for facilitating them and therefore asks the EP and the Council to reject this proposal.

The ETUC is in favour of clear rules for companies to move within the internal market. However, the ETUC asks for progress to be made substantively in the area of stakeholder protection. It is of utmost importance to keep both proposals bundled. The ETUC will continue to monitor closely the proceedings in the EP and the Council. If there are no substantial improvements the ETUC will launch an appeal to the EP to reject the whole package. Workers' voice is a cornerstone of sustainable corporate governance and fair corporate decision making.

Background

The Commission carried out public consultations in 2012, 2013, 2015 and 2017 and received 496, 86, 151 and 207 responses. The ETUC stressed consistently that companies should only be allowed to transfer their registered office if accompanied by the transfer of their real seat. The ETUC repeated each time the need for a horizontal instrument for workers' information, consultation and board-level representation rights. The ETUC was extremely sceptical regarding divisions due to risks of circumvention of thresholds. In parallel there was a process of consultation within the Company Law Expert Group (CLEG) from 2012. An Informal Company Law Expert Group (ICLEG) was established in 2014. In addition, the Commission gathered stakeholder views through bilateral meetings with trade unions and business organisations. In September 2017 in Tallinn a conference discussed the topic. As the views were quite opposed on many issues, the Commission concluded that it had struck the right balance.

In December 2017 the ETUC reiterated its demands in view of the upcoming company law package: "The upcoming company law package can only add value to workers if it puts in place effective limits against letterbox-type practices and against circumvention of workers' involvement ... The ETUC demands an efficient protection of existing national provisions on information, consultation and board-level representation linked to the above-mentioned European approach to extend information, consultation and board-level representation rights to all European companies undergoing a transformation on the basis of European legislation. The escalator approach would protect most national systems and put an end to the circumvention of national provisions through the use of European company law as is the case right now. The escalator contains a dynamic clause which prevents the switching to a European company (or the use of European company law instruments) just before reaching nationally established thresholds. The escalator approach anchors the negotiation principle 'in the shadow of the law' and strong rights. The outcome of negotiations can be quite different from one case to another, but should not impinge on national trade union rights in accordance with national provisions and/or practices. The ETUC claims that companies when using European Company law instruments must apply safeguards for information, consultation and board-level representation rights, as laid down in ETUC position on the new EU framework."⁵

⁵ ETUC position paper: ETUC demands in view of the upcoming company law package. Adopted at the Executive Committee on 13-14 December 2017 https://www.etuc.org/sites/default/files/document/files/adopted-en-etuc_demands_in_view_of_the_upcoming_company_law_package_draft_position.pdf

On the eve of the publication of the company law package, the ETUC urged the European Commission to include in its package “binding measures to protect workers and end ‘regime shopping’ which allows companies in Europe to move their headquarters to another Member State where they pay less taxes and lower wages regardless of where their genuine economic activity take place... Harmonised rules and safeguards for workers are a ‘conditio sine qua non’ for the support of the ETUC.”⁶

On the day of the publication, the ETUC declared “An effective ‘real seat’ principle must be in the final text. The definition of economic activity must be watertight from a tax and legal perspective. ... Furthermore, the proposals on information, consultation and participation rights need serious improvement to ensure that workers are able to anticipate and influence management decisions. ... Company mobility needs to be accompanied by strong information, consultation and board-level representation rights.”⁷

On 15 May 2018, the ETUC sent an open letter to Commissioner Thyssen with copy to Commission President Juncker: “In the case of the Commission’s proposal for the company law package we are confronted with a situation where the different national rules for the transfer of company seats, mergers and divisions are regulated at European level, but there is no similar requirement for workers’ representation. The different national rules on information, consultation and board-level representation rights are not strengthened or complemented by a European-level framework. The Commission proposal offers only the temporary ‘survival’ of existing national regulations. This is clearly insufficient.... Please consider the European Appeal as an encouragement to act and to support ‘More Democracy at Work’. More Democracy is an antidote to populist and right-wing movements which are unfortunately gaining ground in many European Union Member States. Let us take a significant step towards More Democracy at Work”⁸.

⁶ ETUC press release 24 April 2018: EU Company Law package must end ‘regime shopping’
<https://www.etuc.org/en/pressrelease/eu-company-law-package-must-end-regime-shopping>

⁷ ETUC press release 25 April 2018: EU Commission’s company law proposals provide grounds for progress – but clearly need improvement <https://www.etuc.org/en/pressrelease/eu-commissions-company-law-proposals-provide-grounds-progress-clearly-need-improvement>

⁸ ETUC press release 22 May 2018: ETUC letter on the proposal for a directive on the company law package to Commissioner Thyssen <https://www.etuc.org/en/statutorydocument/etuc-letter-proposal-directive-company-law-package-commissioner-thyssen>