

# ETUI Policy Brief

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### The EU company law package: how it should be improved to strengthen workers' rights and avoid abuse through cross-border company mobility

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## Policy recommendations

The proposed EU company law package, which was published in April 2018 by the European Commission, seeks to encourage cross-border company mobility while at the same time protecting stakeholder interests. The ETUI's GOODCORP network of company law experts has identified three areas where the package needs to be revised in the interests of protecting workers' rights and discouraging corporate abuse and makes thirteen specific recommendations for amendment. These areas include: improving worker involvement rights; strengthening procedures for discouraging abusive behaviour such as tax evasion; and reducing the potential for fraud through online company foundations.

## Introduction

In April 2018 the European Commission published the EU company law package, which is the most significant European company law initiative since the Company Law Action Plan of 2003. It consists of two draft Directives. The first, a *Proposal for a Directive amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions* (European Commission 2018a), outlines procedures for three types of company reorganizations involving two or more Member States. The procedure for cross-border conversions, which involves companies exchanging their place of registration and legal form from their original country ("country of origin") for a registered seat and legal form from a new Member State ("destination country"), are new, as there is no European framework in place regulating such activity. The procedures for cross-border mergers, which involve the dissolution ("swallowing") of one or more companies by a company in another Member State, revise the framework defined by the 2005 Directive on cross-border mergers. The procedure for cross-border divisions, which involves the splitting up of a company into two or more companies in at least two Member States, is also new. The need for procedures regulating corporate cross-border activity has become particularly urgent in the wake of the European Court of Justice's Polbud decision (C-106/16), which strengthens the 'freedom of establishment' and the right to regime shopping by company owners. Strikingly, research conducted at the University of Maastricht for the ETUI indicates that cross-border corporate reorganizations are increasingly widespread, despite the lack of

an EU legal framework for the first and third types of activity, and fundamental inconsistencies between Member States' legislation on these matters (Biermeyer and Meyer 2018).

The second part of the EU company law package consists of a *Proposal for a Directive amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law* (European Commission 2018b). This draft Directive aims to promote the 'digitalization of company law' by requiring all Member States to enable the completely online registration of certain types of companies as well as company reporting to national registries.

At the time of writing, the package is being discussed intensively in the European Parliament and Council. The EP has announced an ambitious timetable for considering the package, with the goal of approving the package before the EP elections in May 2019. Draft reports for the Committee on Legal Affairs (JURI) have been published for both draft Directives (European Parliament 2018a; 2018b).

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The ETUI's GOODCORP network of trade union and academic experts on company law and corporate governance has been following closely the development of the EU company law package since its announcement in the European Commission's Work Programme for 2017. Upon publication of the package earlier this year, GOODCORP members wrote up a series of nine briefing papers addressing specific aspects of the package. These briefing papers, which are available at <http://www.worker-participation.eu/Company-Law-and-CG/Company-Law-Package>, identify which problems the package is designed to address, analyse the shortcomings of the package with regards to protection of stakeholder interests, and make recommendations for revision.

This Policy Brief summarizes the content of the briefing papers with regards to the three key areas addressed: worker involvement rights; anti-abuse provisions; and digital tools for company foundations and reporting. The thirteen recommendations are summarised in a box at the end of this Policy Brief.

## Worker information, consultation and participation rights

Since company law clearly impacts workers' rights, this was a key area of concern for the GOODCORP Group. The experts concluded that, rather than firmly anchoring this company law package in the context of the workers' rights *acquis*, the Commission's proposal skirts them or ignores them entirely. This is problematic since the concept of the *acquis communautaire* – the constantly evolving accumulation of legislation, legal acts, and court decisions which constitute the body of European law – is fundamental to the progress of Europe. Where the intersection between company law and workers' rights is evident, each new piece of legislation should take prior legislation into account in order to ensure the cumulative coherence of the whole EU regulatory framework.

The EU *acquis* already provides a solid foundation: the rights of the workforce as stakeholders to be informed and consulted and to participate in the governance of the company is laid down in fundamental documents, such as the Council of Europe European Social Charter, the Community Charter of Fundamental Social Rights, the Charter of Fundamental Rights in the EU, and in the European Pillar of Social Rights. Accordingly, common standards with respect to workers involvement have been laid down across the Union in the EWC Directive, the SE Directive, the Cross-border Mergers Directive, the Framework Directive on Information and Consultation, the Collective Redundancies Directive and the Transfer of Undertakings Directive.

There are two dimensions of worker's involvement rights which must be strengthened: firstly, **employees and their representatives at all levels of the company need to be adequately informed and consulted about the company's plans**: they must know the potential implications for employment and the strategies of the company, especially where the applicable laws governing the company are likely to change. Secondly, since the resulting company will be formed by the application of European law, **information, consultation and participation in resulting entities should also be Europeanised**, as is already the case

for the formation of SEs and the application of the Cross-border mergers directive. Where the resulting company is of a European scale, information and consultation within the company must be complemented by transnational information and consultation arrangements. Equally, where employee representatives had the right to representation within the governing bodies of the company, this form of representation must not only be maintained, but it must also be extended to the workforces on a European scale.

## Information and consultation prior to and during the legal reorganisation

While the Package does foresee an obligation to provide employee representatives with an official report, and allows for the publication of any opinion put forward by the workforce, this clearly does not amount to the structured and rigorous 'information and consultation' as it has been developed across the EU *acquis*. Despite the obvious transnational and multi-level interests at stake, the Commission fails to clarify the obligation that employee representations at all levels are informed and consulted.

There is no need to reinvent the wheel: where the company law package intersects with workers' rights, it must be more **explicitly embedded into existing employment law**, thereby not only strengthening workers' rights in the complexities of practice, but also increasing legal certainty for all parties (Recommendation 1).

## Workers' involvement in the reorganized companies

The outcome of the cross-border legal reorganisation must also ensure workers' involvement on a European scale. Negotiations must be held to develop tailor-made and effective forms of transnational information and consultation in reorganized companies. This precedent has been successfully established by the European Company Statute (SE); analogous to the European Works Councils Directive of 1994, the workforce of an SE has the right to set up bodies to engage in information and consultation on cross-border issues relevant to the workforce. Companies engaging in cross-border reorganizations must also be obliged to follow suit in order to enable the transnational interests of their workforces to be adequately addressed in the new entity.

The current proposal does not foresee negotiations on transnational information and consultation arrangements, referring only to the SE Directive's provisions for negotiating about board-level employee representation. Furthermore, the Commission's proposal that, in the case of a conversion, Member States be able to limit employee representation on boards to one third would undermine the Commissions' declared intent to safeguard acquired rights. By making **comprehensive reference to the SE Directive's provisions for information, consultation and board-level representation** where applicable, the package would more fully take into account the European dimension of the impact of company mobility on workers' rights (Recommendations 2 & 3).

In addition to the need to ensure a transnational level of information and consultation to complement existing national-level arrangements, cross-border company mobility raises specific challenges for national-level information and consultation.

A company's move to another legal jurisdiction may result in the disappearance of the established peak management-level counterpart for the employee side under national and European law (i.e., local, group or European/SE works councils.) In order to counter this risk, EU law should specify that any **obligations of the genuine administrative management are retained** at national level for the purposes of information and consultation of the workforce (Recommendation 4). Furthermore, if the applicable law changes, there must be a right to **renegotiate existing EWC or SE Agreements** (Recommendation 5). Finally, the provisions in the Transfer of Undertakings Directive, which protect the acquired rights of the workforce, must also be explicitly provided for (Recommendation 1).

## Employee representation in company boards

In line with the SE Directive, the proposed company law package already includes provisions whereby, according to a before-and-after principle, employee representatives from across the company are brought together to negotiate future arrangements for board-level employee representation that not only retain or adapt existing arrangements, but also extend this form of representation to the whole EU workforce.

Lessons have not, however, been learned from the experience thus far with the application of the SE Directive and the Cross-border Mergers Directive. ETUI research shows that both Directives have been misused to freeze out employee representation, even where a company later reaches thresholds above which representation rights would apply. Rather than cementing the situation at the moment in which the new legal form is applied, there is a clear **need for a dynamic instrument** that is able to address changes over time (Recommendation 5).

As a means of countering these risks, the Commission makes several proposals. Firstly, there is to be a three-year moratorium on further company law changes which would dismantle the negotiated participation arrangements. As three years is a very short period in the life of a company, this period should be **extended to at least ten years** (Recommendation 6).

Secondly, the Commission proposes that negotiations should be launched when the workforce reaches a level which is four-fifths of the applicable threshold under national law. This effectively lowers the threshold at which participation rights would apply in the new entity, but unless **fall-back solutions also apply before the national thresholds are reached**, it will have no effect whatsoever: decades of research on EWCs and SEs have demonstrated unequivocally that the availability of a fall-back solution is the *sine qua non* of negotiations in the first place. Without this default option, the employee representatives have no leverage in the negotiations (Recommendation 2).

## Anti-abuse provisions

A key concern of trade unions is that cross-border company mobility is used by many companies to avoid taxes, workers' rights and labour standards, and that an overly permissive regulatory framework would encourage more of such activity. Estimates of the number

of letterbox companies in Europe run up to 500,000 companies (European Commission 2017). A recent study by the ETUC shows how letterbox companies are used to avoid labour standards in sectors such as construction, transport and meatpacking, as well as to avoid taxation (ETUC 2017). An analysis of data gathered on cross-border corporate mobility by the University of Maastricht (Biermeyer and Meyer 2018) suggests that this mobility is higher in Member States scoring higher on a 'financial secrecy' index (ETUI/ETUC 2018: 82).

The EU company law package acknowledges this risk, referring a number of times in the recitals to 'artificial arrangements' which are 'aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or members' (e.g., Recital 7). To try to address this risk, in the case of cross-border conversions, the draft Directive creates a procedure whereby an 'independent expert' is to be appointed to examine key documents regarding the reorganization (e.g., the draft conversion terms and the reports to shareholders and employees) as well as other information from the company that wants to convert. On the basis of the independent expert report, the competent authority in the 'departing' Member State may decide to carry out a more in-depth examination. If it believes that the cross-border conversion would result in an 'artificial arrangement', it is authorized to block the conversion. A similar procedure is defined for the case of cross-border divisions.

The first problem here identified by the GOODCORP group is that a procedure has been defined for cross-border conversions and divisions, but not for cross-border mergers. One recommendation is therefore that **any anti-abuse procedure should also apply to cross-border mergers** (Recommendation 7).

A second concern is that the draft Directive is extremely vague about the independent expert – what kind of entity it should be, what kind of experience and skills it should have, how it should be funded, what kind of safeguards should be imposed relating to pre-existing relationships with the company being examined. In principle this is the type of activity that should be undertaken by a state agency or court. As a result, the GOODCORP group recommends that **a public entity, the 'competent authority' of the departure state, carry out the anti-abuse examination**, rather than an 'independent expert' (Recommendation 8).

A third concern is that the list of items to be examined to avoid abuse in the Commission's proposal (net turnover, profit/loss, number of employees, balance sheet) is too narrow, firstly to check if directors have criminal records and secondly to ensure that the 'destination' country of the cross-border reorganization has more than symbolic operations. The GOODCORP group therefore recommends that **background checks be made for company directors and that, in the case of cross-border conversions, a management body must pre-exist in the 'destination' country** (Recommendation 9).

## Digital tools for company foundations and reporting

The second part of the EU company law package, the draft Directive on the use of digital tools and processes in company law, is aimed at promoting the use of online tools for the registration of new

companies and for the fulfilment of reporting requirements vis-à-vis national business registers. The Commission argues that digital procedures could save time and money, thereby boosting the economy, job creation, innovation, etc.

A general concern of the GOODCORP group is that online procedures can increase the 'anonymity' of firm owners and directors and weaken the role that "gatekeepers" such as notaries and courts play in avoiding fraud. Of particular concern is the requirement that Member States enable fully online registration of companies within five business days, without physical presence of the company founders in the country of registration. This requirement could radically increase the ability to establish letterbox companies for fraudulent purposes within the EU. The Commission's estimate that €42-€84 million per year can be saved through online company registration pales in comparison to the costs of business fraud, which are estimated to run into the billions of Euros per year in Europe.

The GOODCORP group has a number of recommendations with regard to this risk. Firstly, **only the highest security level defined by the EU Regulation on electronic identification** (REG EU 910/2014) in conjunction with a video conference should be accepted for cross-border identification of directors and owners (Recommendation 10). Secondly, a **European system for identifying disqualified directors should be implemented** (Recommendation 11), as currently few Member States provide easily accessible lists of persons not suitable to serve as directors. Thirdly, this Directive should exclude legal and ownership forms and sectors where there is a high risk of fraudulent activity. **Only natural persons** should be allowed to found companies online (as the potential for fraud through chains of companies is much greater), and it should be possible **to exclude sectors such as construction and transport**, where fraud through letterbox companies is prevalent (Recommendation 12). Finally, the potential of digitalization to improve company transparency should be realized through **expanding the list of information** companies must provide (specifically employee numbers and agreements on worker involvement), making **documents available free of charge**, and **improving searchability** (including through a European online portal) (Recommendation 13).

## Conclusions

The proposed EU company law package aims at providing a regulatory framework for cross-border corporate reorganizations and encouraging the digitalization of company foundations and reporting. It should be recalled that the European Pillar of Social Rights is geared towards upwards convergence; hence, existing rights should not be downgraded. In summary, the current proposal does not go far enough to protect workers' rights and to avoid abuse and fraud. In order to better achieve these goals in the face of cross-border corporate mobility, the ETUI's GOODCORP group of experts on company law and corporate governance has put forward thirteen specific recommendations for amendment in three areas: worker involvement, anti-abuse provisions and online foundations and reporting. These recommendations are summarized in the following box. A number of these recommendations overlap with the changes proposed in the draft JURI report on the proposed

Directive on cross-border reorganizations (European Parliament 2018b). More detail is available in the briefing papers prepared by this group under [www.worker-participation.eu/Company-Law-and-CG](http://www.worker-participation.eu/Company-Law-and-CG)

### Thirteen recommendations of the GOODCORP group

#### On workers' involvement

- Prior to and during the cross-border legal reorganisation:
  1. Embed the company law package explicitly into the EU *acquis* on information and consultation rights at national and transnational levels
  2. Ensure application of standard rules for employee involvement, even if applicable threshold is not reached;
- After the cross-border legal reorganisation:
  3. Ensure adequate European-scale information, consultation and board-level employee representation and protect acquired rights;
  4. Ensure the existence of genuine and competent management;
  5. Introduction of dynamic element, including the right to renegotiate;
  6. Moratorium on legal reorganisations which would erode employee representation arrangements for at least ten years;

#### On anti-abuse provisions

7. A procedure for examining 'artificial arrangements' should also be included in the section of the Directive applying to cross-border mergers;
8. A public entity, the competent authority of the departure state, should carry out the anti-abuse examination, rather than an independent expert;
9. The catalogue items for 'anti-abuse' checks should be expanded to include a background check of directors and the existence of a management body in the 'destination' country prior to cross-border conversions;

#### On digital tools and processes

10. For online foundations, owners and directors should be identified only through electronic ID compatible with the highest security level of the Regulation on electronic ID in conjunction with a video conference;
11. A European system for identifying disqualified directors should be set up and made available;
12. Legal and ownership forms and sectors where there is a high risk of fraudulent activity should be excluded from online foundations;
13. Transparency of company information should be greatly increased, through expanding required information (e.g. employee numbers, ICP agreements), making documents available free of charge, and improving searchability (including through a European portal).

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