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The European Private Company (SPE): Uniformity, Flexibility, Competition and the Persistence of National Laws

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Abstract

In 2008 the European Commission put forward proposals for a European Private Company (SPE), following up on the adoption of the European Public Company legislation of 2001. Although speedy adoption of the SPE proposals was initially hoped for, subsequent negotiations among the member states have stalled, despite at least two revised drafts of the proposals having been produced by the Presidency of the European Council. This article seeks to identify the challenges posed to the national company laws of the member states by the Commission's proposals for a 'simple and flexible' Community form of incorporation. It seeks to argue that the discussions among the member states have revolved mainly around the question of the appropriate role for mandatory rules in modern company law. Member states have been reluctant to see the SPE freed from mandatory rules to which their national companies are subject, because of the competition to their national laws which the SPE would generate. On the other hand, member states with few mandatory rules in their domestic law have been reluctant to see the SPE burdened with mandatory rules which do not apply to domestic companies, because otherwise their businesses will be deterred from taking up the new European form and obtaining its advantages. The article predicts that, of the possible legislative solutions to this conflict, referring more of the rules applicable to the SPE to the national law of the state in which the SPE is registered is likely to be the dominant one, even though this will undermine both the uniformity and flexibility goals of the proposed legislation. It also considers how effective the 'national law' strategy is likely to be in the light of the Treaty provisions on freedom of establishment.

Keywords: European Private Company (SPE), European Commmunity forms of incorporation, regulatory competition, freedom of association

JEL Classifications: G38, K22

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THE EUROPEAN PRIVATE COMPANY (SPE): UNIFORMITY, FLEXIBILITY, COMPETITION AND THE PERSISTENCE OF NATIONAL LAWS

Paul Davies*

ABSTRACT

In 2008 the European Commission put forward proposals for a European Private Company (SPE), following up on the adoption of the European Public Company legislation of 2001. Although speedy adoption of the SPE proposals was initially hoped for, subsequent negotiations among the member states have stalled, despite at least two revised drafts of the proposals having been produced by the Presidency of the European Council. This article seeks to identify the challenges posed to the national company laws of the member states by the Commission's proposals for a 'simple and flexible' Community form of incorporation. It seeks to argue that the discussions among the member states have revolved mainly around the question of the appropriate role for mandatory rules in modern company law. Member states have been reluctant to see the SPE freed from mandatory rules to which their national companies are subject, because of the competition to their national laws which the SPE would generate. On the other hand, member states with few mandatory rules in their domestic law have been reluctant to see the SPE burdened with mandatory rules which do not apply to domestic companies, because otherwise their businesses will be deterred from taking up the new European form and obtaining its advantages. The article predicts that, of the possible legislative solutions to this conflict, referring more of the rules applicable to the SPE to the national law of the state in which the SPE is registered is likely to be the dominant one, even though this will undermine both the uniformity and flexibility goals of the proposed legislation. It also considers how effective the 'national law' strategy is likely to be in the light of the Treaty provisions on freedom of establishment.

INTRODUCTION

The European Commission recently put forward proposals for the creation of a second general form of Community level incorporation for commercial companies. This is the proposal for a European Private

Company.[1] If adopted, it would supplement the existing provisions for a European (Public) Company, adopted in 2001.[2] The European Company is normally referred to as the SE (derived from the Latin *societas europaea*) and so the European Private Company is frequently referred to, and will be in this paper, as the SPE (*societas privata europaea*).

The main objectives of the SE were two-fold: first to facilitate cross-border mergers within the EC and, second, to reduce the costs of running groups by making it possible to fold existing national subsidiaries into a single SE. What do we know about the take-up of the SE? There have been two important pieces of research on this, one by Dr Kirshner[3] and one by Professor Eidenmüller and colleagues.[4] Dr Kirshner's research, based on case studies, suggests that the intra-group impact of the SE has been fairly limited. Combining subsidiaries in order to reduce the administrative costs of running separate subsidiaries has not proved a major incentive towards adoption of the SE form. However, she did find that in industries subject to regulation there was a move towards the single SE model, because that reduced compliance costs. The rules of only one regulator had to be understood and complied with. So, reducing regulatory costs within groups seems to have been a bigger incentive than reducing administrative costs. Of course, these findings also suggest a rather limited role for the 'bundling' function of the SE.

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[1] Commission of the European Communities, *Proposal for a Council Regulation on the Statute for a European private company*, June 2008 (COM(2008) 396/3) 2 (available at: http://ec.europa.eu/internal_market/company/docs/epc/proposal_en.pdf.) – hereafter 'Commission's proposals'). In addition to the European Public Company (see n 2) other existing forms of Community incorporation are the (long-standing) European Economic Interest Grouping (EEIG) (Council Regulation 2137/85/EEC (OJ L199/1, 31.07.85)), designed to promote cross-border economic development among the members of the grouping but on a non-profit basis, and the more recent Statute for a European Cooperative Society (Council Regulation 1435/2003/EC (OJ L207/1, 18.8.2003)). Neither is heavily used. In addition to its proposals for a European Private Company the Commission has consulted on proposals for a European Foundation (see http://ec.europa.eu/internal_market/company/eufoundation/index_en.htm).

[2] Council Regulation 2157/2001/EC on the Statute for a European Company (SE) (OJ L294/1, 10.11.2001) (hereafter SE statute) together with an accompanying directive on worker involvement in the SE: Council Directive 2001/86/EC supplementing the Statute for a European Company with regard to the involvement of employees (OJ L294/22, 10.11.2001).

[3] J Kirshner, 'Regulatory Competition in Europe? – The Societas Europaea' forthcoming in *European Company and Financial Law Review*.

[4] H Eidenmüller, A Engert and L Hornuf, 'Incorporating under European Law: the Societas Europaea as a Vehicle for Legal Arbitrage' (2009) 10 *European Business Organization Law Review* 1. See also B Keller and F Werner, 'The establishment of the European Company (SE) – The first cases from an industrial relations perspective' (2008) 14 *European Journal of Industrial Relations* 153.

The survey by Eidenmüller and colleagues confirms that in many member states there are rather few SEs and even fewer if one counts only active SEs.[5] However, the findings also show considerable variation across the Community. In particular, the researchers found a surprising number of SEs in Germany. It seems that modification of the domestic codetermination rules was very often a reason for the formation of an SE. This is a very interesting finding because German fears that SEs would allow domestic companies to escape from national rules on mandatory board appointments rights for employees by becoming SEs delayed adoption of the Regulation for many years. First, it was proposed that board level appointment rights for employees should be mandatory for all SEs, but this was not accepted by states without any such domestic requirements. Eventually, the principle of 'no escape, no extension' was adopted whereby the applicable rules on board composition in the SE depend on the rules applying under the national laws to the companies forming the SE.[6] This solution was embodied in a Directive which accompanies the Regulation.[7]

Nevertheless, Eidenmüller and colleagues showed that modifications of the domestic German codetermination regime were available to German companies which became SEs and that these modifications seem to have been powerful enough inducements to take up the SE form in some cases. Although an SE whose founders include a German company subject to German board appointment rules is in principle subject the German rules,[8] three modifications to the domestic regime are available upon formation of an SE. The SE can choose to have a smaller board than German law requires, so that the number, if not the proportion, of employee appointees is reduced and a smaller board might be regarded in general terms as a more efficient decision-making body. The representatives are appointed by the whole of the workforce of the SE and not just by its German employees and possibly with less trade

[5] This finding is supported by the research carried out by Ernst & Young for the Commission which, in early 2009, found that there were 369 SEs in the Community but they were not evenly distributed across the Community. 91 were in Germany and 137 in the Czech Republic, 98 of the Czech companies being shelf companies. 10 member states had that time had no SEs. For the concentration in Germany see below. The Czech situation seems not to have been satisfactorily explained. The number of SEs formed each year was, however, increasing. (Ernst & Young, *Study on the operation and the impacts of the Statute for a European Company (SE)*, December 2009)

[6] An SE can be formed, but only by existing companies, through merger, formation of a joint holding company or joint subsidiary or by simple transformation of an existing company into an SE. Formation of an SE by merger or transformation is confined to existing public companies and in all methods of formation some significant existing cross-border activity must predate the incorporation of the SE. See SE Statute, above n 2, art. 2.

[7] See above n 2. This principle, although simple to state, was immensely complex to implement, in part because the founding companies might be subject to different board appointment rules for employees and in part because management and union can by agreement in most cases opt out of them. See P Davies, 'Workers on the Board of the European Company?' (2003) 32 *Industrial Law Journal* 75.

[8] This would not be the case if another company involved in the formation of the SE were subject to 'stronger' board appointment rules under its national law pre-formation than the German company. See Davies, above n 7.

union influence over the choice of representative than under the domestic German rules. Extending appointment rights to all the employees of the SE and its subsidiaries was a deliberate policy of the SE rules but it might have the effect of diluting the influence of the German representatives who might be the ones most experienced with, and thus best placed to make use of, the appointment rights.[9]

Finally, the SE rule would be the one applicable to the German company at the time of the formation of the SE and it would not alter if, later on, circumstances changed in such a way as would have triggered an upward revision in the appointment rights under national law. Most obviously, the employees of a German company with, for example, 1500 employees would hold appointment rights to one third of the board seats. That entitlement would increase to one half if the number of employees exceeded 2000, if German law still applied.[10] If in the meantime the German company had become an SE, the proportion would remain fixed at one third.[11] Equally, if the German company formed an SE before reaching the 500 employee threshold for one third board level representation, it would escape the German rules if, later but as an SE, it moved above the threshold.

Overall, the SE has been an interesting development, but difficult to say that it has been a success from the point of view of the Commission's goal of encouraging cross-border activities by companies; and at least one main driver of the use of the SE has been a factor (modification of board appointment rights for employees) which the Community legislator positively wanted to exclude. The picture which emerges is (a) modest use of the SE form to date and (b) that use not being driven primarily by the reasons which motivated the Community legislator to introduce this Community form of incorporation. Given this history of limited success with the SE, it is perhaps surprising that the Commission, which

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[9] See supplementary Directive, above n 2, Annex, para 1(a). Any change in the comparative influence of the trade unions over the appointment of the employee representatives turns on (a) which form of the German representation system applied before the formation of the SE (see following note) and (b) the method chosen for the selection of the employee representatives to the SE board. The default rule on the latter point is that the method is determined by the state in which the employees work (Directive, Annex, para 1(b)). This could range from election by the workforce as a whole (thus reducing trade union influence) to appointment by the recognised union or a body which that union dominates.

[10] Leaving aside the iron, coal and steel industries, German law requires appointment rights in relation to one third of the (supervisory) board seats once the company has 500 employees (One Third Participation Act 2004 (Gesetz über die Drittelbeteiligung der Arbeitnehmer im Aufsichtsrat), replacing legislation dating back to 1952) and appointment rights in relation to half the seats once the company exceeds the 2000 employee threshold (Codetermination Act 1976 - Mitbestimmungsgesetz). The union has a stronger formal role in the choice of employee representatives in the parity system than under the one-third arrangements (Codetermination Act §7(2) *cf* One Third Participation Act §§4-6). Once the company exceeds a threshold of 10,000 employees the minimum board size becomes 16 and above 20,000 employees it is 20 (§7(1)).

[11] Article 11 of the Directive accompanying the SE Regulation (above n 2) requires member states to put in place mechanisms to combat the 'misuse' of the SE 'for the purpose of depriving employees of rights to employee involvement or withholding such rights'. This may deter German companies from using the SE mechanism where their sole motive is to modify or freeze the domestic representation arrangements.

has a monopoly over the initiation of legislative projects within the EU,[12] should have decided to devote itself in 2008 to the creation of a further Community level form of incorporation, this time aimed at small and medium-sized enterprises. There may be a political explanation. At the time of the adoption of the SPE proposal the Commission was in the process of backing away from two potentially much more significant legislative initiatives, namely, a requirement that voting and cash flow rights be aligned in publicly traded companies ('one share, one vote')[13] and a proposal which would facilitate the transfer of a company's registered office from one member state to another and thus open up the prospect of regulatory competition within the EU of an intensity previously unknown.[14] The SPE project may have had the advantage to the Commission that it kept up the appearance of momentum in the corporate area and was, moreover, a popular initiative with the European Parliament[15] and some member states, notably France.[16]

In Part One of this paper we identify the gains thought to be available through the SPE legal form and the attributes the SPE would need to possess if those gains were to be realised. These are essentially that the mandatory rules applicable to the SPE should be uniform across the Community, but that the SPE form should give founders considerable freedom to shape the SPE to meet their particular needs, ie that mandatory rules should not predominate. In Part Two the paper points to the competitive threat posed by the SPE proposals to national private company laws, especially those containing significant mandatory rules, and shows the development of opposition to the Commission's proposals from those states which value their mandatory rules. However, it also predicts that states with more liberal national regimes will be unwilling to see extensive importation of mandatory rules into the SPE form, for fear of

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[12] Art 289 of the Consolidated Version of the Treaty on the Functioning of the European Union (TFEU).

[13] Speech by Commissioner McCreevy to the Legal Affairs Committee of the European Parliament, 3 October 2007.

[14] Commission of the European Communities, *Impact assessment on the Directive on the cross-border transfer of registered office*, Brussels, December 2007 (SEC(2007) 1707). Opinions differ on whether, if the legal obstacles to mobility were removed, states would be strongly motivated to attract incorporations and whether companies would attach a high value to the free choice of corporate law. Compare L Enriques, 'EC Company Law and the Fears of a European Delaware' (2004) 15 *European Business Law Review* 1283 and J Armour, 'Who Should Make Corporate Law? EC Legislation versus Regulatory Competition' in J Armour and J McCahery (eds), *After Enron* (Oxford, Hart Publishing, 2006) (also in (2005) 48 *Current Legal Problems* 369).

[15] The EP had come out in favour of the SPE project at an early stage: European Parliament, *Report with recommendations to the Commission on the European private company statute*, 2006 (A6-0434/2006).

[16] The debate on the SPE was effectively launched with the publication in 1998 of *Société Privée Européenne* by the Chambre de Commerce et d'Industrie de Paris and the Conseil National du Patronat Français. As compared with the Commission's initial proposal (above n 1) this proposal (a) left more matters to be regulated by the SPE in its articles and (b) excluded national law more thoroughly. Thus, the Commission's initial proposal can be seen as already taking some steps to protect member states' national company laws from the competitive threat of the SPE. For comment on this early proposal see J McCahery and E Vermeulen 'The Evolution of Closely Held Business Forms in Europe' in J McCahery, T Raaijmakers and E Vermeulen (eds), *The Governance of Close Corporations and Partnerships* (Oxford, OUP, 2004) 206-208.

producing a Community form of incorporation which is unattractive to their business people (the 'access' threat). Part Three of the paper identifies the principal areas of substantive law where these conflicts have revealed themselves in the member states' deliberations on the Commission's proposals. These are the areas of minimum capital, employee board appointment rights, directors' duties and expulsion and exit rights. It shows that the dominant solution to the conflicts among the member states has been a move to derive more of the rules applicable to the SPE from the national law of the member state in which the SPE is registered. Part Four considers the limitations on this 'national law' strategy as a method of protecting member states' domestic company laws in the light of the Court of Justice's interpretation of the Treaty provisions on freedom of establishment and the specific right to transfer the registered office which is granted to the SPE. Part Five concludes.

PART ONE

THE RATIONALE FOR THE SPE

When analysing the Commission's proposals for a European Private Company (hereafter 'SPE') it is useful to identify its reasons for introducing this legal form. It is not obvious that such a form is needed. It is not the case that an integrated market in a federal or quasi-federal political system requires a federal level form of incorporation. We know that because the United States has a highly integrated economy without any federal form of incorporation. On the other hand, Canada makes available both provincial and federal forms of incorporation,[17] whilst Australia, which had state-based incorporation, has moved in recent years to a uniform company law.[18] So, there may be advantages in a federal or Community level form of incorporation or in uniform company law (the two things are not the same, of course), but they are not a sine qua non for the operation of a single market across political units. We cannot simply jump from the goal of a single market to the conclusion that a federal form of incorporation is needed to achieve that goal. A federal form of incorporation may be helpful to the promotion of the single market, but we need to know more precisely how this facilitation is expected to occur.

When we consider the SPE we have a very clear statement from the Commission about its vision of the function of the SPE. As the Explanatory Memorandum attached to the Commission's 2008 proposals

[17] See D Cumming and J MacIntosh, 'The rationales underlying reincorporation and implications for Canadian corporations' (2002) 22 *International Review of Law and Economics* 277.
[18] For a brief survey of the complex federal/state inter-relations in Australia, see R Austin and I Ramsay, *Ford's Principles of Corporations Law* (12th ed, Butterworths, Australia, 2005) 2.170.

puts it, the aim is to facilitate the cross-border operation of SMEs by providing them with "the same, simple, flexible company law provisions across the Member States." An entrepreneur should be able to incorporate in one member state and then engage in cross-border trade making use of a subsidiary incorporated in another member state, the company law rules applicable to the incorporation in the second (and any subsequent member state) being the same as in the first member state. This is the argument for uniformity. However, the Commission put forward not just a uniformity argument: in order to facilitate cross-border activities the new legal form should also be attractive to business people, so it should be 'simple and flexible'. For example, a new Community form which lacked limited liability might achieve uniformity, but it would lack attractiveness. It is crucial to the Commission's plan that the new Community form of incorporation should display both features. To some extent, of course, the goals of uniformity and simplicity/flexibility are in tension with one another. In the above example, flexibility permits the entrepreneur to craft the corporate rules so that they most appropriately fit the relevant business environment and to replicate that choice across borders. However, flexibility also means that the entrepreneur cannot assume that other SPEs which deal with the SPE established by the entrepreneur are subject to the same rules. So, some costs will be incurred in investigating this question as part of inter-company dealings, which costs could be reduced or even avoided altogether if the applicable legal regime were uniform but not flexible.

In fact, there are grounds for being sceptical about the claim that a simple, flexible and uniform Community form of incorporation will be of significant value in promoting cross-border activities by small businesses. The data contained in the European Business Test Panel survey, which the Commission itself uses to justify its proposals, is hardly convincing.[19] Only 8% of respondents currently carrying on cross-border business said that they faced barriers as a result of their 'legal status' when conducting business in other member states, ie barriers resulting from having to form a company in that other member state or register a branch there under the law of that other state. By contrast, just over one third said that they faced barriers not related to their legal status, such as employment, tax or consumer protection law, and just over half that they faced no barriers at all.[20] This suggests that the Commission would do well to identify what these non-company law legal barriers are and establish whether they are more important than legal status barriers. As things stand, the Commission's proposal is open to the

[19] EBTP, *European Survey on European Private Company*, 2007, available on: http://ec.europa.eu/yourvoice/ebtp/docs/epc_report_en.pdf.
[20] Ibid 1.

criticism that it constitutes the use of a sledge hammer to crack a nut, ie it is a disproportionate response to the identified problem.

It is true that 56% of all respondents (whether currently carrying on cross-border business or not) said that uniform company law rules would be useful to them.[21] This is hardly surprising. If you are offered something for free, even if you do not think you will make much, if any, use of it, naturally you will say yes (at least if you are not offered something else which you can have only if you turn down the first offer).[22] However, whilst the SPE is a free good for business people, it is not a free good for the Commission or the Community at large. The Commission incurs an opportunity cost when deciding to secure the SPE legislation as opposed to some other legal reform and so it would have been comforting to see the SPE proposal justified in comparative legal reform terms. It is by no means implausible to think that the Community as a whole would be better off if the Commission devoted itself to securing the passing of a Directive on the transfer of the registered seat for all companies or in pursuing the abandoned project of promoting proportionality between cash-flow and voting rights of shareholders in publicly traded companies or some initiative outside the area of company law altogether. We simply do not have any analysis of this type from the Commission.[23]

One may also wonder how much agreement is to be found underlying the 56% figure. There may be majority agreement among business people across the Community on the platonic ideal of a SPE, but that may conceal considerable disagreement over on any particular manifestation of that ideal. Will business people in any particular member state be happy with a Community-wide corporate vehicle which is significantly different from their tried and tested domestic business form, even if it is uniform across member states? If not, one may expect that the level of business approval for concrete proposals to create an SPE will be considerably less than the 56% figure.

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[21] Ibid 2.

[22] In other words, we get no sense from the Panel's questions how respondents ranked the SPE proposal as against, for example, greater uniformity or simplicity in labour, consumer or tax laws.

[23] The High Level Group in its report of 2002 was lukewarm about the SPE proposal and recommended a feasibility study before a formal proposal was made. See *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe*, Brussels, November 2002, ch VII. The feasibility study which was later commissioned (AETS, *Etude de faisabilité d'un statut européen de la PME*, July 2005), whilst containing much interesting material, did not explicitly address the issue of comparative benefits from alternative legal reforms. On the formulation of the SPE statute itself, its analysis is mainly directed at identifying the likely take up by SMEs in different jurisdictions of differently formulated versions of an SPE statute.

PART TWO

THE SPE PROPOSAL AND THE IMPACT ON NATIONAL COMPANY LAWS

Although one may think that the benefits to businesses of a uniform private company law are likely to be small and have been exaggerated by the proponents of the SPE, this paper focuses on a different question. This is the likely willingness of the member states to accept an SPE which is uniform across the Community, simple and flexible. It is germane to remember at this point that the SPE project will be adopted only if it achieves a very high degree of consensus – or at least indifference – among the member states in the Community's legislative process, since the proposal has been put forward under Article 308 EC,[24] which requires the unanimous consent of the member states.

Why member states will find agreement difficult to reach

Why might it be difficult to build a consensus among the member states on the SPE? I suggest this is, as a first step in the analysis, because the Commission's aim of giving SME's a uniform but flexible form of Community incorporation is likely to bring it into conflict with those member states whose national systems are less flexible and which attach importance to the national mandatory rules which express that lesser degree of flexibility. The SPE statute is likely to be perceived as a competitor with national systems of company law, and in particular as capable of undermining the mandatory rules contained in the domestic system. If a firm can escape the national mandatory rules through the expedient of incorporating as an SPE, then the national rules lose much of their mandatory character, especially if the SPE is overall simple and flexible, so that a switching company is not just exchanging one set of mandatory rules for another equally extensive (if differently directed) set of rules. In other words, the SPE expands the 'menu' of legal forms on offer to incorporators by placing on that menu a particularly attractive 'dish'.[25] The fact that the SPE is an optional form of incorporation will not allay member states' concerns on this point, because it is an option for entrepreneurs, not states. In fact, the optional nature of the SPE is exactly the source of the difficulty, because it allows the firm to opt out of the national mandatory rules. It is precisely the possibility of escaping from national mandatory rules which

[24] Now Article 352 TFEU.
[25] R Kraakmen et al, *The Anatomy of Corporate Law* (2nd ed, OUP, 2009) 22.

has been put forward by commentators as constituting a major incentive to make use of the SPE statute.[26]

In effect, although not formally a harmonising instrument, the SPE statute, as proposed by the Commission, functionally operates in this way and in a deregulatory direction. Countries which suffered a high level of transfer of their companies to the SPE form would come under strong pressure to adapt their national rules so as to bring them closer to the SPE model. There is already experience in the EU with this type of response by companies and counter-response by member states. After the decision of the Court of Justice of the European Union in *Centros*,[27] there was pressure on member states to reduce or eliminate their minimum capital rules to stem the flow of incorporations to jurisdictions with no such requirements (usually the UK).[28] Moreover, it is likely that member states, which successfully resisted the threats to their mandatory rules in the Commission's early programme for the 'top down' harmonisation of the substance of their domestic company laws, will not welcome this indirect, but strong, form of harmonisation through competition from Community forms of incorporation. That harmonisation programme, which began in the 1960s, ran into the sands in the early 1990s because of the impossibility of securing member state agreement (even on a qualified majority vote basis) to the harmonisation of core areas of company law, such as the rules governing board/management or majority/minority shareholder relationships or the derivative action.[29]

There is one group of member states which might be happy with the Commission's proposals – or, at least, apathetic towards them. Those member states whose laws already reflect the rules proposed by the Commission would have no reason to oppose them and might even promote them – for example, if they thought there was an advantage to their business people in having a European 'branding' on those rules

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[26] D Lattuca and P Santella, 'The Case in Favour of the European Private Company (SPE) – A Competitive Alternative for SMEs?'in M Neville and K Sørenson (eds), *Company Law and SMEs* (London, Thomson/Sweet & Maxwell, 2009). See also M Siems, L Herzog, and E Rosenhäger,'The European Private Company (SPE): An Attractive New Legal Form of Doing Business?' (2009) *Butterworths Journal of International Banking and Financial Law*, 247-250. (Available at SSRN: http://ssrn.com/abstract=1350465). Both articles legitimately take as the starting point for analysis the hypothesis that the SPE will be adopted much as proposed by the Commission in 2008. It is that hypothesis which this piece questions.

[27] Case C-212/97, *Centros Ltd v Erhverus-og Selkabsstyrelsen* [1999] E C R I-1459. This line of case-law is discussed further in Part 3 below.

[28] See M Becht, C Mayer and H Wagner, 'Where Do Firms Incorporate? Deregulation and the Costs of Entry', ECGI Law Working Paper 70/2006; U Noack and M Beurskens, 'Modernising the German GmbH – Mere Window Dressing or Fundament Redesign?' (2008) 9 *European Business Organization Law Review* 97.

[29] J Wouters, 'European Company Law: Quo Vadis?' (2000) 37 *Common Market Law Review* 257 at 272ff; L Enriques, 'Company Law Harmonization Reconsidered: What Role for the EC?' ECGI Law Working Paper 53/2005.

rather than just their national one.[30] However, the extent to which this is likely to be so turns on the balance between mandatory and default rules in the SPE statute. A version of the SPE statute which put the main emphasis on SPE choice of rules through its articles might out-gun even some of the most liberal national regimes.[31] In this case, a member state might have to favour an advanced version of the theory of company law as simply 'enabling' law for it to be happy with the SPE proposals.

Strategies for dealing with the SPE's competitive threat

How might one expect member states wishing to protect their national mandatory rules to respond to the uniform but flexible proposals of the Commission? There are three obvious legal/negotiating strategies which could be used to reduce the competitive threat from the SPE. The first is to restrict the range of national businesses which have access to the new European form. The second is to increase the number of mandatory rules in the Directive, thus directly cutting back on the flexibility offered by the new corporate form. The third is to refer a larger number of matters to regulation by national law (ie the law of the state in which the SPE is registered), thus permitting member states, which wish to do so, to maintain their mandatory rules in the referred area. It is the contention of this piece that all three forms of reaction can be found in the versions of the SPE statute, subsequent to the Commission's proposals, which have been produced by successive Presidencies and put forward for consideration in the Council of the European Union.[32] However, the strongest tendency has been the third, reference to national law to set the SPE rules. This paper will focus in particular on the Presidency version of 27 November, 2009,[33] the latest available and the time of writing, but some reference will also be made to the Presidency version of 8 December, 2008.[34]

Of course, these reactions are themselves controversial, because they undermine the rationale put forward by the Commission for the SPE initiative. However, the three restrictive reactions to the Commission's proposals have somewhat different implications for its utility. Specifying conditions for

[30] Some recently admitted member states are said to be in that position. See the AETS study, above n 23.
[31] See the discussion in Section Three of the SPE proposals on directors' duties and their possible impact in the UK.
[32] One difficulty for analysis is that the Presidency drafts are not always publicly available. However, some can be found on the web-sites of interested parties.

[33] Available at: http://www.europolitics.info/pdf/gratuit_en/262452-en.pdf.
[34] Available at: http://www.fecif.org/downloads/FECIF237.pdf.

access to the SPE form essentially divides up jurisdiction to determine the rules as between the member state and the Community. Companies operating within a national state will have their legal regime determined only at member state level[35] because they do not have access to the Community form, whilst others will have it determined at Community level.[36] The other two restrictive approaches leave the SPE form formally available to all businesses but increase the mandatory content of the rules applicable to the SPE, either directly by incorporating them in the SPE statute or by way of reference to national law.

Those in favour of uniformity will be opposed to national rules as a major source of rules for the SPE. Their objection will be that otherwise the SPE will fail to avoid the curse of the European Public Company (SE), namely, that it has turned out to be not a single Community form but a Community form which varies significantly from member state to member state because of the extent of the reliance in it on national law.[37] However, it is predictable that the area in which it will be most difficult to secure member state consent is in relation to the uniform substantive rules to be included in the SPE statute. Any particular proposal for a mandatory rule runs the risk of being opposed by those member states which want a differently constructed mandatory rule incorporated, as well as by those who see no need for a mandatory rule in the area at all. Those states thinking that no mandatory rule is necessary will not be content with the counter-argument that their entrepreneurs can rely instead on the flexible national form provided by that state. If the SPE has value, all states will want their entrepreneurs to have access to it on terms which are not more onerous than those laid down in national law. Consequently, reliance on the national law may turn out to be the path of least resistance in the inter-state negotiating process, since it leaves the member states free to shape the relevant mandatory law or to dispense with a mandatory rule.

Restricting access to the SPE

[35] Of course, post-*Centros* the relevant member state might not be the state where the company carries on its main business activities. Again, it is surprising that none of the Commission's pre-proposal documents deals with the question of whether, over time, regulatory competition confined to the member states' laws would provide the appropriate degree of flexibility for SMEs, without the addition of a competing Community set of rules. Recital 19 of the Commission's proposal simply asserts that the subsidiarity test is satisfied because only the Community can create a Community-level corporate form. Whilst this is self-evident, it does not answer the question of whether a Community form is needed to promote effective competition.

[36] In theory, companies in the latter group could choose to continue to be regulated by national law, but we are proceeding at the moment on the hypothesis that the Community form of incorporation will be highly attractive to businesses which are permitted access to it.

[37] J Rickford, 'Inaugural Lecture – The European Company' in J Rickford (ed) , *The European Company* (Antwerp-Oxford-New York, Intersentia, 2003) ch 2.2.

Under the Commission's 2008 proposals no cross-border element was required for the incorporation of an SPE and it could be formed by natural as well as legal persons.[38] In both respects the Commission's proposals contrasted with the SE statute which, as adopted, is open only to existing corporate bodies (in some cases only to public companies) and, even then, only in circumstances where a cross-border element existed before the creation of the SE.[39] In most cases, the fabrication of a cross-border element for the purposes of obtaining access is restricted by the requirement of a two-year prior period in which the cross-border condition must be satisfied.[40] By contrast, in the Commission's proposals the SPE was a full competitor with the national form of incorporation for SMEs because of the absence of any existing cross-border requirement. Even the European Parliament, generally a strong supporter of the SPE proposal,[41] found this approach too strong. In its Report of February 2009 it recommended a mild amendment to the Commission's approach. The Report argued, probably correctly, that the present proposal would not survive a good faith application of the subsidiarity principle.[42] However, it recommended only a 'light touch' cross-border requirement, lest that requirement 'be used as a pretext for hindering the creation of companies.'[43]

It is thus not surprising that the Presidency 2009 proposal contains some restrictions on access to the new corporate form, but they are indeed distinctly light touch. The required cross-border component can be satisfied in a number of ways, including having the intention to do business in a member state other than the one in which the SPE is registered or having a cross-border business objective stated in the articles of association.[44] Thus, cross-border activities are not required at the time of formation. Prospective activities of this type are enough, and there is no obvious check on whether the intentions are later realised, for example, a requirement that the SPE convert to a national form of incorporation if no cross-border activities are embarked upon within a certain period of time.

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[38] Above n 1, art.3.1(e).
[39] See n 6 above.
[40] SE statute, art. 2. The two-year prior period does not apply to the formation of an SE by merger, but only public companies have access to the formation of an SE in this way. At least two of the merging companies must be subject to the laws of different member states, but one of them, it appears, could have been incorporated for the purpose of the merger.
[41] See n 15 above
[42] "Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level." (Art 5(3) TFEU).
[43] European Parliament, *Report on the proposal for a Council regulation on the Statute for a European private company*, February 2009 (A6-0044/2009) 44.
[44] Presidency 2009 proposals, above n 33, art. 3.3. Nor is it clear how the incorporators' intentions are to be manifested.

It is probably correct to conclude that these changes will not greatly deter those who have a strong incentive to escape from national regulation into the new form. The SPE may thus remain a significant competitor for national forms of incorporation, especially for the most dynamic and successful businesses, even if a cross-border qualification of the above type is introduced.

Increasing the quotient of mandatory rules

With the gateway to the new corporate form only slightly narrowed by the above changes, it is not surprising that the attention of the member states turned to the two other strategies for dealing with the competitive threat posed by the SPE statute, ie strengthening the mandatory rules in the proposed statute and leaving more issues to be regulated by national law. Four substantives areas have proved to be controversial so far in the negotiations, together with the question of whether the registered office and centre of administration of the SPE should be required to be in the same member state. Some of these issues are familiar from the negotiations on the SE, others are not.[45] It has not been possible to reach agreement on all of them and so the negotiating process among the member states has stalled,[46] though it is not absolutely clear which are the sticking points within these disputed areas. We look at the substantive questions in Part Three and the 'seat' issue in Part Four.

PART THREE
AREAS OF CONTENTION AND THE TREND TOWARDS NATIONAL RULES

Minimum capital

In view of the scholarly debate, which has undermined the case for the type of low-level, uniform and non-adapting minimum capital requirement typically found in corporation law statutes,[47] it is perhaps

[45] Minimum capital, for example, was not an issue in relation to the SE because Community law already required minimum capital for national public companies: Second Council Directive 77/91/EEC, [1977] OJ L26/1, art 6. This Directive was the second in the harmonisation programme referred to above in the text attached to n. 29.

[46] See 'European Private Company still blocked in Council', *Europolitics*, 7 December 2009 (available on: http://www.europolitics.info/business-competitiveness/european-private-company-still-blocked-in-council-art256918-4.html.

[47] J Armour, 'Legal Capital: An Outdated Concept?' (2006) 7 EBOR 1 argues that adjusting creditors do not need the protection of minimum capital rules (at 19), and concludes 'that it is hard to find a category of non-adjusting creditors for whom minimum capital rules offer useful protection' (at 21). Of course, minimum capital rules could be reformulated so as to play a significant protective role, as is currently the case of banks and other financial institutions, where the rules are in the process of being strengthened. However, effective minimum capital provisions would require a much more sophisticated set of rules, as well as a significantly higher level of regulatory input to enforce them than is currently provided for the general

surprising that member states have been so reluctant to let go of the requirement in relation to private companies. Although some states have either abolished or softened minimum capital requirements for private companies in recent years – perhaps more as a result of regulatory competition than conviction[48] - others have either retained them and yet others, whilst engaging in reform, have hedged around access to company formation on the basis of only a nominal capital with other restrictions.[49] The appearance of the SPE as a potential competitor to national company laws causes these battles to be fought out again, but this time at Community level.

In line with its commitment to flexibility, the Commission proposed that the SPE should require a minimum capital of only €1 – in effect, no minimum capital.[50] Despite its commitment to the promotion of SMEs, the Parliament has been more cautious, proposing a minimum capital requirement of €10,000 in its original report of 2006[51] and one of €8000 in its 2009 report on the Commission's proposals, unless, under the 2009 report, a solvency statement was made mandatory for distributions, in which case €1 was to be sufficient.[52] The latter proposal represented, of course, a significant softening of Parliament's original proposal.[53] Nevertheless, we know from research[54] that any minimum capital requirement has a significant impact on entrepreneurs' choice of jurisdiction for incorporation (though virtually no impact on re-incorporation decisions). We can speculate with some confidence that even the Parliament's revised proposal (essentially substituting enhanced management liability for a minimum

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run of companies. It is extremely doubtful whether the benefits would exceed the costs of applying (some version of) the fininancial institutions' rules to small companies whose failure poses no systemic risk to the economy. Nor does the modern critique of minimum capital rules destroy the case for controls on distributions. The issue there relates to the type of control that should be imposed: capital-based or some alternative. See J Rickford, 'Legal Approaches to Restricting Distributions to Shareholders: Balance Sheet Tests and Solvency Tests' (2006) 7 EBOR 135 and W Schön, 'Comment: Balance Sheet Tests or Solvency Tests – or Both?', ibid 181.

[48] See Becht et al, above n 28.

[49] Noack and Beurskens, above n 28 at 111-2, noting that the new German form of private company which may be established with a minimum capital of €1 (the *Unternehmergesellschaft (haftungsbeschränkt)* - no abbreviation permitted for the *haftungsbeschränkt* part of the name) is nevertheless subject to a restriction on making distributions (25% of profits must go to a non-distributable reserve) until its capital reaches that required for the full GmbH, ie €10,000.

[50] Above n 1, art. 19.4.

[51] Above n 15, p 5.

[52] Above n 43, p 42.

[53] The Committee's *rapporteur* is delightfully indecisive on the issue of the value of mandatory minimum capital, saying (ibid): "The rapporteur has a certain sympathy for this simple condition [€1] for establishing an SPE. In practice, capital stock does not help to protect creditors. However, it cannot be denied that a certain amount of 'start-up capital' may represent a threshold for solidity that will enhance the SPE's reputation. . . The rapporteur would clearly state, however, that he does not see this proposed amendment as crucial for the general acceptability of the SPE. The key point is that minimum capital should not represent a serious obstacle to establishment. In this context, a lower amount of capital stock is also conceivable".

[54] Becht et al, above n 28.

capital) would not prove attractive to entrepreneurs if they could obtain incorporation without either minimum capital or enhanced liability. If this is so, then the Parliament's 'compromise' did not solve the conflict between member states attaching and those not attaching value to a minimum capital requirement. An SPE statute with a minimum capital requirement or enhanced management liability will render the new legal form of little or no interest in jurisdictions whose national laws impose no such requirement, whilst those jurisdictions with more onerous restrictions will fear their rules will be rendered practically useless as new incorporations are made in the SPE form, unless a significant minimum capital requirement is applied to the SPE.

In the light of the above it is no great surprise to see that in the Presidency 2009 proposals took a different approach to the matter. The rule proposed was that there should be a Community cap of €8000 on the minimum capital required of an SPE, but, within that figure, member states should choose the level of minimum capital. Member states should also be free to choose whether to require a solvency certificate for distributions (irrespective of their decision on minimum capital).[55] Thus, as of the end of 2009 the strategy proposed to deal with minimum capital amounted to a shift away from both the flexibility proposed by the Commission and that of inserting a minimum capital requirement (or equivalent) into the mandatory content of the statute (as proposed by the Parliament) to that of leaving the choice to national law (Presidency 2009 proposals).[56] This revised approach was doubtless welcome to member states without minimum capital requirements: their entrepreneurs would not have to take on a requirement perceived as burdensome to obtain the advantages of the SPE form of incorporation (for example, the European 'brand'). For those states with minimum capital requirements in national law, which they wished to preserve, the effect of this rule was to shift the debate to the seat rule, as discussed in Part Four.

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[55] Above n 33, arts 19.3 and 21.4. However, the 2009 Presidency's proposals on raising capital are not entirely based on the 'member state choice' model. Some mandatory rules for public companies from the Second Directive are proposed to be extended to private companies, for example, the rules on the minimum amount to be paid up on issue (25% of the nominal value and the whole of the premium), the maximum time limit for the payment of sums due (3 years), and the ban on services as consideration. Ibid art. 20. In the UK, for example, none of these rules applies to private companies. In some cases these restrictions might prove unwelcome to small companies, for example, high-tech start ups wishing to allot a significant amount of capital to employees in exchange for their services, but there are probably ways around the restrictions.

[56] An additional argument in favour of the national solution approach is that member states without ex ante minimum capital rules tend to deal with the risks of inadequate capitalisation through ex post standards. However, such standards are often found in insolvency rather than corporate law, but insolvency was never proposed to be regulated by the SPE statute but was left to national law: Commission proposals, above n 1, art. 40. This is an example of the law's conceptual structures getting in the way of functional Community law.

Employee participation

This proved to be the most difficult area to resolve in the negotiations over the SE statute. Agreement was reached eventually only on the basis of a highly complex set of rules laid down at Community level.[57] These are default, rather than mandatory, rules but opting out of them requires agreement of both management and employee representatives and in some respects the freedom of the employee representatives to contract out is limited. Agreement to a regime which is less demanding than the default will usually require supermajority approval of the employee representatives, whilst waiving participation rights entirely will always require such approval and in the case of formation of an SE by transformation of a single existing company such waiver is not permitted.[58] So, the default is constraining. The essence of the default is that, subject to certain threshold requirements, the most 'advanced' form of board level participation applying under national law to any of the companies[59] participating in the formation of the SE should apply *mutatis mutandis* to the SE. This would be the case no matter in which jurisdiction the SE chose to register. Of course, if none of the companies participating in the formation of the SE is subject to mandatory participation requirements under national law, the SE is not either. In terms of the legal strategies we have been discussing in this piece, the approach adopted in the SE statute is closest to that of referring the matter to national law, but with the highly significant amendment that the national law to which the matter is referred may not be the law of the state in which the SE is registered. Thus, an SE formed by the merger of a large British and a large German company and registered in the UK will be subject to the codetermination rules applying to the German company before the merger, unless management and employee representatives agree otherwise.

In considering its approach to this neuralgic issue, the Commission in 2008 appears, rightly, to have entertained no hope of providing a flexible solution (each company decides on its board participation arrangements) or a uniform one (same rule applied to all SPEs). Instead, it proposed reference to national law, but in a significantly different way than under the SE statute. The Commission proposed a general rule that the participation rules of the state of registration should apply, with the exception that

[57] See text attached to n 7 above.
[58] Directive, above n 2, art 3(4) and (6).
[59] It should be recalled that only companies can form an SE. See n 6 above. 'Advanced' is defined by reference to the proportion of board seats over which a particular national system gives the employees influence. Thus, a right to recommend appointments to half the board seats is more 'advanced' than a right to elect one third of the board: Directive, above n 2, art 2(k) and Annex, Part 3.

where, after incorporation of the SPE, there was a subsequent transfer of registered office of the SPE to another member state,[60] an SE-type solution to the problem of worker participation should apply. This exception would preserve the pre-transfer rules on participation, where at least one third of the SPE's total workforce was employed in the transferor state and the transferee state provided a lower level of board appointment rights than the transferor state (or none at all), unless the company and the employee representatives negotiated something different. Thus, on the Commission's proposal a firm would be free to choose a state without any mandatory participation rules on initial incorporation but not to abandon the applicable participation rules (if any) upon later transfer out of that state.[61]

The Commission may have hoped that employee participation rights would be a less controversial topic in relation to the SPE than the SE, because few member states have participation requirements for companies with small numbers of employees. However, some do, for example, Sweden.[62] More important, the private company form is available to and is used by companies with rather large numbers of employees. There is no limitation in the SPE statute on the numbers of persons it may employ and so it is entirely conceivable that some SPEs would break through, for example, the 500-worker threshold for minority board representation in Germany.[63] Perhaps the central problem in the Commission's proposal was with its distinction between initial incorporation and later re-incorporation. An SPE may be formed either by natural persons (and thus be a true initial incorporation) or by existing companies (through transformation or merger). In the latter case, although there is an initial incorporation of an SPE, there is in effect a re-incorporation of the national companies. As with the SE, the most controversial type of formation was formation of an SPE by transformation of an existing national company into SPE form. Could, for example, a German company transform itself into an SPE registered in a member state with no or less demanding codetermination rules than the national ones and thus escape from the German rules? The Commission's draft seemed to permit this, because of its rule that participation was to be regulated by the law of the state in which the SPE was registered. By the time of Presidency's 2009 draft, however, an SPE formed by transformation was required to maintain its registered office in the same jurisdiction as the pre-transformation entity. As for an SPE formed by

[60] Transfer of the registered office of the SPE is dealt with in Part Four below.
[61] Above n 1, arts 34 and 38 .
[62] Board Representation (Private Employees) Act (1987: 1245) – threshold of 25 employees. See G Brulin, 'Sweden: Joint Councils under Strong Unionism' in J Rogers and W Streeck (eds), *Works Councils* (Chicago and London, University of Chicago Press, 1995).
[63] See n 10 above.

merger with a company in another member state (without mandatory employee participation requirements), that was subjected to the Cross-border Merger Directive, which applies, with some modifications, the prior national law rule of the SE statute, not the law of the jurisdiction of registration.[64] Thus, by 2009 the rules on employee board appointment rights in the SPE had moved very much closer to those of the SE.

However, the Presidency's 2009 proposals went much further than dealing with employee participation rules at the point of incorporation of the SPE, a development which suggests that the employee participation issue had become more difficult to solve in relation to the SPE than in relation to the SE, despite the generally lesser likelihood that an SPE would fall within the national board participation rules if it were a national company. This conclusion is suggested by the inclusion within the Presidency 2009 proposals of a dynamic set of rules dealing with employee participation, in contrast to the static rules applying to the SE. The SE participation rules apply only at the time of formation of the SE – indeed, the application of those rules is a pre-condition for the creation of the SE.[65] Whatever system is then agreed or imposed will remain in place, as discussed above,[66] unless either management and worker representatives agree something different.[67] This will be the case even if changes occur within the company (most obviously an increase in the number of its employees) which, if it were a national company in its original jurisdiction, would bring it within a national system of board level participation for the first time or move it to a more demanding level of participation.

The dynamic response to the participation issue in relation to the SPE was possibly a reaction to the failings of the SE rules in this regard, as discussed in the Introduction. That dynamic response in the case of the SPE is to be found partly in the Commission's original starting principle that the SPE should be subject to the participation rules of its state of registration. So, an SPE registered in Germany and having 400 employees would become subject to the German one-third board level requirement[68] once it

[64] Above n 33, art 5b.2 and 5(c); Directive 2005/56/EC (OJ L310/1, 25.11.2005), Annex. If the SPE subsequently sought to transfer its registered office, it would be caught by the rules discussed in the text (ibid art 35.1a(b)). If the SPE subsequently sought to escape the participation rules applying to it by merging with a company in a jurisdiction without mandatory employee participation rules, the Cross-border Merger Directive would, again, apply.
[65] Above n 22, art 12.2.
[66] H Eidenmüller, A Engert and L Hornuf, above n 4.
[67] Or possibly, it converts into a national company, as it is free to do, in a jurisdiction without mandatory board representation rules for employees.
[68] Above n 10.

reached 500 employees. However, the effectiveness of this rule depends upon the SPE's choice of place of incorporation being constrained, which the Commission does not wish to impose and which may in any event be incompatible with the Treaty.[69] Hence one finds the second element in the dynamic approach put forward in the Presidency 2009 proposals. This consists in subjecting an SPE, once formed, to a continuous review (the check to be carried out at least once every three years) to see whether it should be made subject to more demanding participation rules. If the review reveals that the SPE (wherever registered) has at least 500 employees and that at least half of them habitually work in a member state whose national law requires a higher level of participation than does the law of the state of registration, then an SE-type process of negotiation and, in default, the imposition of standard rules based on the higher requirements is to be triggered.[70]

Thus, the employee participation issue has proved no more tractable in relation to the SPE than the SE. Indeed, since at least some SPEs will be rapidly growing companies and employee participation thresholds are tied in national law so rigorously to employee numbers, it is easy to see why this should be. Nevertheless, the deep divisions among the member states over the desirability of board level participation requirements meant from the beginning that this issue in relation to the SPE was referred to national law and subsequent drafts of the statute have produced ever more complicated formulae for determining which national law should be referred to. Even the European Parliament, in general a staunch proponent of the exclusion of national law from the SPE statute, here supports reliance on national formulae.[71]

Board/shareholder relations

It might be thought from the above that a member state which has no minimum capital rules for private companies in its domestic law and no mandatory rules on board-level participation (such as the UK) can observe the above debates with detachment, because the SPE proposals present no challenge to its domestic private company law. This is, however, a mistaken view. Whenever it is difficult to formulate an efficient rule across all the jurisdictions of the EU, there will be cause for most member states to

[69] See Part Four below.
[70] Above n 33, arts 35-35d. These proposals take up one feature from the Cross-Border Merger Directive, ie a permission to the member states to cap the default participation requirement at one third of board seats (art 35d.3), so that an SPE with 2000 employees, at least half of whom habitually work in Germany, will not be subject to default parity codetermination, if the member state so decides.
[71] Above n 24 at 43.

oppose the mandatory rule chosen for the SE, if it differs from their own. Either it will be less demanding than the national rule and thus present a competitive threat or it will be more demanding than the national rule or at least unfamiliar to the domestic entrepreneurs, and so will discourage them from taking up the SPE and obtaining the benefits of the Community form (the threat to access). If instead the formulation the rule is left to the SPE in its articles, this will be opposed (for competition reasons) by those member states having a mandatory rule on the topic in their national laws. Only a member state which concludes that the SPE form (however formulated) will have no value to its entrepreneurs and that, as formulated, it will not be attractive to them can afford to be completely indifferent.[72] These dynamics can be seen at work not only in relation to employees' board level appointment rights (which only about half the member states of the EU have adopted in the private sector) and in relation to minimum capital, but also in relation to the core issues which the SPE law has to determine: relations between board and shareholders and relations between controlling and non-controlling shareholders. We look at each issue in turn.

As is well known, the UK (and Ireland) have developed an extensive body of standards which are used by courts to review the conduct of directors ex post. Continental jurisdictions have not gone as far down this route, for reasons which are understandable and may be good.[73] The British duties are now set out at a high level in the Companies Act 2006 and include an (objective) duty of care, a core duty of loyalty and a clutch of duties aimed at dealing with conflicts of interest: related party transactions, corporate opportunities, accepting benefits from third parties and failing to exercise independent judgment.[74]

The Commission's proposals were clearly influenced by this approach. Article 31 of its draft[75] contained a core duty of loyalty (duty to act in the best interests of the company), a duty of care, a duty to avoid situations likely to give rise to a conflict of duty and interest (subject to the articles), a liability provision

[72] The UK government's position comes close to this view, but even it eventually realised that escape from some important parts of domestic UK law was offered by the SPE. See Department of Business, Enterprise and Regulatory Reform, *Proposal for a European Council Regulation on the Statute for a European Private Company (SPE): Consultation Document*, October 2008 (URN 08/1318); BERR, *Government Response to the Consultation Document on the Proposals for a European Council Regulation on the Statute for a European Private Company (SPE)*. Both are available on: http://www.berr.gov.uk/consultations/page48513.html.

[73] More concentrated shareholding in continental Europe may render directors' duties otiose as a tool for monitoring managers (controlling shareholders can do that job without legal help), whilst the political influence of controlling shareholders may have stymied the developed of directors' duties as a tool for protecting minorities.

[74] Companies Act 2006, Part 10, Ch 2 – discussed by P Davies and J Rickford, 'An Introduction to the New UK Companies Act' (2008) 5 *European Company and Financial Law Review* 48.

[75] Above n 1.

(confined to damages for loss; no disgorgement of profits), and a provision leaving everything not so covered to national law. The Presidency 2008 version of Article 31 retained the core duty of loyalty and duty of care but deleted the rest. Rather more worrying from the perspective of the British government, it appeared to leave to the articles of association of the SPE the regulation of related party transactions and 'any specific duties' of the directors.[76] Since regulation in the articles would have priority over national law, at this point the proposals appeared to give British entrepreneurs a method of escaping from the national conflict of interest provisions.[77] So, the draft had moved from making something along the lines of the British rules mandatory for all SPEs to providing flexibility to SPEs as to how far they should be subject to directors' duties, British-style. The Presidency 2009[78] version of Article 31 removed mention of directors' duties entirely, and confined the matters which could be dealt with in the articles to the question of whether and, if so, how related party transactions needed to be authorised. All other aspects of directors' duties thus appeared to be left to regulation by national law. At this third stage, then, reference to national law became the dominant strategy, as against either uniform mandatory rules or flexibility for the SPE.

This short history, it is suggested, supports the argument that it will be difficult for a member state to export a central body of corporate rules, with which the other member states are unfamiliar, through the mechanism of a Community instrument. This is understandable. A rule drawn from one member state comes with an interpretive background in that state which clarifies the meaning of that rule. However, that interpretive (and institutional) background will not carry over into the SPE statute for the other member states, and so the other member states may be rightly unclear about what they are taking on. There would be great uncertainty as to how the transplanted legal rules would work out in the new host systems. For example, directors' duties, being formulated as standards, depend enormously for their impact on the ability of shareholders to enforce them and on courts' expertise in interpreting them. From the point of view of the receiving countries, the new rules might appear very uncertain. Their resistance is thus to be expected. However, this story about directors' duties might also suggest that the other member states will also refrain from providing an escape through a Community form of incorporation from a set of corporate rules which is important for a particular member state, in this case the UK. Given

[76] Above n 34, art. 4.1 and Annex I.
[77] Although to some extent the British conflict provisions can be modified by the articles under national law, the basic principle applying to them is that they are not contractible: Companies Act 2006, s 232.
[78] Above n 33.

the need for unanimity for the adoption of the SPE statute,[79] this concern to protect the important interests of even single member states is not surprising. Perhaps directors' duties can be seen as the British equivalent to codetermination for Germany. In both cases, finding a solution involved the abandonment of the goal of a uniform set of rules for the SPE.

Controlling and non-controlling shareholders

A somewhat similar story can be told about the statute's expulsion and withdrawal provisions. These are crucial provisions in a private company. Investors are usually locked into the company, because there is no or no reliable market for their shares, whilst small companies are often established on the basis that all the shareholders will be involved in its management. However, close working relations among the shareholders are always at risk of breaking down, creating a functional need for exit on fair terms, in the interests of all participants. Consequently, provisions which enable majorities to expel dissentients and minorities to withdraw focus on an area which is crucial to the sustainability of the small company. However, crafting these provisions is not easy and different member states have gone in different directions.[80] The Commission's draft adopted a particular set of provisions, said to be based on Dutch law.[81] These provisions gave the court, on the application of the minority, a broad power to expel a minority where 'the continuance of the shareholder as a member of the SPE is detrimental to its proper operation'.[82] By contrast, the right to withdraw was limited to four specific (but important) cases and, within those cases, gave the court power to order the purchase of the minority's shares at a fair price only where 'the interests of the shareholder have suffered serious harm.'[83]

Clearly, there was much scope for argument about these powers: was the expulsion power too wide or the withdrawal right to narrow? The Presidency 2008 proposals maintained these provisions, with some minor amendments to the withdrawal right.[84] The Presidency 2009 proposals[85] deleted both sets of

[79] See n 24 above.
[80] For a theoretical analysis of the problems in this area see E Rock and M Wachter, 'Waiting for the Omelet to Set: Match-Specific Assets and Minority Oppression in Close Corporations' in J McCahery, T Raaijmakers and E Vermeulen (eds), above n 16.
[81] R Drury, 'Private Companies in Europe and the European Private Company' in ibid at 389.
[82] Above n 1, art 16.
[83] Ibid, art 17.
[84] Above n 34, arts 17 and 18. Non payment of dividends for three years ceased to be a ground for withdrawal, but the SPE was authorised to add other grounds for withdrawal in the articles.
[85] Above n 33.

provision and seem to have left the matter to the law of place of registration. Once again, therefore, a difficult issue has been dealt with by leaving it to national law.

PART FOUR
REFERENCE TO NATIONAL LAW AND THE CONNECTING FACTOR ISSUE

The question whether the registered office and the central administration/principal place of business of the SPE have to be in the same jurisdiction is a central issue for the 'national law' strategy for dealing with the SPE's competitive threat. Some national company laws impose this requirement on their domestic companies ('real seat' states) whilst others to not, so that for the latter group only registration in the jurisdiction is necessary to subject the firm to the company laws of that state ('incorporation' theory states). The choice between real seat and incorporation theories is potentially significant for the legal strategy of identifying the rules applicable to the SPE by reference to the laws of the state in which the SPE is registered. This choice is clearly irrelevant if the rule on a particular matter is determined in the SPE statute itself, either because a mandatory rule on the topic is laid down in the statute or because the statute empowers the SPE to fashion the rule in its articles of association.[86] By contrast, where references is made to national law to identify the relevant SPE rule, the question whether the founders of the SPE have freedom to choose the relevant national law by choosing the state of incorporation for the SPE is potentially very significant.[87]

Initial Incorporation

The SE statute imposes a requirement that the registered office and central administration be in the same jurisdiction and requires member states to provide for the winding up of the SE if a divorce between the two arises.[88] By contrast, the Commission's 2008 proposal permitted the SPE to have its registered office and central administration in different member states: this freedom was to be permitted as a matter of Community law.[89] This would have enabled the SPE freely to choose the national law to which it was

[86] Rules determined by the SPE statute have priority over rules determined by national law: above, n 1, art 4.
[87] An SPE, like the SE, must choose to incorporate in one of the member states of the EU. There is no 'federal' registry.
[88] SE statute, above n 2, arts 7 and 64. However, the SE statute does provided a mechanism whereby an SE can transfer its registered office to another member state (Art 8) provided this occurs more or less simultaneously with the transfer of its central place of administration. The requirement must be reviewed by the Commission after five years (Art 69)
[89] Ibid n 1, art. 7.

to be subject, to the extent that the rules applicable to the SPE depended on national law, without having to commit itself to having its central administration in that member state or even, it would seem, to carry out any business in that state. This proposal might have been uncontroversial so long as a near complete set of rules for the SPE was set out in the statute, either by way of mandatory rules or by way of SPE choice in its articles. However, with greater reliance on national laws to supply the SPE rules, the Commission's acceptance of the incorporation theory threatened to undermine the gains that some member states might expect from that strategy. Even if member state A was free to impose, for example, a minimum capital requirement on SPEs registered in its territory, but the founders could register an SPE in member state B, which imposed no minimum capital requirement, and carry on business wholly in member state A, the regulatory control which member state A had hoped to gain through the reference to national laws might well prove illusory. Just as a substantial number of German entrepreneurs set up British private companies to escape German minimum capital requirements, but operated wholly in Germany, so might they set up SPEs registered in the UK but operating wholly in Germany.[90] Consequently, a shift away from the Commission's proposals on the seat point was to be expected as part of the shift to national law to provide SPE rules.[91]

In the Presidency's 2008 proposals the choice of connecting factor (real seat or incorporation) was left to national law.[92] A further shift away from the Commission's starting point occurred in the Presidency 2009 proposals which added the qualification that for two years from the date of adoption of the statute coincidence of registered office and central administration would be a requirement of the statute; after that, it would be a matter of member state choice.[93] So, the real seat principle obtains for the first two years by Community fiat and thereafter in those member states which choose to adopt it. The level of protection to national mandatory rules provided by the principle of member state choice of connecting factor is, however, highly debatable in the light of the Treaty provisions on freedom of establishment and the European Court's recent interpretation of them. In a series of cases, applying those provisions of the treaties,[94] the Court of Justice has held that a real seat state cannot refuse to accept the validity of the incorporation of a company in an incorporation theory state (or impose domestic 'pseudo foreign'

[90] See Becht et al, above n 28. As noted there, Germany moved to soften its minimum capital requirements in consequence of this shift of incorporations.
[91] The European Parliament, however, was happy with the Commission's decision on the seat issue. Its proposed amendments to art 7 were essentially procedural. See n 43 above.
[92] Above n 34, art 7.
[93] Above n 33, art 7.
[94] Now art 49 TFEU

company rules on it), even where the company carries out no business in the state of incorporation and indeed carries out the whole of its business the real seat state.[95]

These cases all involved companies incorporated under national law but the same conclusion presumably applies to the SPE, since the Community legislator does not have the competence to override the provisions of the treaties.[96] If this is correct, use of national laws to determine SPE rules will not protect member states' national company laws from regulatory competition. It is true that the competitive threat to the national company law of member state A will no longer be represented by an SPE registered in member state A, as would have been the case if the SPE statute itself contained more attractive rules for entrepreneurs than A's national law. However, competition will still exist and will come from an SPE registered in member state B, whose national law is more attractive than that of member state A (to the extent that national laws are used to determine the rules applicable to the SPE). Even if A is a real seat state, it must recognise the validity of an SPE founded in B by entrepreneurs from A. It can be argued, of course, that this latter form of competition is one to which member states are currently exposed, by virtue of the European Court cases mentioned above. Consequently, the SPE statute, even with extensive reference to national law, will not facilitate higher levels of regulatory arbitrage by companies than are currently available. Member state A will still be able to insist that entrepreneurs wishing to take advantage of more attractive law must accept the costs of foreign incorporation – by incorporating an SPE in member state B rather than using the presumably more familiar procedures of member state A to form an SPE there. However, the costs of foreign incorporation do not appear to be high, at least at the point of incorporation.[97]

Re-incorporation

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[95] Case C-212/97 *Centros Ltd v Erhverus-og Selkabsstyrelsen* [1999] E.C.R. I-1459; Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* [2003] E C R I-10155; Case C-208/00, *Überseering BV v Nordic Construction Company Baumanagement GmbH* [2002] ECR I-9919. Some domestic rules can be imposed on the foreign incorporated company under the 'public interest' test, but it is unclear how far this goes. Could, for example, Germany impose its codetermination requirements on foreign companies operating substantially in Germany but without creating a German subsidiary? Germany does not currently seek to do so.

[96] Art 54 TFEU applies the freedom of establishment provisions to companies 'formed in accordance with the law of a member state' and this phrase seems to include the SE and SPE since they are registered in a member state, albeit that the national rules on formation are determined at Community level (above n 1, Chapter II).

[97] Becht et al, above n 28, point to the emergence of German incorporation agents skilled at offering low-cost incorporations in England to German firms.

Whilst regulatory competition is reasonably well developed at the point of incorporation, regulatory competition after incorporation ('midstream' re-incorporations) is very underdeveloped in the EU. Do the SPE proposals hold out the prospect of any change here? Crucially, they provide a procedure for the transfer of the registered office of the SPE from member state A to member state B.[98] Since, as envisaged in the latest draft of the SPE statute, member states will be free to apply the real seat theory to the SPE, a real seat transferee state will apparently be able to insist that such re-registration be accompanied by transfer of the place of central administration. Where, however, the transferee is an incorporation theory state, the transferor real seat state will apparently be unable to refuse to recognise the validity of the transfer effected under the terms of the SPE statute, even if the business of the SPE continues to be conducted wholly in the transferor state.[99] Overall, therefore, the right to transfer the registered office facilitates regulatory competition through the life of the SPE, provided attractive company law is made available by incorporation theory states, though transferor states will have an ill-defined power to prevent the transfer on public interest grounds.[100]

Since, as already noted, the Community has backed away from providing a right for all companies registered in the EU to transfer their registered office,[101] the availability of this provision for SPEs might be thought to facilitate a higher level of midstream regulatory competition in relation to this class of corporate vehicle than is generally available. As with competition at the point of incorporation, however, this is probably not the case. A private company from member state A can transfer its registered office to member state B by forming a subsidiary in B and then merging with that subsidiary under the national laws transposing the Cross-border Merger Directive.[102] This mechanism is available to private companies[103] and there appears to be no requirement that the subsidiary be in existence for any particular period of time or to have carried on business prior to the merger. However, it also appears that member state B can insist on the central administration being transferred as well as the registered office, if it is a real seat state; and there is the same ill-defined right of member state A to oppose the merger.[104]

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[98] Presidency 2009 proposals, above n 33, arts 36ff.
[99] Art 36(3) explicitly provides that after the transfer of the registered office the laws of the transferee state shall determine the rules applicable to the SPE, in so far as national rules apply to the SPE.
[100] Art 38(2a).
[101] Above n 14.
[102] Directive 2005/56/EC (OJ L310/1, 25.11.2005).
[103] Ibid arts 1 and 2(1)(a).
[104] Art 4(1)(b). Complex issues of compatibility with the Treaty are raised: see J Rickford, 'The Proposed Directive on Cross-border Mergers and its Impact in the UK' [2005] *European Business Law Review* 1393, 1404-1408.

Consequently, cross-border mergers to gain the benefit of attractive corporate law are feasible only where that law is provided by an incorporation theory state.[105]

Thus, it seems correct to conclude that, neither at the point of incorporation nor in relation to re-incorporation, does the latest version of the SPE proposals add to the competitive pressures on member states' company laws from the laws of other member states. However, it is as important to note that the latest proposals do nothing to reduce the force of those pressures as currently operating as a result of the European Court's interpretation of the freedom of establishment provisions of the Treaty and of the Cross-border Merger Directive. The implication of this second point for the strategy of moving the mandatory rules applying to the SPE from the SPE statute to the national law of the place of registration of the SPE is that it only partially protects member states seeking to maintain the integrity of national mandatory rules. Member state A will still face competition where its mandatory rule is not replicated, either formally or functionally, in the company law of member state B, assuming that B's company law contains no other mandatory rule, unattractive to entrepreneurs, which is absent from A's company law.[106]

Conclusion

This conclusion might be thought to render the strategy of using national law to shield member states from regulatory competition from the SPE an unattractive one. However, the 'national law' strategy has to be viewed in comparative terms against the other three strategies. Setting the applicable rule in the articles of association of the SPE provides no protection against the competitive threat; on the contrary, it enhances it. Better protection against competition would be achieved by incorporating a demanding mandatory rule in the SPE statute, but that requires the consent of all the member states under the legal basis chosen for the SPE statute.[107] Thus, reliance on national rules becomes the best of three non-ideal strategies for protecting national mandatory rules. However, if those states seeking protection of their national mandatory rules conclude that the 'national law' strategy will be ineffective in the light of the

[105] Even in this case it is not absolutely clear that the European Court will regard a mid-stream transfer simply for choice-of-law purposes as an exercise of the right to freedom of establishment: *cf* Case C-196/04, *Cadbury Schweppes plc* [2006] ECR I-7995.

[106] As noted above (n 14) the existence of a legal freedom to choose the applicable company law is only one of the pre-conditions for extensive jurisdictional competition. Companies must take the view that the benefits of choice of company law will outweigh the costs of that choice and competition will probably be enhanced if at least some member states see benefits for themselves from attracting incorporations.

[107] See n 24 above.

freedom of establishment provisions of the Treaty, they may seek to secure that the two-year requirement for coincidence of the place of registration and the central place of administration be made a continuing requirement of the SPE statute – as it is of the SE statute. On its face, this would deprive SPEs of any possibility of regulatory arbitrage, but would squarely raise the question of whether the coincidence requirement is itself compatible with the Treaty.[108]

However, it might be useful here to introduce a fourth legal strategy for protecting national law from competition from the SPE, which consists of turning the unanimity requirement around so that it aids rather than hinders the state seeking to protect its national laws. Member state A could withdraw consent from the SPE project and thus bring it to a complete halt because of the need for unanimity. However, this strategy is not attractive if member state A sees benefits to its entrepreneurs from the availability of the SPE form (provided it can be fashioned in an appropriate way). Nor does the strategy protect member state A's national law from competition from the national laws of member state B at the point of incorporation (because of the *Centros* line of authority) and so member state A will have to form a judgment as to how much greater the competitive threat from member state B will be if B can offer the SPE as well as purely national forms of incorporation to entrepreneurs from A. Nevertheless, the implication of the above arguments is that it is difficult to judge whether protection against competition will push the SPE project in the direction of more reference to national laws or bring the project to a complete halt.

PART FIVE
CONCLUSIONS

In its influential report of 2006, which in many ways launched the Community's legislative initiative on the SPE, the European Parliament stated: "The European Parliament takes the view that an EPC Statute should be based as far as possible on Community legislation and thus dispense with references to national law: it should therefore be conceived as a uniform and definitive statute. The company law provisions of the regulation on the statute for a European Company should therefore apply exclusively,

[108] See n 104 above and Wolf-Georg Ringe, 'The European Company Statute in the Context of Freedom of Establishment' (2007) 7 *Journal of Corporate Law Studies* 185 for a consideration of this issue in the context of the SE.

and the areas of law regulated in this regulation should be withdrawn from the jurisdiction of Member States."[109] There then followed an extensive list of matters which were thought to be appropriate for inclusion in the proposed statute, which the Commission's 2008 proposals by-and-large followed. The desire to avoid the extensive reference to national law which the SE statute had adopted was a strong influence on the Parliament.[110] This paper has sought to argue that the drift away from this model of the SPE in the member state negotiations is entirely understandable. If a member state regards the SPE project as worth while, it has a strong incentive to avoid the inclusion in it of mandatory rules not found in its domestic law, in order to maintain the attractiveness of the project for 'its' business people (the 'access' argument). Whether it regards the SPE project as worth while or not, it has an even stronger incentive, for competition reasons, to ensure that the SPE contains all the mandatory rules which it regards as important in its own system. Since the highly conflicting goals of the member states cannot all be reconciled by any conceivable single set of mandatory rules to be contained in the Community instrument and since the legal base in the Treaty for the instrument requires unanimity, a substantial move away from uniformity (ie mandatory rules in the statute) will occur. Of the three possible moves - restricting access to the SPE form, SPE choice via the articles or member state choice - the first has proved unattractive presumably because tight access rules would transparently demonstrate the limited utility of the proposals and the second does not solve the competition risk to the member states' national laws. Consequently, the dominant strategy in the redrafts of the Commission's proposals has been the third: member state choice, ie the legal strategy adopted for the SE.

It might be argued that this is a mistaken view on the part of the member states towards what constitutes good company law. Member states should be increasing the menu of legal forms available to entrepreneurs, not insisting on incorporation through a single, heavily mandatory legal form.[111] Thus, member states should welcome the SPE, not oppose it. However, it is not clear that the Community's legislative process is a good place for this debate to be played out. If a member state is convinced about the value of increasing the range of corporate forms available, it can take that step itself. It is far from clear that opposition to the SPE project, as originally formulated, comes solely from states which want

[109] Above n 23, Recommendation 1.
[110] "The SE Statute took a long time to develop and the outcome is unsatisfactory, for the market has not yet adopted the SE as a company form for limited companies. One reason for this is that the SE is not a uniform European form of company, but has remained a patchwork owing to the many references to national law. This increases legal uncertainty and is expensive." Ibid, *Explanatory Statement* I.
[111] See McCahery and Vermeulen, above n 16.

to insist on a single, heavily mandatory form of company vehicle. Member states which have made a range of vehicles available might well see the SPE as potentially upsetting the balance among the national forms on offer, for cross-border gains which are limited. As to states which have not been convinced of the merits of enabling company law, it is conceivable that participation in the process of debate on a Commission proposal will perform an educative function for them. Even so, they might prefer the greater control over the implementation of that new approach which national law reform would give them to having the matter determined at Community level.

What will the future bring? Here we turn from analysis to speculation. As far as this writer is concerned, it is impossible to predict whether, given the political resources already devoted to it, an SPE statute will emerge, but extensively qualified by member state choice, or whether, given the limited gains arguably available to enterprises even under the model proposed by the Parliament and Commission, the project will collapse under the weight of its irreconcilable demands.

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