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Subject European Company Law was supported by project: Jean Monnet Actions - GRANT AGREEMENT - Project 101176603 — EU Tax and Corporate Law

EUROPEAN COMPANY LAW

Course description, lectures and reading materials

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General Information

European Company Law – instructions:

Coursework:

Before each seminar, reading materials with guiding questions will be opened on a Moodle platform to each student. Each student is expected to read the assigned reading materials, as the class will be held in an active way through questions and discussions. Note that seminars are not a lecture, we will go through a topic that you have already read before, the teacher is a guide not a lecturer explaining the content of the reading materials during the seminar. It is recommended, especially if you have no previous experience with company law, to prepare answers to the questions in writing before the class. However, you cannot read your answers during the class as you need to able to address the answer in your own words.

Classroom participation:

Students' participation will be checked in the beginning of each class. Students are expected to actively participate in the classroom discussions. Each student may be called upon to address specific questions raised by either the teacher or another student participating in the seminar. If the student is not sufficiently prepared for the class, additional work in a form of essay/case study may be assigned to this student by the teacher.

Students are allowed to be absent from the class during the semester based on the internal regulation of the Faculty of Law.

Classroom communication and participation in the discussions are considered when the student's coursework is evaluated.

Evaluation (continuous assessment):

Part A of the evaluation - 40% (40 points) of the student's grade depends on:

- the student's performance in class (25%, 25 points), during each class you can gain 5 points (maximum 25 points)

- case study (15%, 15 points) – you will be assigned a case study in a group of students from different jurisdictions, you will be asked to solve the case from the perspective of your jurisdiction and/or EMCA, and you will present the case in front of other students and we will ask you additional questions

Part B of the evaluation - 60% (60 points) of the student's grade depends on the final case study written during the class – 10 December

To pass the class you need reach at least 60 points together form Part A and Part B of the evaluation.

1st assignment (European Company Law)

After completing this seminar, students should have acquired knowledge in the following main issue of the topic:

Harmonized Areas in EU Company Law – The EU harmonized areas like company formation, disclosure, capital formation, and corporate governance to create a consistent legal framework across member states.

Company Formation and Disclosure – The EU harmonized company formation rules and disclosure requirements, ensuring transparency and consistency through Directive (EU) 2017/1132.

Importance of Disclosure – Disclosure ensures transparency, accountability, protects stakeholders, and fosters informed decision-making in the corporate sector.

Capital Formation and Corporate Governance – The EU harmonized capital formation and maintenance, but corporate governance and group company regulations remain inconsistent due to differing national approaches.

Compulsory reading materials:

- VICARI, A: EU Company Law. 1. Chapter

Voluntary reading materials:

- DE LUCA: EU Company Law

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EU Company Law



Harmonization process



Legal basis of the harmonization



Forms of harmonization



Adopted directives and regulations

2

Harmonization process

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- The harmonization of company law within the European Union **is important for crea the common market** as it is considered that **different national company law systems might have harmful effect on trade and competition between countries**
- Variety of national company law systems results in **growth of transaction cost** for companies and their legal advisors while dealing with the cross-border situations
- The reduction of these costs can be **reached by the harmonization of company law systems between Member States**

3

Legal basis of the harmonization

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TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION (TFEU)

Article 50 (2) (g) TFEU:
"(2) The European Parliament, the Council and the Commission shall carry out the duties devolving upon them (under the preceding provisions), in particular:
…
(g) by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 54 with a view to making such safeguards equivalent throughout the Union."

Article 54 (2) TFEU:
'Companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

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Forms of harmonization

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1. **Directives**
   - Directives belong to secondary law of EU Law and they "are binding as to the end achi while leaving some choice as to form and method open to the Member States."

2. **Regulations**
   - Regulations are, as well, secondary law of EU Law and "are binding in their entirety, and directly applicable in all Member States." Regulations in the area of European company law are used for the introduction of supranational organizational forms.

3. **Decisions of the Court of Justice of the European Union**
   - no system of binding precedent
   - 267 TFEU: The Court of Justice of the European Union has jurisdiction to give preliminary rulings concerning:
     a. the interpretation of the Treaties,
     b. the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union.

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Originally: 11 Adopted directives

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First Directive – Disclosure Directive
Second Directive – Capital Directive /creation of capital and its maintenance/
Third Directive – Mergers
Fourth Directive – Annual Accounts
Sixth Directive - Divisions
Seventh Directive – Consolidated Accounts
Eighth Directive – Statutory Audit
Tenth Directive – Cross-border Mergers
Eleventh Directive - Branches
Twelfth Directive – Single-member Company
Thirteenth Directive – Takeover Bids

6

Since 19/07/2017: Simplification of company law by the DIRECTIVE (EU) 2017/1132 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 June 2017 relating to certain aspects of company law (codification)

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- This directive codifies a number of Directives and repeals those codified as follows:
  - The Sixth Company Law Directive
  - The Eleventh Company Law Directive
  - The Tenth Directive
  - Directive 2009/101 which replaced the First Company Law Directive
  - Directive 2011/35 which replaced the Third Company Law
  - Directive 2012/30 which replaced the Second Company Law

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Disclosure of limited liability companies

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- Originally regulated by the Disclosure directive (First Directive)
- Since 19/07/2017 regulated by the DIRECTIVE (EU) 2017/1132
- The aim of the Directive was to create a **guarantee of the access to basic information** about limited liability companies, which will create certainty in legal actions of the company
- The Directive stipulated requirements on **disclosure of particular company documents, reasons of the nullity of the company, registration of the company and validity of the agreements concluded by the company**

8

Maintenance and alteration of the capital of the limited liability companies

Funded by the European Union

- Originally regulated by the Capital Directive (Second directive)
- Since 19/07/2017 regulated by the DIRECTIVE (EU) 2017/1132
- The objective of the Directive was the **coordination of national legislation dealing with the foundation of public limited liability companies and preservation of common minimal standards for protection of shareholders and creditors**

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Mergers of public limited liability companies

Funded by the European Union

- Originally regulated by the Mergers Directive (Third directive)
- Since 19/07/2017 regulated by the DIRECTIVE (EU) 2017/1132
- The Directive stipulated provisions concerning mergers between public limited liability **companies from one Member State**
- Its aim was the determination of minimal standards for protection of shareowners, creditors and other persons in the process of merger of companies

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Annual Accounts

Funded by the European Union

- **Fourth Directive**
- This Directive harmonized provisions on annual accounts
- The aim of the Directive was to provide **access to information on the financial balance of the company and the possibility to create "truthful picture" about the financial and economic situation within the company**

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Divisions of public limited liability companies

Funded by the European Union

- Originally regulated by the Divisions Directive (Sixth directive)
- Since 19/07/2017 regulated by the DIRECTIVE (EU) 2017/1132
- This Directive harmonized **rules concerning divisions of public limited liability companies from one Member State**
- The aim of the Directive was to stipulate the **common standard for the protection of shareowners, creditors and other persons in the process of division of public limited liability company**

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Consolidated Accounts



- Seventh Directive
- The objective of this Directive **was to provide consolidated accounts, which help to determine the economic situation of the whole company** regardless of the position of each enterprise of the company

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Statutory Audit



- Eighth Directive
- This Directive harmonized provisions stipulating requirements for **statutory auditors of accounting documents**
- The aim of the Directive was to standardize requirements for the qualification of persons, who are authorized to perform the audit, moreover, to safeguard their independency and impeccability, as well as to assure the official authorization of these persons, their theoretical knowledge and practical experiences

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Cross-border mergers

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- Originally regulated by the Cross-border mergers Directive (Tenth directive)
- Since 19/07/2017 regulated by the DIRECTIVE (EU) 2017/1132
- This Directive harmonized provisions stipulating cross-border mergers of companies
- **Directive stated a framework with a common rule that each merging company is governed by rules of its national law applicable on domestic mergers**

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Branches

Funded by the European Union

- Originally regulated by the Eleventh Directive
- Since 19/07/2017 regulated by the DIRECTIVE (EU) 2017/1132
- The goal of the Directive was to stipulate **provisions concerning the disclosure requirements for company branches, because the First Directive regulated just disclosure requirements for companies**

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Single-member company



- Twelfth Directive
- This Directive forced Member States to make already existing form of private limited companies available to a single shareholder and harmonize provisions regarding the single-member limited company
- Specifically, this legal regulation stipulated the **obligation of all Member States to enable the settlement and existence of single- member private limited companies and possible limitations for this opportunity from the side of Member States**

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Takeover bids



- Thirteenth Directive
- The aim of the Directive was to achieve better legal certainty in the area of takeover bids and create greater protection for shareholders, especially minority shareholders, employees and other interested parties
- **This Directive enables the takeover bids in the whole European Union and consequently facilitates the free movement of capital**

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Adopted regulations

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- Regulations:
  1. European Economic Interest Grouping
  2. European Company
  3. European Cooperative Society

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European Economic Interest Grouping

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- The main objective of this regulation was to create a legal tool to **facilitate the cross-border cooperation and encourage companies from different Member States to participate on business together**
- However, **the grouping is limited by its objective and by other provisions of the regulation – limited number of employees, unlimited liability of all members**

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European Company

Funded by the European Union

- Its main objective is **to eliminate obstacles of business resulting form different national legislations**
- **SE makes possible cross-border mergers of companies, configuration of the holding, creation of joint subsidiary and possible conversion of existing public limited company**
- Moreover, this regulation stipulates the recognition **of the place for involvement of employees in European companies**

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European Cooperative Society

Funded by the European Union

- Creates a new legal form which facilitated the cross-border economic cooperation in the European Union
- This form **enables a formation of new cooperative entities by natural as well as legal persons at the European Union level and the improvement of cross-border cooperation of such entities**
- Moreover, SCE includes protection and involvement of employees in business by the protection of their rights to information and consultation

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Current amendments of the DIRECTIVE relating to certain aspects of company law

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- Directive (EU) 2019/1151 of the European Parliament and of the Council of 20 June 2019 amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law
- Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions
- **Directive (EU) 2025/25 of the European Parliament and of the Council of 19 December 2024 amending Directives 2009/102/EC and (EU) 2017/1132 as regards further expanding and upgrading the use of digital tools and processes in company law**

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2nd assignment (Company/Corporation)

After completing this seminar, students should have acquired knowledge in the following main issue of the topic:

Main Characteristics of a Company – Companies are separate legal entities with limited liability, transferable shares, delegated management and distinct ownership and control structures.

Separate Legal Personality & Limited Liability – A company has its own legal personality, protecting shareholders with limited liability, meaning they are only liable up to their investment.

Transferable Shares & Delegated Management – Companies allow shareholders to transfer shares and delegate management to appointed directors, separating ownership from day-to-day control.

Public vs. Private & Open vs. Closed Companies – Public companies can offer shares to the public (through a stock exchange) and are heavily regulated, while private companies restrict share transfers; open companies allow broad ownership, while closed companies limit it.

Obligatory readings materials:

- FERRAN: The Company and Corporate Group

Voluntary reading materials:

- SHEPPARD-MANDARAKA, A.: Piercing the Corporate Veil

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1

Company Law

- Can you name any company?
- How do you understand a company?
- Why do we create companies?
- What is a company?
- Characteristic features of a company
- Private and public company

2

Why do (did) we create companies?

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- Raising large amounts of money
- Diversifying financial risk
- Structure to control and manage the raised capital

- First companies ?
  a. Dutch East India Company (1602)
  b. East India Company (1600)
     - Originally created to trade valuable goods from Asia to Europe
     - Legal personality ? – no separate legal personality as we know it now (Salomon v. Salomon & Co Ltd 1897)

3

What is a company?

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1. **Fiction theory**
   - Company is a fiction to which law gives an effect
   - Law gives companies capacity to act (and determine the extend)
   - Is there difference between companies and people?

2. **Contractual theory**
   - Company is a nexus of contracts (shareholders, directors, creditors, employees, customers,…)
   - Hard to explain the legal personality through this theory
   - Economic explanation

3. **Realist theory**
   - Actions of group of people with common interest
   - No need for state intervention to give the company legal personality
   - Organs to think and act
   - Social responsibility

4

Different types of companies

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- Limited liability company
- Joint-stock company
- Partnership
- Limited liability partnership
- Societas europaea (SE)

- In this course – company – capital company
  - Limited liability company
  - Joint-stock company

5

Public v. private companies I.

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- Public companies – allowed to raise capital from the public on stock exchange (listed companies), BUT can be held privately, it is company type
- What is a stock exchange?

1. New York Stock Exchange (NYSE)
- Largest stock exchange in the world by market capitalization (**$25 trillion)**
- Known for long-established, blue-chip companies (e.g., Coca-Cola, Disney).

2. NASDAQ
- Second largest US exchange by market capitalization (**$20 trillion**)
- Known for tech-heavy listings (e.g., Apple, Microsoft, Amazon, Meta).

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Public v. private companies II.

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1. Euronext (€6.3 trillion)
- A pan-European exchange operating in several countries (Amsterdam, Brussels, Dublin, Lisbon, Milan, Oslo, Paris).
- Largest exchange group in Europe by market capitalization.
- Hosts major indexes like the CAC 40 (France), AEX (Netherlands), FTSE MIB (Italy).

2. London Stock Exchange (LSE) (£42.9 billion)
- Based in the UK, historically Europe's most influential market.
- Home of the FTSE 100 index (top 100 companies by market cap).
- Attracts many international listings, including large mining, energy, and financial firms.

3. Deutsche Börse (Frankfurt Stock Exchange, FWB) (€41-45 billion)
- Based in Frankfurt, Germany.
- Hosts the DAX index (40 leading German companies, e.g., Siemens, BMW, SAP).
- Known for large industrials and financials.

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Public v. private companies III.

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- **Public companies**
  - **Public v. listed**
  - more regulated (separation of ownership and management) - heavier harmonization in the EU – BUT gold-plating
  - large number of shareholders (dispersed ownership), shareholders are not members of the board of directors (separation of ownership and management)
  - freedom to transfer shares
  - majority – 51% or lower (?)

- **Private companies**
  - operate under more relaxed regime
  - no or limited separation of ownership and management (shareholder = director)
  - centralized ownership
  - restrictions on transferability of shares

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Terms used by the European company law directives I. public limited liability companies



- **Austria:** die Aktiengesellschaft
- **Czech Republic:** akciová společnost
- **Denmark:** aktieselskaber
- **Finland:** julkinen osakeyhtiö/publikt aktiebolag
- **France:** a société anonyme
- **Germany:** die Aktiengesellschaft
- **Ireland:** public companies limited by shares and public companies limited by guarantee having a share capital
- **Poland:** spółka akcyjna
- **Slovakia:** akciová spoločnosť
- **Spain:** la sociedad anónima
- **United Kingdom:** public companies limited by shares and public companies limited by guarantee having a share capital

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Terms used by the European company law directives II. limited liability companies



- **Austria:** die Aktiengesellschaft, die Gesellschaft mit beschränkter Haftung
- **Czech Republic:** společnost s ručením omezeným, akciová společnost
- **Denmark:** aktieselskab, kommanditaktieselskab, anpartsselskab
- **Finland:** yksityinen osakeyhtiö/privat aktiebolag, julkinen osakeyhtiö/publikt aktiebolag
- **France:** société anonyme, société en commandite par actions, société à responsabilité limitée, société par actions simplifiée
- **Germany:** die Aktiengesellschaft, die Kommanditgesellschaft auf Aktien, die Gesellschaft mit beschränkter Haftung
- **Ireland:** companies incorporated with limited liability
- **Poland:** spółka z ograniczoną odpowiedzialnością, spółka komandytowo-akcyjna, spółka akcyjna
- **Slovakia:** akciová spoločnosť, spoločnosť s ručením obmedzeným
- **Spain:** la sociedad anónima, la sociedad comanditaria por acciones, a sociedad de responsabilidad limitada
- **United Kingdom:** companies incorporated with limited liability
- **General Definition:** a company with share capital and having legal personality, possessing separate assets which alone serve to cover its debts and subject under the national law governing it to conditions concerning guarantees such as are provided for by Directive 68/151/EEC for the protection of the interests of members and others

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Characteristic features of a company

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I. Legal personality
II. Limited liability
III. Transferable shares
IV. Delegated management
(separation of ownership and management)
V. Investor ownership

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I. Legal personality

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- Company does have separate legal personality, distinct from people who holds shares in it (shareholders) — *if I buy and then sell shares of Meta (Facebook) – will anything happen to Meta?*
- Shareholders / directors come and go – company stays
- Salomon v. Salomon & Co Ltd.

- Company is capable of
  a. entering into contracts
  b. owning its own property
  c. delegating authority to agents
  d. suing and being sued in its own name
- Can company be liable? And for what? Civil / Corporate / Criminal liability?
- Piercing the corporate veil (courts, by law)

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II. Limited liability

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- Who is protected? Shareholders… Why? Risk…
- Contribution (monetary / non monetary) exchange for limited liability
- Limited liability
  - shields the owner of the shareholders from company's creditors claims
  - protects the assets of the company´ shareholders from the claims of the companies´ creditors (exception – piercing the corporate veil)
- Shareholders are residual claimants
- Payment order
  - Who has priority before shareholder?
    → Creditors? (Employees, State, Banks)

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II. Limited liability

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- Creditors of the corporation
  - are limited to making claims against assets owned by the company itself
  - have no claim against assets that the shareholders of the company hold in their own names

! The concept of limited liability does not work in the case of <u>qualified misuse of the corporate form by the shareholders</u> – in that case the shareholders can be also held liable for the debts of the corporation = *piercing the corporate veil*!

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III. Transferable shares

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- **Transferability of shares**
  - permits the corporation to conduct business uninterruptedly as the identity of its owners (shareholders) changes so that a member withdrawal is not necessary
  - makes it easier for shareholders to construct and maintain diversified investment portfolios – investing into multiple companies
- Private versus public companies
- **Free transferability**
  - maximizes the liquidity of shareholdings and the ability of shareholders to diversify their investments
  - gives the corporation maximal flexibility in raising capital

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IV. Delegated management (separation of ownership and management)

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- Companies (Corporations) often have numerous and constantly changing shareholders – therefore an allocation of control rights to the management is necessary
- Corporate law typically vests **principal authority** over corporate affairs in a **board of directors or a similar body**
  - authority to bind the company to contracts
  - authority to exercise the powers granted to the company by its contracts
  - authority to direct the uses made of assets owned by the company

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IV. Delegated management (separation of ownership and management)

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- **Board of directors – main characteristics:**
  - is a body that is periodically elected, exclusively or primarily, by the shareholders
  - is usually separate from the operational managers of the corporation (private v. public companies)
  - is usually formally distinct from the shareholders – except for the fundamental decisions regarding the corporation, the board of directors is not supposed to inform the shareholders and obtain their consent for his acting on behalf of the corporation on business decisions (economization on the costs of decision-making)
  - has ordinarily multiple members – this facilitates mutual monitoring and checks idiosyncratic decision-making

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V. Investor ownership

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- most important rights of the shareholders:
  - right to control the company (voting in the election of directors, voting to approve major transactions – on general meeting)
  - right to receive the profit

- both rights are typically, proportional to the amount of capital contributed to the corporation by the shareholder

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New Trends in Piercing the Corporate Veil: The Conservative Versus the Liberal Approaches

*Aleka Mandaraka-Sheppard**

1 Summary[1]

The 'unyielding rock' of corporate law, *Salomon v. A Salomon,*[2] established the century-old principle that a corporation has a separate juristic personality, commonly known as the corporate veil. From this 'the legal structure of modern businesses' was born. This unyielding rock protects shareholders' private assets and provides a method of limiting liability which is acceptable to company law in order to facilitate business development and international trade. A rigid application of the principle, however, may sometimes cause damage to the rights of parties who deal with the corporate because its controllers may be using the corporate structure as a façade to perpetrate wrongdoing. Fraud apart, to what extent can the law protect such parties by applying the doctrine of piercing the corporate veil? Is that doctrine applicable merely when justice demands it? What type of wrongdoing is required and is wrongdoing alone sufficient to pierce the corporate veil? Can the doctrine apply if there are other remedies available in law? Finally, can the controllers be made parties to the corporate's contract of which the corporate is in breach? These questions have preoccupied the English courts and, in particular recently, in two very important non-shipping cases, which reached the Supreme Court; in the one the Court left the rock untouched, while in the other, it reached the desired result by choosing a different route.

A powerful statement by Lord Sumption in *Petrodel Resources Ltd v. Prest*[3] speaks for itself: '*The recognition of a limited power to pierce the corporate veil, in carefully defined circumstances, is necessary if the law is not to be disarmed in the face of abuse*'.

Internationally, there are no uniform principles, and the doctrine's application in various jurisdictions produces polarized results.

* Practising as Arbitrator and Mediator, Founder/Chairman: the London Shipping Law Centre, formerly solicitor, Professor of Maritime Law, University College London, and Head of the Shipping Law Unit; alex@alekasheppard.com.

[1] This paper contains extracts from my book 'Modern Maritime Law' 3rd edition, 2013, Informa Law from Routledge, but it expands on the subject, since the recent decisions of the Supreme Court were published at the stage of reviewing the proofs and there was no sufficient space to include comments about how such cases might have affected the law. This paper was delivered at the 8th International Conference of Maritime Law organized by the Piraeus Bar Association and Athens University in October 2013, and it will appear in the book to be published in memory of Professor Antabassis, which will contain all contributions. It is also due to be published in the Business Law Review, January/February issue, 2014.

[2] [1897] AC 22 (HL).

[3] [2013] UKSC 34, at para 27.

2 Introduction

1. The issue of the corporate veil and the circumstances in which it might be pierced has, in recent years, been again before the English courts. By and large, the cases have concerned alleged fraudulent conduct, or mis-representation by the controllers of the corporate defendant in order to induce the claimant to a contract with the corporate defendant. There have also been other cases where the facts seemed to indicate that a particular corporate personality might have been used to conceal the true position of the parties involved in a transaction.
2. Applications to the courts (not just English courts) by claimants seeking the piercing of a corporate veil are made in the context of freezing injunctions, arrest of ships, and the USA Rule B attachment, to obtain security for claims, as well as in other circumstances, when claimants wish to recover money being due to them by the company, or the major shareholder/controller of the company.
3. I approach the matter, mainly, from an English law perspective, but I will also compare English law with the approach of: (i) USA courts in 'alter ego' cases with regard to Rule B attachments, (ii) South African courts in associated ship arrest cases, and (iii) the SC of Greece in piercing the corporate veil of shipping companies, in view of recent developments. This comparison is important to show the contrast between English law (a restrictive application of the doctrine) and the law of the other three jurisdictions (an approach of extensive justice and fairness requirements). Thus, I refer to them in this paper as 'the liberal jurisdictions'. My research material is drawn from the 3rd edition of my book, Modern Maritime Law, 2013, in which Alan Van Praag, NY lawyer, has contributed the chapter on Rule B attachments.[4]
4. The law is still developing in other jurisdictions, but the purpose of this paper is not to perform a comparative study. I have selected, only, recent examples of cases, which were decided in the jurisdictions referred to above, in order to show the recent trends.

3 Corporate veil: the unyielding rock

5. It is generally accepted by the law of most advanced legal systems that the concept of legal personality given to a corporation means that, no matter who the shareholders are, the company is a legal person separate from its controllers, with its own separate rights and liabilities, and its own assets.
6. A 'one-man company' is a legal entity, distinct from its owner and controller who is not liable for the company's obligations or liabilities. Thus, creditors of the company cannot go behind the corporate veil to pursue the shareholders and persons controlling the company, or its subsidiaries, for liabilities of the company. Equally, creditors of the controller of a company cannot pursue the

[4] I acknowledge my gratitude to Alan Van Praag, partner, Eaton & Van Winkle, law offices New York, for his contribution; any reference to USA law in this paper is based on his research and on my interpretation of the *Blue Whale* case, which he kindly sent me.

company for his own personal debts. In the words of Lord Halsbury LC in *Salomon v. A Salomon*:[5]

> *A legally incorporated company must be treated like any other independent person with its rights and liabilities appropriate to itself . . ., whatever may have been the ideas or schemes of those who brought it into existence.*

4 THE DOCTRINE OF PIERCING THE CORPORATE VEIL

4.1 Overview

7. The decision in *Salomon v. A Salomon* (1897) represents a substantial obstacle to an argument that the veil of incorporation can be pierced. The result of piercing the veil is drastic in that it disregards the corporate personality and identifies the owner/controller of the company, in law, with the company by virtue of that ownership and control.

8. From 1897 to 1966, as the House of Lords could not overrule itself, the classic application of *Salomon* was applied. In 1966, the rules changed and the House of Lords could change its mind. By 1969, Lord Denning MR seemed to pursue a crusade to encourage lifting of the veil[6] in the interests of justice, but his decisions,[7] which regarded the companies of a corporate structure as one economic unity, brought uncertainty to the safety of corporations and were overruled. In 1978, Lord Keith in *Woolfson v. Strathclyde* (see later at para. 9) disapproved of the 'Denning decisions' and set the parameters of the doctrine of piercing the veil. His decision had a strong and persuasive influence. In 1988, there was the celebrated decision of the Court of Appeal (Lord Donaldson MR) in *Evpo Agnic* (see at para. 78, below), which crystallized the legitimacy of one-ship companies and non-interventionism with legitimate corporate structures. In 1989, the pendulum swung further to non-interventionism by the decision of the Court of Appeal in *Adams v. Cape* (see fn. 10), which established that the companies of the corporate structure could not be taken as one economic unity and that the veil could not be pierced on the basis of 'what justice would require'. In 2013, this principle is confirmed by the Supreme Court in *Petrodel v. Prest* (see later at paras 16–32), which limits the doctrine further. It is stated that: if the doctrine of piercing is to exist, the circumstances in which it can apply must be limited and be as clear as possible.[8]

9. Until *Petrodel v. Prest* and *VTB Capital v. Nutritek* (paras 40–45), there existed a strong consensus, as derived from previous authorities, referred to in this paper, that for the corporate veil to be pierced there must be evidence of either fraud, or use of the company as a sham or a façade to evade or conceal liabilities.[9] The generally accepted scope of the doctrine as expounded by Lord Keith (albeit obiter) in *Woolfson v. Strathclyde*[10] was that: '*it was appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere façade concealing the true facts*' (meaning a deliberate dishonest purpose). There have also been English court decisions[11] – not referred to at the hearing of *Petrodel* – in which the courts, in the special circumstances of these cases, pierced the veil. It should be noted, however, that in other cases (see fn. 28), the corporate veil was not pierced particularly when there was another suitable remedy in law. The courts approached the issue on a case by case basis.

[5] *Salomon v. A Salomon and Co Ltd* (1897) AC 22 (HL), at pp 30-31. In this case a sole trader decided to set up a limited liability company with his family members as shareholders to conduct his leather and boot-making business. Upon the insolvency of the company, unsecured creditors sought to obtain payment from Mr Salomon and applied to the court for an order to pierce the corporate veil. It was held that Mr Salomon could not be made liable for his company's debts, which were legally the debts of the company, and there was no fraud involved simply in using a limited liability company as a vehicle for conducting legitimate business.

[6] See historical overview by C. Mitchell in 'Lifting the corporate veil in the English Courts: An Empirical Study' [1999] 3 *Company Financial and Insolvency Law Review* 15, Blackwell pdf file.

[7] *Littlewoods Mail Order Stores v. IRC* [1969] 1 WLR 1214; *DHN Food Distributors Ltd v. Tower Hamlets* [1976] 1 WLR 852.

[8] Per Lord Neuberger in *Petrodel Resources Ltd v. Prest* [2013] UKSC 34, at para. 67.

[9] E.g. *Gilford Motor Co Ltd v. Horne* [1933] Ch. 935 and *Jones v. Lipman* [1962] 1 WLR 832 are examples of the controller having had pre-existing legal obligations which he was attempting to evade by setting up a company. In both cases, the court allowed equitable remedies, but these cases, according to Arnold J in *VTB Capital*, are not regarded as decisions by which the corporate veil was pierced.

[10] *Woolfson v. Strathclyde* [1978] SLT 159 (HL); the principle stated by Lord Keith had a strong and persuasive influence in subsequent cases and was used by the courts as a yardstick in the examination of whether or not to pierce the corporate veil: e.g. see *Adams v. Cape Industries* [1991] 1 All ER 929, which was regarded as having settled the general law on the subject; the criterion of 'what justice would require' was rejected. This case established that the corporate veil should not be pierced just because a group of companies operated as a single economic entity. They may be one entity for economic purposes but not one unit for legal purposes. Cape had used the corporate form legitimately. [In the family division of the English court, the judges have followed a less rigid approach on the basis of 'what is just and necessary' to protect families after divorce, and the corporate veil would be pierced if the relevant company was a one-man company and the alter ego of the husband, e.g. see *Nicholas v. Nicholas* [1984] FLR 285 (CA), *Mubarak v. Mubarak* [2001] 1FLR 673. However, in 2007 Munby J. said firmly in *A v. A* [2007] 2 FLR 467, at paras 18–19: *'There is not one law of "sham" in the Chancery Division and another law of "sham" in the Family Division. There is only one law of "sham" to be applied equally in all three Divisions of the High Court, just as there is but one set of principles, again equally to be applicable in all three divisions, determining whether or not it is appropriate to "pierce the corporate veil"'*.]

[11] See a few examples: *Re A Company* [1985] 1 BCC 99 (see also fn. 21) The controller had established a network of corporate structures and trusts to which he was diverting assets to avoid liabilities; *Kensington International v. Congo* [2005] EWHC 2684 (Comm) (relating to freezing injunctions and orders for disclosure against third parties, Vitol and main controllers): there was strong evidence that the Vitol group had collaborated with the Congo to enable it to export oil in ways that ensured, as far as possible, that it had no assets abroad that might be amenable to execution. The methods employed for that purpose included the use of front companies by both the Congo and the Vitol group to disguise the true identity of the parties to the transactions and the structuring of contractual arrangements, in ways designed to ensure that no debts or other financial benefits accrued to the Congo (*see* paras 24 and 25) CA [2008] 1 Lloyd's Rep 161.

10. The meaning of a 'sham' was defined by Diplock LJ in *Snook v. London and West Riding Investments Ltd,*[12] thus:

> *. . . it means acts done or documents executed by the parties to the "sham" "which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligation (if any) which the parties intend to create . . .. but . . .for acts or documents to be a "sham", with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating . . .*

11. 'Façade' has been understood to mean 'a mask to conceal the true facts'.[13] However, Lord Sumption considered in *Petrodel* that the words 'sham' or 'façade' beg too many questions and do not give satisfactory answers to finding what is a relevant wrongdoing (see para. 26, below).

12. In civil law jurisdictions, the juridical basis of piercing the corporate veil is generally the concept of abuse of rights, to which the International Court of Justice (ICJ) referred in *Re Barcelona Traction, Light and Power Co Ltd*.[14] The ICJ derived from municipal law a limited principle permitting the piercing of the corporate veil in case of misuse, fraud, malfeasance or evasion of legal obligations. English law has no general doctrine of this kind, but it has a variety of specific principles which achieve the same result in some cases.[15]

13. The courts of the jurisdictions referred to earlier apply some distinct criteria to ascertain the required control by the shareholders of companies, or the alter ego of the relevant company, for the piercing of the corporate veil for certain purposes.

4.2 *Lifting is Distinguished from Piercing the Corporate Veil*

14. Before an order for the piercing of the corporate veil might be made, English courts have been prepared to look behind the veil by ordering evidence to be adduced in order to ascertain whether or not piercing the veil would be required. This is known as 'lifting the veil' i.e. 'peeping behind it'. The court may not order evidence to be so adduced unless there is an arguable case of a sham.[16] Staughton LJ, in *The Coral Rose,*[17] which concerned an application for a Mareva injunction, said:

> *To pierce the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To lift the corporate veil or look behind it, on the other hand, should mean to have regard to the shareholding in a company for some legal purpose.*

15. Thus, piercing the veil is the ultimate result. It is the sanction or remedy, whereupon the company is identified with its controllers in certain circumstances. But its scope now is less than the ambit given to it by Staughton LJ, above. In many cases, judges have treated the two steps, lifting and piercing, as indistinguishable.

As will be seen at paras 26–29, Lord Sumption in *Petrodel* treated the 'concealment' cases as cases of lifting the veil.

5 The current English conservative approach

5.1 *Petrodel v. Prest*

16. *Petrodel v. Prest* is a case of significant commercial importance but, apart from general observations made by the seven SC Justices, the decision may be limited to the specific facts of this case. Mrs Prest (YP) sought payment of £17.5 million from her ex-husband Mr Prest (MP), being the sum ordered by the court with regard to the divorce settlement. MP (an oil-tycoon) was claiming that he did not have the money and the residential homes were the property of various companies he had established for his oil business. The judge at first instance, by way of partial satisfaction of that payment, directed MP to procure that certain companies in the Petrodel group transfer seven UK properties to YM, on the basis that the companies were wholly-owned and controlled by MP. He relied on the statutory provision, section 24(1)(a) of the Matrimonial Causes Act 1973 (MCA), which he considered conferred a special jurisdiction on the court in matrimonial cases to 'pierce the corporate veil'. The judge further held that there was no general power on the court entitling him to 'pierce the corporate veil' to access the companies' properties, in this case, because there was no impropriety by MP that would justify the disregard of the companies' separate legal personalities. MP appealed, and the Court of Appeal, by majority, reversed the judgment and held that the court had no jurisdiction to order the companies to convey the properties to YP in satisfaction of the judgment debt against MP. YM appealed to the Supreme Court (SC).

17. The SC (Lord Sumption delivering leading judgment) explained that the court could access the properties to satisfy the order against MP on three possible bases: (i) the court's general power to pierce the corporate veil; (ii)

[12] [1967] 2 QB 786, at 802.

[13] *Dadourian Group International v. Simms* [2006] EWHC 2973 (Ch) at paras 682-3. The controllers of the company (Charlton) were held jointly liable for the costs and expenses of arbitration and litigation incurred by the claimant (DGL) on the basis of misrepresentation and the tort of deceit; but the controllers were not held liable for the sum awarded by the arbitrators against the company for breach of contract (which remained unsatisfied), because they were not parties to the arbitration agreement. There was no need, Warren J held, in order to give the claimant redress for misrepresentation, to lift the veil at all: the judge's decision was approved by the Court of Appeal in most parts [2009] EWCA Civ 169.

[14] [1970] ICJ 3, referred to by Lord Sumption in *Petrodel Resources Ltd v. Prest*, ibid, (at para 17) (see later).

[15] Per Lord Sumption in *Petrodel v. Prest*, ibid, at para 18 of his judgment.

[16] Examples of cases in which an order was made to peep behind the veil were: *The Kommunar (No 2)* [1997] 1 Lloyd's Rep 8; *The Aventicum* [1978] 1 Lloyd's Rep 184; *The Glastnos* [1991] 1 Lloyd's Rep 482.

[17] *Atlas Maritime Co SA v. Avalon Maritime Ltd* [1991]1 Lloyd's Rep 563, at 571; see also *Adams v. Cape Industries* [1991] 1 All ER 929.

section 24(1)(a) of MCA 1973; (iii) by virtue of the beneficial ownership of the properties by MP.

18. Allowing the appeal of YP, the court ordered the transfer of the relevant properties to her on the basis of MP's beneficial ownership[18] (considering particularly the obstructions by MP to disclose evidence). The properties held within the corporate structure were held on bare trust for the benefit of MP, who had provided the purchase money and the properties were then gratuitously transferred to the companies; in such circumstances, they should be transferred to YP in satisfaction of the financial settlement. The SC held that this was not a case based on any general power of the court to pierce the corporate veil. While MP used the companies' assets as his own, he was not – by doing so – concealing or evading any legal obligations owed to his wife because the properties were vested in the companies long before the break-up of the marriage.

19. The SC Justices agreed broadly that the doctrine (or metaphor, or label per Lords Mance and Walker) of piercing the corporate veil was incoherent and unclear. Lord Sumption said (at para. 16) that the expression '*piercing the corporate veil, properly speaking, means disregarding the separate personality of the company*.' He referred to a range of situations in which the law attributes the acts or property of a company to those who control it, without disregarding its separate legal personality: for example when:

(i) The controller may be personally liable, in addition to the company, if he acts as its agent, or as a joint actor;
(ii) Property legally vested in a company may belong beneficially to the controller, if the arrangements in relation to the property are such as to make the company its controller's nominee or trustee for that purpose;[19]
(iii) Specific statutory provisions exist (e.g. the Companies Acts) under which a company's legal responsibility may be engaged by the acts or business of an associated company.

20. In such cases, equitable remedies, such as an injunction or specific performance may be available to compel the controller whose personal legal responsibility is engaged to exercise his control in a particular way. He further stated:

> *but when we speak of piercing the corporate veil, we are not (or should not be) speaking of any of these situations, but only of those cases which are true exceptions to the rule in Salomon v. Salomon, . . . i.e. where a person who owns and controls a company is said, in certain circumstances, to be identified with it in law by virtue of that ownership and control.*

21. Although it was noted that the doctrine has been criticized as being unprincipled, Lord Neuberger reached the conclusion not to discard it because it represented a '*potentially valuable judicial tool to undo wrongdoing in some cases, where no other principle is available'* (at paras 75–80). He and Lord Sumption agreed that most cases in which the corporate veil was pierced could have been decided on other grounds. But the consensus that there are circumstances in which the court may pierce the corporate veil is impressive, Lord Sumption said, and he was not willing to undo it, because, he stated (at para 27):

> *the recognition of a limited power to pierce the corporate veil in carefully defined circumstances is necessary if the law is not to be disarmed in the face of abuse.*

5.2 The Limits Imposed on the Doctrine by Petrodel

22. Since on the facts of this case there was no need to pierce the veil, it is arguable that the following limits to the doctrine are just obiter. Even so, it appears that such limits were not agreed upon even by the majority of the seven SC Justices.

5.2.1 Evasion of Existing Liabilities

23. Lord Sumption concluded (at para 35) that:

> *there is a limited principle of English law which applies when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control. The court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality . . . the principle has been recognised far more often than it has been applied. But the recognition of a small residual category of cases where the abuse of the corporate veil to evade or frustrate the law can be addressed only by disregarding the legal personality of the company is, I believe, consistent with authority and with long-standing principles of legal policy.*

5.2.2 No Public Policy Imperative to Do Justice

24. Lords Sumption, Neuberger, and Clarke, each expressly endorsed the judgment of Munby J. in *Ben Hashem v. Shayif,*[20] and, in particular, his holding that: if the court had the power to pierce the veil, it could only do so when all other, more conventional, remedies had proved to be of no assistance. Therefore, according to the three SC Justices (no express view was stated by the other SC Justices, but no disagreement either), if it is not necessary to pierce the corporate veil, it is not appropriate to do so, because on that footing there is no public policy imperative which justifies that course, as there are other remedies available in law.

5.2.3 The Circumstances for Piercing the Veil – Adoption of the Munby J Five Rules

25. Save for any reference by Munby J to *concealment (*which is here omitted from his exposition of the summary of the six rules for piercing the veil), the following five rules were accepted as being correct:

(a) Ownership and control of a company are not of themselves sufficient to justify piercing the corporate veil;

[18] But Lady Hale and Lord Wilson held that s. 24(1)(a) of MCA 1973 also applied in the circumstances of this case.

[19] This category touches upon those shipping companies, which do not involve sophisticated corporate structures to distance the real beneficial owner and controller from the registered owner who is a legal owner acting as a trustee for the person behind the trust.

[20] [2008] EWHC 2380 at paras 160–166.

(b) The court cannot pierce the corporate veil merely because it is thought to be necessary in the interests of justice, but only in so far as it is necessary to provide a remedy for the particular wrong and not for all purposes;
(c) The corporate veil can be pierced if there is some impropriety, but not just if the company's wrongdoing is breach of contract;
(d) The impropriety must be linked to the use of the company structure to avoid liability. It follows that, if the court is going to pierce the veil, it is necessary to show both control of the company by the wrongdoer(s) and impropriety;
(e) A company can be a façade, even though it was not originally incorporated with any deceptive intent; the question is whether it was so used at the time of the relevant transaction.

5.2.4 Distinction between 'Concealment' and 'Evasion'

26. The issue of 'concealment' was regarded by Lords Sumption and Neuberger as not involving piercing the veil. In particular, Lord Sumption said (at para 28): '*the difficulty is to identify what is a relevant wrongdoing. References to a "façade" or "sham" beg too many questions to provide a satisfactory answer*'. But behind these two terms, he said, there are two distinct principles: the 'concealment principle cases' and the 'evasion principle cases'. As to 'concealment', he explained that:

> *. . . the interposition of a company . . . to conceal the identity of the real actors will not deter the courts from identifying them, assuming their identity is legally relevant. In these cases the court is not disregarding the façade, but only is looking behind it to discover the facts which the corporate structure is concealing.*

27. In this sense, it seems, he equated the exercise of discovering what is concealed behind the veil ('concealment cases') with 'lifting the corporate veil to peep behind it', as Staughton LJ had pondered in the *Coral Rose* (at para. 14, above).

28. The evasion principle, on the other hand, is different, Lord Sumption said (at para. 28):

> *It is that the court may disregard the corporate veil if there is a legal right against the person in control of it which exists independently of the company's involvement, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement. Many cases will fall into both categories, but in some circumstances the difference between them may be critical.*

29. He and Lord Neuberger preferred to limit the doctrine of piercing the corporate veil to the 'evasion' cases. Lord Neuberger said (at para. 61):

> *I also agree that cases concerned with concealment do not involve piercing the corporate veil at all. They simply involve the application of conventional legal principles to an arrangement which happens to include a company being interposed to disguise the true nature of that arrangement. Accordingly, if piercing the corporate veil has any role to play, it is in connection with evasion.*

30. By contrast, Lords Mance (with whom Lord Clarke agreed) and Lady Hale (with whom Lord Wilson agreed) expressed more flexible views:

Lord Mance stated (at para. 100):

> *It is . . .often dangerous to seek to foreclose all possible future situations which may arise and I would not wish to do that. What can be said with confidence is that the strength of the principle in Salomon's case and the number of other tools which the law has available mean that, if there are other situations in which piercing the veil may be relevant as a final fall-back, they are likely to be novel and very rare.*

Lord Clarke said (at para. 103):

> *Lord Sumption may be right to say that it will only be done in a case of evasion, as opposed to concealment, where it is not necessary. However, this was not a distinction that was discussed in the course of the argument and, to my mind, should not be definitively adopted unless and until the court has heard detailed submissions upon it . . . I expressed the same view in VTB Capital v. Nutritek . . .And I adhere to it now. However, I also agree with Lord Mance and others that the situations in which piercing the corporate veil may be available as a fall-back are likely to be very rare and that no-one should be encouraged to think that any further exception, in addition to the evasion principle, will be easy to establish. It will not.*

31. Lady Hale expressed her concerns about the division between evasion and concealment (at para. 92):

> *I am not sure whether it is possible to classify all of the cases in which the courts have been or should be prepared to disregard the separate legal personality of a company neatly into cases of either concealment or evasion. They may simply be examples of the principle that the individuals who operate limited companies should not be allowed to take unconscionable advantage of the people with whom they do business. But what the cases do have in common is that the separate legal personality is being disregarded in order to obtain a remedy against someone other than the company in respect of a liability which would otherwise be that of the company alone (if it existed at all). In the converse case, where it is sought to convert the personal liability of the owner or controller onto a liability of the company, it is usually more appropriate to rely upon the concepts of agency and of the 'directing mind'.*

32. Although the 'evasion principle' does limit the scope of the doctrine considerably, it provides, as it seems, more certainty and clarity about the criteria to be applied. It appears to me, however, that, since the public policy requirement 'to do justice'[21] is not an imperative, if there are other remedies available, the 'concealment' type of cases should be given a chance for further consideration and analysis; and that was the view of Lord Clarke. In practice, there can be cases in which there is a blurring between concealment (which may amount to a dishonest ploy to avoid liabilities) and evasion. Drawing a line, by way of imposing a general definitive principle, will disable judges from looking at instances of concealment in particular cases.

[21] The case in which the Court of Appeal was prepared to pierce the veil if it was necessary to do justice was in *Re A Company* [1985] 1 BCC 99. However, in *Adams v. Cape* [1990] Ch. 433, the Court of Appeal was reluctant to go that far by applying just this criterion. In both *VTB v. Nutritek* and *Petrodel v. Prest,* it was clarified that only if there were no other remedies there would be no public policy imperative because it would not be necessary.

5.3 The Scope of Piercing the Veil and Its Effect on Contractual Transactions

33. The English courts were swamped in the last ten years by foreign litigants seeking justice in cases in which it was alleged they had been defrauded or misled by those hiding behind the corporate veil of their contractual partners. Except for Burton J in the *Gramsci* and the *Alliance* cases (see below), in which he held there was an arguable case, on the facts, to pierce the corporate veil in order to make the controllers of the company parties to the contract entered into between the company and the claimant, no other judge was prepared to go that far. There had been no other authority on this issue and the other judges distinguished the decisions of Burton J from the one they had to decide.

34. The claimants in *VTB Capital* (below) were sent back to where they came from (Russia) to find justice because the alleged, or actual, deceit was committed there, and the English court (as it was held) was not the most appropriate forum.

5.4 The Main Question

35. The critical question in such cases has been this: what would be the effect and consequence of a finding that the circumstances of the particular case did justify the piercing of the corporate veil? In other words, how far the scope of the doctrine of piercing the corporate veil could be extended. If the purpose of disregarding the corporate veil by applying the exception to the *Salomon* rule is to identify those behind that veil, the controllers, with the company, should they not, by law, be bound to the particular contract in question, as if that contract had been made between them and the claimant?

5.5 The Burton J Decisions

36. Burton J. in *Antonio Gramsci Shipping Corp. v. Stepanovs*[22] and his subsequent decision in *Alliance Bank LSC v. Aquanta Corp.*[23] reached that conclusion. He said in the *Gramsci* case (at para. 26):

> *There is in my judgment no good reason of principle or jurisprudence why the victim cannot enforce the agreement against both the puppet company and the puppeteer who, all the time, was pulling the strings. The claimants seek to enforce the contract against both puppeteer and the puppet company.*

37. In *Gramsci v. Stepanovs*, the claimants (thirty 'one-ship companies', all in the ultimate beneficial ownership of Latvian Shipping Co. (LSC)), brought proceedings against five corporate defendants alleging that between 2003 and 2005 they were victims of massive fraud. As the corporate defendants failed to comply with a court order by which they had been ordered to make a payment into court of US$40 million, as a condition to be able to defend the case, a judgment was issued in default, which remained unsatisfied. The claimants, therefore, brought proceedings against Mr Stepanovs, who with four other persons were the beneficial owners of the corporate defendants. It was alleged that the corporate defendants (by a fraudulent scheme of its controllers) were interposed by becoming the charterers for the sixty-three ships of the claimants (at less than the market rate), so that the defendants could siphon, dishonestly, the profits by sub-chartering to third parties at market rate, instead of the claimant companies chartering out their vessels to arm's length commercial charterers. So the claimants commenced this action seeking to pierce the corporate veil in order to hold Stepanovs jointly and severally liable with each of the corporate defendants in respect of the claimants' losses. In order to establish jurisdiction against the defendant, the claimant relied, primarily, on the jurisdiction clause of the charter parties. On the claimants' case, the defendant, by virtue of piercing the corporate veil, was a party to the charter parties and the jurisdiction agreement contained in them.

38. The judge held that there was a good arguable case that the veil should be pierced in order to permit the claimants to seek to enforce the charter parties as against the defendant, who was not, originally, a party to them, and there was no principle or jurisprudence against such finding.

39. In *Alliance Bank v. Aquanta*, Burton J. also held that by the application of the alter ego principle, there was an arguable case that the off-shore companies were the puppets of the defendants; there was a serious issue to be tried by piercing the corporate veil to determine whether three of the defendants were to be treated as parties to the loan agreements.

5.6 Reaction to and Disapproval of the Decisions of Burton J

40. His decisions caused heated debates and were disapproved of by the Court of Appeal in *VTB Capital v. Nutritek,*[24] which held that there was no such principle extending the scope of the doctrine to pierce the veil, and this was confirmed by the Supreme Court in this case.[25]

41. Arnold J commented in *VTB Capital* (at para 101):

> *. . . It seems to me that the decision in Gramsci v. Stepanovs is not so much a decision to pierce the corporate veil as a decision to ignore privity of contract.*[26] *Burton J accepted the argument he set out at [23] that there was no difference in principle between making the puppet liable under the puppeteer's contract, as in Gilford v. Horne and Jones v. Lipman,*[27] *and making the puppeteer liable under the puppet's contract. For the reasons I have explained, however, I consider that this argument starts from a false premise. Neither in Gilford v. Horne nor in Jones v. Lipman were damages awarded against the puppet for breach of the puppeteer's contract. Rather, equitable relief was granted against the puppet to stop the puppeteer evading his own contractual liability. Thus the puppet was not treated as being party to the puppeteer's contract.*

[22] [2011] EWHC 333; 1 Lloyd's Rep 647.
[23] [2012] 1 Lloyd's Rep 181; also CA [2013] 1 Lloyd's Rep 1.
[24] [2012] EWCA Civ 808, and the Court of Appeal in *A Gramsci v. Lembergs* [2013] 2 Lloyd's Rep 295, which mainly deals with the application of Art. 23 of the Brussels I Regulation.
[25] [2013] UKSC 5.
[26] Arnold J said, in this connection (at para. 101), that the Contracts (Third Parties' Rights) Act 1999 is a limited statutory incursion into the doctrine of privity of contract which otherwise left it intact.
[27] Op. cit at fn. 9.

42. The facts of *VTB Capital* are not uncommon.[28] VTB, an English bank, being a subsidiary of a Russian State-owned bank, lent money under a facility agreement to a Russian company RAP to fund the purchase of a dairy business from Nutritek. The agreement provided for English law and Jurisdiction; RAP defaulted on the loan. VTB brought an action for fraudulent misrepresentation alleging that it was induced to enter into the contract by Nutritek, who allegedly colluded with RAP, and the controller of Nutritek, Mr Malofeev. The two alleged misrepresentations were that RAP and Nutritek were not under common control and the value of the dairy business was stated to be much higher than it was. VTB later sought to amend its pleaded case to content that Mr Malofeev (the controller) and another should be treated as being jointly and severally liable with RAP for breaches of the agreements, seeking to pierce the corporate veil.

43. Arnold J. at first instance[29] rejected the bank's claim for damages in contact against the non-party to the contract. His reasoning was accepted by the higher courts and was much quoted in subsequent cases. Having analysed relevant authorities, he said that the true basis upon which the courts have pierced the corporate veil is that the company was being used by its controller in an attempt to immunize himself from liability for some wrongdoing which existed entirely *independently* from the company. That is an anterior and independent wrongdoing by the controller.

44. The Court of Appeal agreed; on appeal to the Supreme Court by VTB, Lord Neuberger, delivering the main judgment, with whom the other Lords agreed, held that there could not be an extension to the scope of piercing the corporate veil to the extent that the controller of the company in question becomes contractually liable to the claimant bank for the debt of the company under the facility agreements. Lord Clarke, although he agreed that it was not appropriate to pierce the veil on the facts of this case, expressed the wish to reserve for future decision the question as to what is the true scope of the circumstances in which it is permissible to pierce the veil; that included the question whether *Antonio Gramsci v. Stepanov* (on its facts) was correctly decided.[30]

45. The fundamental objection to the case of VTB Capital was that the doctrine was being invoked so as to create a new liability, which would not otherwise exist, namely, to make the controllers of the company jointly and severally liable on the company's contract. It was emphasized, in this case, that even if the criteria for piercing the veil were met, such as control coupled with impropriety by the controller of the company, the court would decline to pierce the veil if there were other remedies available and, in most cases, there have been. For example, equitable remedies could be granted against a company in respect of legal or equitable wrongdoing committed by an individual, the controller of the company, but it would not necessarily follow that the individual could be held liable for breach of contract entered into by the company.

46. VTB had an arguable case based on the torts of deceit and conspiracy to defraud, allegedly committed by the defendants. The tort of deceit was committed in England, so the English court had jurisdiction. But the alleged tortious responsibility of all the defendants depended upon proof that they were parties to a common design. On the facts, Lord Mance found, that the common design for the tort of conspiracy was formed in Russia. Thus, the Russian courts had jurisdiction also and it was held that, on balance, Russia was the most appropriate forum.

[28] Other claimants also came before the English courts seeking to pierce the corporate veil: e.g. *Lindsay v. O'Loughnane* [2010] EWHC 529 (QB), in which Mr Lindsay contended that Mr O'Loughnane had misrepresented his company's activities, which induced Mr Lindsay to enter into contracts with the company. His claim was in deceit and he sought to pierce the veil in order to hold Mr O'Loughnane liable under the contracts. Flaux J. concluded that the claim in deceit succeeded, but rejected the claim to pierce the corporate veil; In *Dadourian Group International Inc v. Simms* [2006] EWHC 2973 (Ch), at paras 684 and 685, Warren J. held that where a claim in deceit succeeded against the person controlling the company, it would be inappropriate to permit the veil to be lifted to enable the claimant to pursue a contractual claim against that person. As he put it, the claimant *'recovers all his loss arising as a result of the misrepresentation by his tortious claim in deceit'*;

In *Linsen International Ltd v. Humpuss Sea Transport PTE Ltd* [2011] EWHC 2339 (Comm), the claimants entered into charter parties with the Humpuss group. The first vessel was chartered to the first defendant but the market collapsed and the first defendant refused to pay; he transferred assets to the other defendants as part of a restructuring within the group. The claimants obtained an arbitral award against the first defendant and then sought to pierce the veil and hold the third to thirteenth defendants liable under the charter parties. They first obtained a freezing injunction ex-parte. On the return date, the claimants applied to continue the injunction which was resisted by the defendants. Flaux J. held: the first evidence, which might be described as abuse of the corporate structure was when the restructuring of the Humpuss companies commenced in 2009. As to that, the claimant could show a good arguable case that the purported sales of vessels and transfers of assets to the third defendant were shams or façades designed to render enforcement against the first defendant more difficult and that the corporate structure of the Humpuss group was misused from July 2009 until sometime in 2010 to that end, so that, at least, as between the first and third defendants, (but not beyond) there was an arguable case for piercing the corporate veil. However, whether or not the corporate veil could be pierced as against, or between one or more of, the third to thirteenth defendants, the effect of piercing did not make those defendants liable under the underlying contracts, the basis on which the freezing injunction had been obtained. Accordingly, there was no basis for its continuation. He further said at paras 18–19: '*it is not enough to show that a company or a group of companies is closely controlled by an individual or a family or by a holding company. If the element of control were sufficient in itself, the English courts would have accepted the concept of the "single economic unit" which . . .has been consistently rejected by our courts. The claimant who wishes to pierce the corporate veil must show not only control but also impropriety, in the sense of misuse of the company or the corporate structure to conceal wrongdoing*'. As to the action against the guarantor, second defendant, he held there was no basis for piercing the corporate veil; there was no suggestion that he tried to evade his liability under the guarantee by transferring his assets.

[29] [2011] EWHC 3107 (Ch), the judge helpfully reviewed relevant authorities.

[30] This question was not directly answered by the subsequent Supreme Court decision in *Petrodel v. Prest* because such issues did not arise in that decision as seen earlier in this paper.

6 Liberal jurisdictions: the 'alter ego' cases – indicators for piercing the veil

47. In the USA and South Africa, the indicators applicable for piercing the veil are similar and are, broadly, based on who controls, or dominates, the company in question.

6.1 The USA Approach in the Context of the Rule B Attachments

48. It should be noted that different jurisdictions in the United States apply Rule B differently, in that there is a significant variance in the veil piercing standards applied by the various Circuits. For example, courts within the Second Circuit in New York and Connecticut apply Rule B differently from courts within the Eleventh Circuit in Florida, Georgia and other Southern States. In the Fifth Circuit, the rule is applied when the person or parent company exercised complete domination over the corporation with respect to the transaction at issue, and such domination was used to commit a fraud or wrong that injured the party seeking to pierce the veil. In the Second Circuit, it seems, that committing a 'wrong' alone is sufficient. Ultimately, in all jurisdictions the corporate veil will be pierced if upholding the corporate separateness would work out injustice and produce inequitable results.[31] The Second Circuit Court of Appeals enumerated ten factors that are considered as indicators of domination of the defendant (corporation) by its alter ego:[32]

1. The absence of corporate formalities;
2. Inadequate capitalization;
3. Personal use of corporate funds;
4. Overlapping personnel and ownership;
5. Common office space, address, telephone numbers;
6. The amount of business discretion displayed by the allegedly dominated corporation;
7. Whether the related corporations deal with the dominated corporation at arms' length;
8. Whether the corporations are treated as independent profit centres;
9. The payment of or guarantee for debts of the dominated corporation by other corporations in the group;
10. Whether the corporation in question had property that was used by the other corporations, as if it were its own.

49. However, there is no set rule as to how many of these factors must be present to warrant piercing the corporate veil, and the courts have considered additional factors as well.

50. In *Milestone Shipping SA v. Estech Trading LLC,*[33] the court summarized the standard for evaluating alter ego claims by observing that a primary consideration is whether affiliated defendants operated as a single economic entity.

51. In a recent decision of the Second Circuit Court of Appeals, *Blue Whale,*[34] the Appellate court re-examined the 'alter ego' claim of Blue Whale in the context of Rule B attachment and, by conducting a choice of law analysis, decided that Federal common law applied, overruling the decision of the US district court (Southern District of NY). The district court had concluded that, pursuant to the charter party choice of law provision, English law applied and, on the basis of that law, there was no adequate prima facie claim to pierce the corporate veil:

(i) Blue Whale (shipowners) contracted with Grand China Shipping Development (charterers) to transport goods from Brazil to China. A dispute arose as to unpaid freight, which was referred to London arbitration, pursuant to the charter party. In anticipation of an arbitration award, Blue Whale sought to obtain security for their claim by applying for a Rule B attachment against the assets of the charterers' alter ego, HNA Group Co Ltd, another Chinese company, which owned property in the Southern District of NY (providing the connection with the jurisdiction). Blue Whale alleged that the charterer and HNA were in fact a single business enterprise and sought to pierce the corporate veil to reach the assets of HNA.

(ii) There was no dispute that Blue Whale had a valid prima facie admiralty claim against the defendant in order to seek the attachment (procedural issue). The dispute was about which law applied to the court's assessment of the validity of the claimant's prima facie claim (substantive issue). It was noted by the Second Circuit Court of Appeal that there had been a split of authority in the Southern District of NY on this issue. Some district courts within the Circuit presumed that federal law governs all questions concerning the validity of Rule B attachment, while others regarded that the existence of a valid prima facie claim turns on the substantive law of the relevant contract. The Second Circuit held that neither of these presumptions were correct.

(iii) It held that while admiralty law provides the remedy, substantive law defines the right to the remedy. However, it considered that the more difficult question was which substantive law controlled the validity of Blue Whale's alter ego claim?

(iv) On this point, the Second Circuit confirmed that Federal maritime law cannot automatically apply to assess 'alter ego' claims. Since the alter ego claim is collateral to the contract, in all such cases district courts within the Circuit must always conduct a choice of law analysis in determining what law applies to evaluate Rule B alter ego claims. Such analysis led the court to the application of Federal common law, rather than the application of the charter party choice of law provision. It ruled that the choice of law clauses in underlying contracts are irrelevant to assessing alter ego claims;[35] the issue here was about the legal status of HNA as an alter ego of the charterer and not about the obligations or violations of the charter party between Blue Whale and the charterer.

[31] As advised by George Gaitas of Chalos & Co, International law firm, Houston, and Alan Van Praag, referred to in fn. 4, above.

[32] *Tide Line Inc v. Eastrade Commodities* 2006 WL 4459297, 2007 A.M.C. 252, 265.

[33] 2011 A.M.C. 968 (S.D.N.Y).

[34] 2013, July 16, No. 13-0192- cv.

[35] It is interesting to note that Lord Neuberger in *VTB Capital v. Nutritek* applied English law as being the law appropriate to determine the question of piercing the veil, as there was no single choice of law rule to govern the issue (at paras 131–132).

6.2 South African Law Approach in the Context of Associated Ship Arrest

52. Under the law of South Africa, the indicators (seen under para. 46, above) are relevant in the context of associated ship arrest. The conditions for an associated ship arrest are set in the Admiralty Jurisdiction Regulation Act No. 105 of 1983, as amended in 1992 (the Act). In effect, the associated ship arrest allows the claimant to go behind the veil of a company and circumvent the protection afforded to shipowners by one-ship companies.

53. Section 3(7) defines a sister ship as the one owned by the same person or company who owns the guilty ship, and it defines 'associated ship' and 'control' under (e) and (f):

(a) An associated ship means a ship, other than the ship in respect of which the maritime claim arose, that is:
   i. Owned, at the time when the action is commenced, by a person who controlled the company which owned the ship concerned when the maritime claim arose, or
   ii. Owned, at the time when the action is commenced, by a company which is controlled by a person who
      a. owned the ship concerned, or
      b. controlled the company which owned the ship concerned, when the maritime claim arose.

(b) For the above purpose, a person shall be deemed to control a company if he has power, directly or indirectly, to control the company.

54. The provision requires proof of control (at the relevant times). A person may control a company without controlling all the shares in the company, and even without majority shareholding.[36]

55. The Supreme Court of Appeals of South Africa interpreted the above provision in *Belfry Marine Ltd v. Palm Base Maritime (the M/V Heavy Metal)*.[37] The claimant sought to obtain security for his claim in damages for the defective condition of the ship MV *Sea Sonnet*, which he bought under an MOA. He arrested the *Heavy Metal* (not belonging to the same company as the one which sold to him the *Sea Sonnet)* pursuant to the above provisions of the SA Act; the owner of the *Heavy Metal* applied to set the arrest aside.

56. With regard to the meaning of 'control' under the statute, the Supreme Court held that control is expressed in terms of power of: either (a) to manage the operations of the company, or (b) to determine its direction and fate. Where these two functions happen to vest in different hands, it is the latter that the legislator had in mind when referring to 'power' and hence 'control'. 'Indirect power' in the Act was thought to refer to the person who, de facto, wields power (that is, the beneficial owner) through someone else. That 'someone else' is the person who wields direct power vis-à-vis the company and the outside world (the legal owner) and who, in the eyes of the law (that is, de jure), controls the shareholding and determines the direction and fate of the company. The same person may exercise both de facto and de jure control. If, for example, the person having de jure power happens to control, at the relevant time, the companies concerned, that is, the company that owns the guilty ship and the one that owns the targeted ship, the statutory requirements of a nexus between the two companies will have been satisfied.

57. Mr Lemonaris, a Cypriot lawyer, held the position of de jure controller because, when he registered the companies and the ships in Cyprus pursuant to the law of Cyprus, he had to hold the position of the nominee shareholder of the two different beneficial owners of the ships. Thus, pursuant to the SA Act, the *Heavy Metal* was an associated ship with the *Sea Sonnet*.

58. The *Heavy Metal* decision is controversial but it is the current status of the law.[38] The principles and purpose of the associated ship arrest were confirmed by a relatively recent decision of the Supreme Court of SA, *The Cape Courage*,[39] which gave the final blow to shipowning legitimate corporate structures. The court confirmed that the SA legislation goes beyond a sister ship arrest by widening the net and providing for a statutory piercing of the veil to combat the practice frequently adopted by shipowners seeking to evade the sister ship provision by setting up a series of one-ship companies.[40]

59. The SA Act cuts through what is not allowed under English law, for example, what has been seen in the cases of *Evpo Agnic* (two sister companies), the *Maritime Trader* (a parent and a subsidiary) and the *Aventicum* (a parent with various subsidiaries, all of which were controlled by one person sitting over and above all companies).

6.3 Greek Law Approach: Recent Supreme Court Decision

60. In February 2013, piercing of the corporate veil was clarified by the highest court of Greece (Αρειος Παγος) constituted of twelve members (ΑΠ Ολ 2/2013),[41] which overruled the Court of Appeal decision. The general principles applicable to the corporate veil and the exceptions to its protection are set clearly by this decision, thus:

(i) The corporate personality, which is a creature of the law, is separate from those individuals who are the owners or shareholders of the company (separability principle).
(ii) It is legitimate to have one person or a shareholder of the company to manage the company and other sister companies [επιχειρηματιαζ], or to provide finance by way of loans, or guarantees, for its operations, and to identify its interests with the interests of the company in a legitimate way.
(iii) The establishment of one-ship companies in the shipping business is legitimate for the protection of the property of

[36] *Dole Fresh Fruit International Ltd v. MV Kapetan Leonidas* 1995 (3) SA 112, at 119.
[37] 1999 (3) All SA 337 (A).
[38] See Hare, J: Shipping Law and Admiralty Jurisdiction in South Africa, Part I, at paras 2-2.6.2–2-2.6.3, 2nd edn (2009) JUTA & Co Ltd.
[39] 2009 ZASCA 74.
[40] The reaction to the Heavy Metal by shipping businessmen led to the reorganization of their affairs by creating the most complex corporate structures; for example, see *China National Chartering v. MT GC Guangzhou,* where the Chinese claimant was not successful on the associated ship arrest.
[41] No names of cases are given in the reported cases.

the beneficial owner from the risks or dangers to which the ships are exposed.

(iv) Abuse or misuse will occur when the legal personality of the corporate is used by the shareholder/controller to present the activities of the corporate, or of himself, as legitimate in cases in which:
   a. there is a breach of the rules of law,
   b. there is breach of good faith principles, or
   c. there is deliberate intention to harm third parties, or to avoid legal obligations of the corporate or of himself which were created with knowledge of corporate or personal inability to perform.

61. The sanction for such conduct is the piercing of the legal personality to extend the particular liabilities or consequences from the company to the shareholder/controller or vice versa. Such a consequence is temporary and limited to the particular transaction concerned. But the liability of the company and of the controller is joint and several.

62. The Greek Supreme Court set the following indicators which will, normally, be considered as relevant, when a court examines cases in which piercing the corporate veil is sought:

– Inadequate finance or capitalization in the company;
– Conflation between the company's property with the controller's personal property;
– The conduct of the dominant shareholder in his dealings with persons of the company is taken into account:
   i. When the company does not have its own business organization;
   ii. When the formalities are not kept and it is the controller, in fact, who enters into contracts and deals with outsiders for its own benefit;
   iii. When, under the guise of the corporate personality, third parties were led by the controller to enter into a particular contract with the corporate body due to the presentation to them of misleading facts.

63. The case was not unusual and concerned a debt owed to a bunker supplier. A fleet of a number of ships, each owned by one-ship companies, was controlled by X, who was also the main shareholder of the holding company in the group of the subsidiaries; the holding company, in turn, was owned by another (the parent company) of which X was the main shareholder. Some of the subsidiary shipowning companies were registered in Liberia and others in Panama (typical structure). X became a personal guarantor for loans provided by banks to the parent company, the purpose of which was to finance the subsidiaries. X also mortgaged his personal property as additional security for the loans. The drop in the freight market and difficulties in finding employment for all the ships caused financial problems for the group.

64. The fleet was managed by another Liberian company, A, based in Greece. A was functioning independently from the shipowning companies. On behalf of subsidiaries, A entered into a contract with M (bunker supplier) for the supply of bunkers, which were supplied. During the negotiations, the head of supplies of A sought extension of time for payment by instalments and M was reassured that payment would be regular; in particular, M was persuaded to agree on the basis that there was no need for concern, since the head of the fleet was X (the implication being that X was a well-known figure in shipping!). X confirmed personally on the telephone to M his leading position in the fleet and indicated that he would be personally responsible for the payment. (It should be noted that it is not reported in the decision what was said precisely during this telephone conversation.) The amount of the invoice being USD 138,883 remained unpaid. There was default on the loan repayments and the bank took possession of some ships; consequently, the fleet collapsed.

65. M sued X and the relevant subsidiary which purchased the bunkers, seeking from the court the piercing of the corporate veil so that the debt was paid by X, since the purchasing subsidiary had collapsed.

66. The Supreme Court of Greece, reversing the decision of the CA,[42] ordered the piercing of the corporate veil. It agreed with the CA only to the extent that, despite X being a guarantor for the loans and the controller of all subsidiaries in the group for their commercial operation, these factors alone were not indicative of an excessive use of power by X, nor was there conflation of the company's finances with X's personal ones. However, taking all the circumstances into consideration and, in particular, the fact that, at the time the contract was made on behalf of the debtor company, the company and the other subsidiary companies in the group were undergoing severe financial difficulties, the Court held that X transferred, in effect, the risk of financial default arising from his own business activities to the claimant, M. M had been persuaded to enter into the contract as he had been led to believe by X himself that the money would be paid as agreed, since X was the decision maker about matters of the fleet.[43]

67. In the circumstances, and with regard to the particular transaction, it was held that there was abuse of the legal personality of the company which constituted breach of principles of good faith under the Greek Civil Code and an abuse by X of his own position and rights, so as to justify the piercing of the corporate veil and render X liable to pay this particular debt. The piercing was limited and temporary for the purpose of rendering both the company and the main shareholder jointly and severally liable to the bunker supplier under the particular contract between M and the company.

68. This case is distinct from other cases decided in other jurisdictions, because the Greek Supreme Court introduced an additional criterion to piercing the corporate veil based on the Civil Code of Greek private law. In particular, it held that there was breach by the controller of Article 281 of the Code, which imposes an obligation that, when a person exercises a right (namely here the right to control the company), he must do so in

[42] The CA had reversed the first instance decision, and did not identify X with the corporate personality of the subsidiary companies.

[43] The view of the CA on this point was that, since M was an experienced supplier of bunkers to shipping companies, he should have known that the ship of a one-ship Company is the only asset against which he could enforce his claim.

compliance with good faith principles and the socio-economic purpose of his right. For the purpose of this paper, there is no need to refer to the other Articles upon which the Court relied, other than to mention that the decision has serious implications for shipping companies operating in Greece.

7 How would the other jurisdictions deal with such a case?

69. Under English law, pursuant to the analysis of the doctrine of piercing the corporate veil by *VTB v. Nutritek,* the facts of this case would not lead to piercing the veil in order to make the shareholder/controller liable to the contract entered into on behalf of the company.

70. Nevertheless, the same result, as that reached by the Greek Supreme Court, might have been reached through different routes:

(i) Arguably, depending on what exactly was said during the telephone conversations between X and M, when X was giving assurances, promises, that payment of the price would be made, which led M to deliver the bunkers, an implied collateral contract might have sprung up binding X to pay the price, if the company could not pay. In this sense, he might have been regarded as a personal guarantor.

(ii) Alternatively, the court might have concluded that X had assumed personal responsibility by the way he conducted himself towards M. Thus, X might have been held liable in tort. That was the route recently adopted by the Court of Appeal in *Chandler v. Cape Plc.*[44]

(iii) Depending on what was said during the negotiations to persuade M to enter into the contract, if there was evidence of dishonesty, a cause of action against X could, arguably, be based on the tort of deceit, if it could be shown that the representations made by X were false and dishonest intending to lead M to rely on them and enter into the contract with the company, on which M did rely and suffered loss.[45] Whether or not an English court would hold X liable on these bases, would depend on skilful cross examination of X in court.

71. Under USA law, but in the context discussed in this paper, if there was an application for a Rule B attachment on funds of X, based in a USA district, the facts of this case would lead the court to apply 'alter ego' principles, because: (i) X was controlling the dominated companies; (ii) the company in question lacked sufficient finance to perform its corporate responsibilities; (iii) the debts of the dominated corporation were guaranteed by X; (iv) there was no discretion displayed by the dominated corporation; and (v) the companies were one economic entity.

72. Under the SA law, if X owned a ship which visited a port in SA, it would be arrested on the basis of the associated ship arrest, because the court would consider that X had control (meaning the power), when the cause of action arose, over the company which owned the ship concerned.

8 What is the effect of these developments upon shipping companies?

73. Under English law, the legitimate corporate structures of one-ship companies are safe, as the unyielding rock principle of *Salomon v. A Salomon* has been strengthened. Contractual transactions of the company and liabilities arising from them remain those of the company, and vice versa. An extension of the doctrine of piercing the corporate veil is unwarranted, when there are other remedies available in law for the claimant (*VTB Capital v. Nutritek*).

74. The Supreme Court in *TVB Capital* reiterated that the doctrine cannot be invoked merely where there has been impropriety (Lord Neuberger at para. 128), quoting the much approved decision of Munby J in *Ben Hashem,*[46] that '*it is necessary to show both control of the company by the wrongdoer(s) and impropriety, that is, misuse of the company by them as a device to conceal their wrongdoing . . .at the time of the relevant transaction*'.

75. It may seem that the Supreme Court by its subsequent decision in *Petrodel v. Prest* excluded cases of 'concealment' from the doctrine and limited it only to cases of '*evasion of existing liabilities*' (but Lords Sumption and Neuberger were in the minority). Considering the comments of Lord Clarke, referred to earlier at para. 30, it is likely that future cases concerning concealment of true facts will be looked at, and such cases may be shipping related.

76. In this connection, the decision of Eder J in *Caterpillar v. Saenz*[47] should still be, even after *Petrodel*, good law on the facts of that case. Caterpillar had advanced finance to the first and second defendant companies for the acquisition of two yachts. The borrowers defaulted on the loan. The third defendant was one of the loan guarantors and the controlling mind of all companies. Caterpillar obtained a judgment against the guarantor/controller by piercing the corporate veil for the limited purpose of enforcing the judgment against one of the properties. Prior to the advancement of the loan, the guarantor had declared that the relevant property was his own property. During the hearing, however, he asserted that the property belonged to the fourteenth defendant and that he had no beneficial interest. Eder J. allowed Caterpillar to pierce the veil and said:

> *the court will only pierce the veil so far as is necessary to provide a remedy for the particular wrong which those controlling the company have done. Here it seems to me that the particular wrong which [the Guarantor] has done, is that he has misused the company as a device, in effect, or is now seeking to do that.*

The most important factor taken into account by the judge in this case was, as the evidence showed, that the guarantor owned certain valuable properties, in which the Company had a shareholding interest, and he asserted in court that he did not own them.

[44] [2012] EWCA Civ 525.

[45] *Eco 3 Capital Ltd and others v. Ludsin Overseas Ltd [2013] EWCA Civ 413,* the Court of Appeal reviewed the authorities and considered the requirements for making a case in the tort of deceit.

[46] *Ben Hashem v. Shayif* [2008] EWHC 2380 at para. 160.

[47] [2012] EWHC 2888 (Comm).

77. Only in a few shipping cases was the corporate veil pierced: e.g. the *Saudi Prince,*[48] where the controller of the one-ship company transferred the ship to another company (especially created for the benefit of his children), without obtaining payment for the sale, to avoid existing liabilities; the *Tjaskemolen,*[49] in which the ship was transferred to another company after a claim had arisen and without payment of the price. It was found on evidence that the whole arrangement was a sham to ensure that the ship was not made subject to arrest by the claimant to obtain security for the existing claim.

78. On the other hand, the veil was protected in the *Evpo Agnic,*[50] in which Lord Donaldson MR refused to pierce the corporate veil of one-ship companies and held that it is legitimate for shipowners to arrange their affairs by running a series of one-ship companies as a group, and cause them to use their individual assets to their mutual benefit. Mr Pothitos' companies, each owning one ship, were legitimate and he was not regarded as the beneficial owner of the ships owned by the separate corporate structures, even if he was the controlling shareholder of the sister companies. There was no impropriety done by Mr Pothitos. The claimant sought to arrest the ship of the sister company which was not the ship in connection with which the claim had arisen. Each company's ships were not sister ships with each other.

79. However, as seen in this paper, the approach of the courts in South Africa causes great concern. The *Heavy Metal* decision has gone too far to cut across the traditional corporate arrangement when a nominee lawyer, usually, appears in the register of the incorporation as a representative of the company and has nothing to do with actual control.

80. Similarly, the approach of courts in the USA (particularly in the Second Curcuit), in relation to Rule B attachments, is in sharp contrast to English law by applying the concept of 'a single economic entity', which is foreign to English law, as Flaux J. said in *Linsen v. Humpuss*:[51]

> *it is not enough to show that a company or a group of companies is closely controlled by an individual or a family or by a holding company. If the element of control were sufficient in itself, the English courts would have accepted the concept of the "single economic unit" which . . . has been consistently rejected by our courts*.

81. Now the Greek jurisdiction has become one of the liberal ones, and a new element is taken into account, that is, breach of good faith principles. Being an open-ended concept, it poses a serious threat to traditional shipping business.

9 Conclusions

82. In a snapshot, two general rules derive from the recent English SC decisions for the application of the doctrine:

(i) '*piercing the corporate veil is* a *potentially valuable judicial tool to undo wrongdoing in some cases, where no other remedy is available'*[52] (the narrow rule), and

(ii) '*the recognition of a limited power to pierce the corporate veil, in carefully defined circumstances, is necessary if the law is not to be disarmed in the face of abuse'*[53] (the broader rule).

83. The SC emphasized that the doctrine, or metaphor, of piercing the corporate veil has its place only in limited circumstances, when there is both impropriety and control by the controller to evade existing liabilities, with the further limitations: (i) the doctrine will not apply if there are other remedies available; and (ii) the exception to the *Salomon* rule should not be extended so as to render the controller liable under the contractual transactions of the company.

84. It is important to remember, however, that, on the facts of *Salomon v. A Salomon*, the evidence about the legitimacy of Salomon's business was very clear. By contrast, nowadays, there are examples of cases in which the controllers have used the vehicle of the company to hide serious improprieties, causing damage to innocent third parties for whom other legal remedies may be cumbersome, and even difficult to obtain through other routes of the law and in jurisdictions where the outcome may be unpredictable. In this regard, it is submitted, judges should be allowed to exercise their discretion rather than look for evasion cases only.

85. It seems, however, that the effect of the dicta of both *Petrodel* and *VTB Capital* is to restrict such discretion. But since, on the particular facts of these cases, the doctrine could not be expanded because the claimants could obtain a remedy via other legal routes, the dicta that might have the effect of limitation of the doctrine are fact specific. There should be prospects, in future cases, for further exploration of the scope of the doctrine, even if a further exception to the Salomon rule, other than in the 'evasion' cases, may be difficult to establish.[54]

86. The comments of Lords Mance and Clarke that it would be dangerous to foreclose all possible future situations, and Lady Hale's view[55] that it was not possible to classify all cases neatly into cases of either 'concealment' or 'evasion', should be borne in mind. In particular, as Lady Hale pointed out, people who operate limited companies should not be allowed to take unconscionable advantage of those with whom they do business. In this connection, the reasoning of the Court of Appeal in *Re A Company,*[56] allowing the piercing of the corporate veil because it considered it necessary to do justice for unconscionable conduct by the controller of the company, has been misunderstood by commentators after the *Adams v. Cape* case. The reasoning, of course, in *Re A Company* could have been dressed up in different words, such as: 'it was necessary to prevent the controller from evading his liabilities to creditors, or to prevent disarming the law in

[48] [1982] 2 Lloyd's Rep 255.
[49] [1997] 2 Lloyd's Rep 465.
[50] [1988] 2 Lloyd's Rep 411.
[51] Op. cit. at fn. 28.

[52] Per Lord Neuberger in *Petrodel* and *VTB Capital*.
[53] Per Lord Sumption in *Petrodel*.
[54] Per Lord Clarke (at para. 103).
[55] At para. 92 in *Petrodel*.
[56] [1985] 1 BCC 99; the controller had established a network of corporate structures and trusts to which he was diverting assets to avoid liabilities.

the face of abuse'. It seems that semantics played a great part in the judgment of Lord Sumption in the *Petrodel* case.

87. By limiting the piercing of the corporate veil only to cases of clear 'evasion' of an antecedent and independent liability of the controller is to designate too narrow a scope to the doctrine, to the extent that the law will be rendered powerless in the face of abuse. The additional limitation that the doctrine will be applicable only in cases where there is no other remedy in law may have the effect of increasing the risk of abuse, particularly, as other remedies may not in practice be easy to obtain.

88. Speaking of the other jurisdictions, seen earlier, by contrast, the trends are that the ambit of the scope of the doctrine is expanded to the extent that it can be unruly, disregarding legal certainty principles and rules of corporate law. These trends show a tendency of the courts for an over-extensive justice and fairness by the application of open-ended concepts of 'control', 'power', 'single economic entity' and 'good faith principles.' Unless the limits of such concepts are clearly defined, their application can be indiscriminate.

89. In my view, for the rules of the doctrine to be consistently applied, at an international level, and for the avoidance of polarizing the results of the doctrine's application, an International Convention is needed for the purpose of uniformity, certainty and delineation of the scope of the doctrine by international rules.

90. However, whether or not States will be prepared to sign up to such a Convention will depend on their respective legal, political and economic considerations. On the one hand, a non-interventionist approach to corporate structures, (as English law has adopted), encourages business and economic development in the particular State, as shareholders' assets are protected. That means that creditors should take their own protection, because the risk of a limited liability company with which they do business is, in effect, transferred to them.

91. On the other hand, overprotectionism of corporations carries the risk of erosion of the rule of law; although morality with regard to how corporations organize their affairs is not the concern of corporate law, taking unconscionable advantage over the people the corporates do business with should be an important consideration for both the legislator and the courts. The *Salomon* principle of the unyielding rock of a corporate personality was about a 'one-man' company , and it may no longer be appropriate with regard to the sophisticated corporate structures of today, which operate in a globalized world.

3rd assignment (Management structure and directors duties and liabilities)

After completing this seminar, students should have acquired knowledge in the following main issue of the topic:

Board of Directors & Structure – Companies may have a board of directors, structured either as a one-tier system (single board) or a two-tier system (supervisory and management boards)

Executive vs. Non-executive Directors – Executive directors are involved in day-to-day management, while non-executive directors oversee and provide strategic guidance without direct management responsibilities.

Supervisory Board – In a two-tier system, the supervisory board monitors the company's management, ensuring accountability and compliance.

Duties of Directors – Directors owe fiduciary duties to the company, including a duty of care (acting reasonably) and a duty of loyalty (putting the company's interests first).

Director's Liability & Business Judgment Rule – Directors are liable for breaches of duty, but the business judgment rule protects them from liability when acting in good faith and with reasonable judgment.

Readings materials:

- EMCA

Related case studies (facultative):

- C-556/15 Erzberger case
- C-101/21 HJ and de directeur d'une société
- C-232/09 Dita Danosa
- C-229/14 Ender Balkaya

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DIRECTORS OF THE COMPANY

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1

Board of directors - general characteristics

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- Corporation – legal person -> rules for specifying to third parties the individuals who have authority to buy and sell assets and enter into contracts in the name of the corporation = right to act on behalf of the corporation
- management body can be composed of a single director or several directors
- EU law contains no binding rules on the management structure of public or private limited companies
- Fifth Company Law Directive concerning the structure of public companies was eventually withdrawn by the Commission

2

Possible board structures

Funded by the European Union

1. **one-tier board structures:**
   - company is governed by a unified board performing both management and supervisory functions; there is no separate supervisory board: UK

2. **two-tier board structures:**
   - this structure is based on a clear separation of supervision and management, each function allocated to a separate company body: the supervisory board (*Aufsichtsrat*) and a management board (*Vorstand*); no double mandates are allowed;
   - a clear separation of supervision and management; supervisory body cannot engage in management decisions or usurp management decisions: Germany

3. **systems in between (modified system):**
   - Nordic countries

3

Appointment and dismissal of the members of the management board

Funded by the European Union

- elected and withdrawn by
  - **either** supervisory board (only with two-tier board structures possible)
  - **or** general meeting (shareholders' meeting)
- some countries have provisions on employee representation on the supervisory board **(**Austria, the Czech Republic, Denmark, Finland, Germany, Hungary, Luxembourg, the Netherlands, Slovakia, Slovenia and Sweden)

4

Decision-making in a corporation

Funded by the European Union

- the board of directors is not obliged to inform the shareholders and obtain their consent for his acting on behalf of the corporation concerning day-to-day management; only: fundamental decisions regarding the corporation
- little direct impact of shareholders especially in the public limited companies
- **but** a majority shareholders can exercise influence on the management from the background ("shadow director")

5

Directors' duties and liabilities

Funded by the European Union

- **Fiduciary duties**
  a. Duty of care
  b. Duty of loyalty
- **Liability**
- **Business judgement rule**

6

Fiduciary duty

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- The person who has a **fiduciary duty** is called the **fiduciary**, and the pers… whom he owes the **duty**, is typically referred to as the **principal** or the **beneficiary**
- Fiduciary duty is the core of **agency theory** (principal/agent, agent owns fiduciary duty to the principal)
- Consists of **duty of care** and **duty of loyalty**

7

Duty of care

Funded by the European Union

- Delaware Supreme Court: "amount of care which an ordinarily careful and prudent men would use in similar circumstances"
- duty to exercise an informed business judgement
- duty to act in an informed and deliberate manner

8

Duty of loyalty I.

Funded by the European Union

- Delaware Supreme Court:
  - directors are not permitted to use their position of trust and confidence to further their private interests
  - duty of loyalty demands that there be no conflict between the duty of a director and his self-interest
  - a person in his/her position as a director of a corporation is not allowed in his/her decision-making to be influenced by personal or extraneous considerations; his/her decision has to be based entirely on the corporate merits of a transaction

9

Duty of loyalty II.

Funded by the European Union

- A rule that demands of a director
  a. NOT ONLY to protect the interests of the corporation committed to his charge
  b. BUT ALSO to refrain from anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it

10

Duty of loyalty III.

Funded by the European Union

- If conflicts of interest happen … fiduciaries are required to put the **company's interests ahead of their own**
- Breach of the duty of loyalty: i. g. if a director diverts **company** assets, opportunities, or information **for personal gain**

- Directors need to be loyal
- **BUT…**
- **to who?**

11

Loyal to who?

Funded by the European Union

- **Shareholder primacy**
  - Decisions in the company are made in the interest of shareholders
  - Maximises profit for shareholders
  - **Pros:** effective decision making in the company
  - **Cons:** no interest in other stakeholders

- **Stakeholder primacy**
  - Decisions in the company are made in the interest of stakeholders (shareholders, creditors, employees, customers, …)
  - **Pros:** ethics, sustainable development
  - **Cons:** hard to determine the interests of stakeholders and balance them

12

Enlightened shareholder value model I.

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- Shareholder primacy is balanced with stakeholders interests
- **UK** (172 CA 2006) *"A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—*
    a. *the likely consequences of any decision in the long term,*
    b. *the interests of the company's employees,*
    c. *the need to foster the company's business relationships with suppliers, customers and others,*
    d. *the impact of the company's operations on the community and the environment,*
    e. *the desirability of the company maintaining a reputation for high standards of business conduct, and*
    f. *the need to act fairly as between members of the company."*

13

Enlightened shareholder value model II.

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- **EMCA** (Section 9.04) *"Directors must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so the director should have regard to a range of factors such as the long-term interests of the company, the interests of the company's employees, the interest of company's creditors and the impact of the company's operations on the community and the environment."*

14

Liability



Liable for how the function is exercised?
OR
Liable for the result?

- Liability is based on agency law
- What if a director hired an expert advisor? Limitation of his/her liability?
- What if the business decision went wrong?...

15

The business judgment rule I.



"Executive officers shall not bear liability for damage ***if they can prove*** *that they proceeded in exercising their powers with professional care and in good faith that they were acting in the company's interest."*

- is a judicially created doctrine
- protects directors from personal civil liability for the decisions they make on behalf of a corporation (= they made in their capacity as directors), so long as certain disqualifying behaviors are not established
- is a crucial part in the balancing act between directorial autonomy and accountability

16

The business judgment rule II.

Funded by the European Union

- presumption that directors acted on
  a. an informed basis,
  b. in good faith and
  c. believing that their action was in the company's best interest
  d. serves as **safe harbour**

- reversed burden of proof: BJR requires a plaintiff to meet the burden of proof in establishing the existence of certain conditions, such as fraud, illegality, self-dealing or lack of decision by the board

17

Main purpose of the doctrine of BJR

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- BJR ensures that decisions made by directors in good faith are protected even though, in retrospect, the decisions prove to be unsound or erroneous
  - otherwise directors would be too concerned about their personal liability to take risks with the corporation's business

18

Other remedies available for errors made by individual directors

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- shareholders who are unhappy with the decisions made by a director, or team of directors, have the ability to vote them out of office annually and replace them with ones who will take a different approach to decisions that might be more in accordance with shareholders' wishes or philosophies

19

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20

EUROPEAN MODEL COMPANIES ACT (EMCA)

2017

1ST EDITION

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General Comments[50]

1. EU law

EU law contains no binding rules on the management structure of public companies. In 1972, the Commission proposed a 5th Company Law Directive (OJ L 73, 27.3.1972) concerning the structure of public companies. The recommendations suggested a choice for companies between one-tier or two-tier board structures. However, the draft was eventually withdrawn by the Commission.

The SE (*Societas Europaea*) Regulation (Council Regulation (EC) 2157/2001) allows for both one-tier and two-tier structures. Articles 43-45 of the SE Regulation contain a description of the one-tier board system and Articles 39-42 provide for a description of the two-tier board system. According to Article 38(b), the SE Regulation only allows for these two systems, although both systems can be accommodated to suit corporate structures that do not fit this dichotomy. Common rules applying to both systems are stated in Articles 46-51 of the SE Regulation.

Management structures of private companies are not regulated in the EU. The Draft Directive of 2014 on single-member private limited liability companies only proposes that a *Societas Unius Personae* (SUP) should have a management body (composed of a single director or several directors) but leaves it to the Member States to provide for a SUP to have a supervisory board.[51]

The Commission's 2003 Action Plan recommended offering additional organisational freedom to listed companies.[52]

In the Commission's 2012 Action Plan,[53] the Commission acknowledged the coexistence of these different board structures, which are often deeply rooted in the country's overall economic governance system, and signalled no intention to challenge or modify these arrangements. This reflects the view expressed in the 2011 report of the Reflection Group on the Future of EU Company Law that different corporate governance systems and structures should be seen as a treasure-trove of time-tested solutions to be used by business.[54]

Further, the 2012 Action Plan stressed that there is a need to improve the effective oversight of executive directors and management boards by non-executive directors and supervisory boards.

The Commission opined also that (supervisory) boards should give broader consideration to the entire range of risks faced by their companies. Extending the reporting requirements with regard to non-financial parameters would help in establishing a more comprehensive risk profile of the company, enabling a more effective design of strategies to address those risks.

This additional focus on non-financial aspects would encourage companies to adopt a sustainable and long-term strategic approach to their business.

In order to encourage companies to enhance board diversity and give greater consideration to non-financial risks, in 2014 a directive was adopted to strengthen disclosure requirements with regard to board diversity policy and risk management through amendments to the Accounting Directive (Directive 2013/34/EU).[55]

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[50] The working group o Chapter 8 was chaired by Professor Harm-Jan de Kluiver (University of Amsterdam, The Netherlands) and Professor Joti Roest (University of Amsterdam, The Netherlands).
[51] Proposal for a Directive of the European Parliament and of the Council on single-member private limited liability companies (COM(2014) 212 final), Article 22 (version dated 21 May 2015, 8811/5).
[52] Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward (COM(2003) 284 final), pp. 15-16.
[53] COM(2012) 740 final, pp. 5-6.
[54] Report of the Reflection Group on the Future of EU Company Law, Brussels 5 April 2011, p. 11-12.
[55] Directive 2014/95/EU Of The European Parliament And Of The Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15.11.2014, p. 1.

On 9 April 2014, the Commission presented a proposal for the revision of the Shareholders' Rights Directive (2007/36/EC)[56] and Directive 2013/34/ EU.[57] On the same date the Commission presented a Recommendation to improve the quality of corporate governance reports, and in particular the quality of explanations provided by companies when they depart from requirements of the relevant corporate governance code.[58]

2. National law

Originally, supervision of management was in most companies left to the annual general meeting of shareholders. However, the understanding of the need to monitor management continuously provided for certain jurisdictions to allow for establishment of permanent supervisory bodies most often comprised by shareholders. In the late 19th century, Germany introduced a two-tier structure based on a clear separation of supervision and management, each function allocated to a separate company body: the supervisory board (*Aufsichtsrat*) and a management board (*Vorstand*). The division was strict and no double mandates were allowed. In the Nordic system, non-executives serve a dual function: to make the overall strategic decisions and to supervise the daily management carried out by the executives. Consequently, the notion of a two-tier system is based upon a clear separation of supervision and management, often reinforced by ensuring that the supervisory body cannot engage in management decisions or usurp management decisions and a prohibition against double mandates whereby a person can serve on both organs. Many systems differ in the degree to which they place importance on supervision. They can be viewed as modified one-tier systems to the extent that they view management as divided between strategic and daily tactical management and they allow double mandates.

Thus, at present two basic corporate governance concepts can be found in the EU Member States: the one-tier and the two-tier system. As concerns the legal regulation of governance structures, only a one-tier system exists (except for the *Societas Europaea*) in Member States such as Belgium, Greece, Ireland and the UK, while in other Member States, such as Austria and Germany, a two-tier system is mandatory. In addition, at least for public companies, there are Member States such as France (since 1966), Italy (since 2003), the Netherlands (since 2013) and Luxembourg (since 2006) that allow shareholders to decide whether to adopt a one or two-tier system, according to the articles of incorporation. Finally, there are Member States, which have introduced systems in between such as the Nordic countries with their modified version of a one-tier system.

2.1. One-tier system

The UK is normally used as the typical example of a one-tier system. In the UK, both private and public companies have a single tier board of directors. The board has actual authority to manage the company as determined by the articles. The shareholders exercise control over the company at the general meeting and decide on those matters for which they have responsibility either under the articles or the Companies Act 2006.

For public and private companies, the appointment of non-executive directors (NEDs) on the board of the company is optional. As far as listed companies are concerned, the UK Corporate Governance Code requires that the board includes executive and NEDs. Executive board members carry on the business and monitor the execution and performance of the company's activities. NEDs, also called "outside directors", have the dual function of developing strategy, and monitoring the execution of the business. NEDs scrutinize the performance of management in meeting agreed goals and objectives and they monitor the reporting of performance. Thus, the division between supervisory and managing directors is created within a single tier board.

[56] On 9 December 2016, the EU presidency and the EU Parliament agreed on the final version of the new Shareholders Rights Directive.
[57] Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, COM(2014) 213 final, amended by the European Parliament 8 July 2015.
[58] Commission Recommendation of 9 April 2014 on the quality of corporate governance reporting ('comply or explain') (2014/208/EU) OJ L 109/43, 12.4.2014.

2.2. Two-tier system

Germany is normally used as the typical example of a two-tier system (in public companies).

Public companies

In Germany, the control of a public company is divided into two tiers: the *management board* (*Vorstand*) is entrusted with the task of managing the company, while the *supervisory board* (*Aufsichtsrat*) has only a controlling function. The German Stock Corporation Act (*Aktiengesetz)* calls for a clear separation of duties between management and supervisory functions and therefore prohibits simultaneous membership on both boards.

According to the German Corporate Governance Code (as amended in 2015):

> Section 3.1: *"The Management Board and Supervisory Board cooperate closely to the benefit of the enterprise"*.
>
> Section 3.2: *"The Management Board coordinates the enterprise's strategic approach with the Supervisory Board and discusses the current state of strategy implementation with the Supervisory Board in regular intervals"*.
>
> Section 5.1.1: *"The task of the Supervisory Board is to advise and supervise the Management Board in the management of the enterprise. It must be involved in decisions of fundamental importance to the enterprise"*.
>
> Section 5.4.4: *"Management Board members may not become members of the Supervisory Board of the company within two years after the end of their appointment unless they are appointed upon a motion presented by shareholders holding more than 25 % of the voting rights in the company. In the latter case appointment to the chairmanship of the Supervisory Board shall be an exception to be justified to the General Meeting"*.

According to the German two-tier system, the supervisory board and the management board interact intensively.

The management board is entrusted with full responsibility for managing the company. The board can consist of one or more persons. If the management board consists of more than one member, all the members will have to act jointly when representing the company, unless otherwise stipulated in the articles of association. The managers are required to report their activities to the supervisory board on a regular basis.

German law requires the management board to take appropriate action in order to detect detrimental developments which might endanger the survival of the company. In particular, the management board is obliged to establish a risk management system (§ 91(2) German Stock Corporation Act). The management board is required to inform the supervisory board on all issues important to the company with regard to corporate planning.

The main functions of the supervisory board are the appointment and dismissal of the members of the management board, the supervision of the management board and the approval of the accounts and other transactions, as set out in the articles of association.

The supervisory board is required to monitor and assess the established risk management system. This ensures that members of the supervisory board become more sensitive to, and aware of, the need to monitor risky business decisions and to make a contribution to risk precaution.

The supply of information strengthens the advisory function of the supervisory board, because a better-informed supervisory board is significantly more capable to advise the management board on fundamental issues of corporate strategy. Knowledge of corporate planning data provides the supervisory board with an insight into the prospective business policy of the company, and it improves its competence to promptly detect and prevent corporate malfeasance.

According to Section 110(3) of the German Stock Corporation Act, the supervisory board is required to meet twice in a semi-annual period. Section 171(2) provides for an "incentive rule", requiring the supervisory board to inform the general meeting which committees it has established and how often the supervisory board and its committees have actually met. This requirement makes the monitoring process of the supervisory board more transparent. Moreover, the provision aims to incentivize the supervisory board to establish an appropriate number of committees since it is accountable to the general meeting. Which committees the supervisory board establishes and how often it and its committees actually meet, depends on the size, structure etc. of a given company, as well as on the size and structure of the supervisory board.

Several provisions of the German Stock Corporation Act require that the supervisory board receive adequate accounting- and auditing-related information from the auditor(s). It is responsible for making the audit assignment which improves the independence of the auditor vis-à-vis the management board.

Section 5.4.2 of the German Corporate Governance Code requires the supervisory board to consist of *"an adequate number of independent members."* It is assumed that conflicts of interests that may interfere with the supervisory board members' monitoring duty vis-á-vis the management board are avoided when independent supervisory board members monitor the business decisions of the management board.

The members of the supervisory board are appointed by the shareholders at the general meeting. In codetermined companies, special rules apply to the representatives of the employees on the supervisory board. The rights and duties of the supervisory board apply equally to all its members. See below Part 4, Section 31 on employee representation.

Private companies

In Germany, the legal framework for private companies is not as strict as that for public companies and it permits a high degree of flexibility in the drafting of the articles of association. Only two compulsory corporate bodies are required: the managing directors and the shareholders' meeting. Further, the companies may determine whether to establish advisory boards or shareholder committees. The duties of such committees are to be defined in the articles of association. The managing directors (one or more) are responsible for managing the company. The shareholders' meeting has overall competence on all matters related to the company on which it wishes to decide. However, in the event that the company has more than 500 employees in Germany, the two-tier board structure is mandatory and a supervisory board must be established.

2.3. Systems in between/Modified systems

As noted earlier, some countries, such as the Nordic countries, have systems that fall in between the one-tier and two-tier systems. In other words, within the aforementioned two systems mentioned, modifications are possible. In Denmark, for example, companies have been allowed to choose between different governance systems since 2009. Every limited liability company must have an executive board (*direction)* that is responsible for the day-to-day management of the company. Public companies may choose between the traditional Nordic model, which is described as a modified one-tier structure, where a board of directors (*bestyrelse*) performs the dual function of making strategic decisions and supervising the executive board, or an alternative management structure inspired by the German two-tier structure where all executive powers are vested with the management board and supervision is left to a supervisory board. In the former one-tier system, double mandates are allowed, whereas in the latter two-tier system, they are not.

The traditional Nordic governance system is generally characterized as a modified one-tier system. It consists of a board structure with an executive board and a board of directors. While the board of directors is the superior executive body of the company, the executive board is in charge of its day-to-day management and is subject to the instructions of the board of directors. Compared to the German two-tier system, there is no clear allocation of rights and duties between the different company organs and the system is very flexible. The executive board is responsible for the daily management of the company but the executive board may not, such as the German management board (*Vorstand*) does, claim exclusive rights over individual tasks. The board of directors, as the upper level of management, maintains responsibility for the overall strategic management and control function.

Private companies in the Nordic countries do not have to have an executive board but can rely on the board of directors as the single management body. They may, however, choose the same systems as public companies and introduce an executive board to handle day-to-day management, in which case the board of directors will assume the dual function of overall strategic management and supervision. If employee representation exists, a private company must have the latter system, because employee representatives must be directors in the upper management body, the board of directors. In Finland, public companies enjoy the same right as private companies to choose whether to have one management, the board of directors and an executive board, or just on single management body, the board of directors.

Like the Nordic system, the *Italian and Portuguese systems* are based on an optional approach. The shareholders can choose one of three different systems: (1) the traditional system with a management board and a board of statutory auditors (which has a similar role as a supervisory board) ; (2) a German style two-tier system; or (3) an Anglo-Saxon style one-tier system in which non-executive directors are appointed.

The establishment of a supervisory board is discretionary in France, Lithuania, Luxembourg and Portugal.

In the *Netherlands* a so-called 'large company regime' exists. This regime applies both to private and public companies in which the equity exceeds EUR 16 Million and the total number of employees in the company (and its subsidiaries) is 100 or more while a works council has been established. Such large companies may choose between either a two-tier regime or a one-tier system in which non-executive directors are mandatory. One third of the members of the supervisory board or the non-executive directors may be nominated by the works council. The supervisory board or the non-executive directors do have special powers apart from supervising and advising the management board/executive directors. The supervisory board (or the non-executives in a one-tier structure) appoints (and dismisses) the members of the management board (or the executive directors in a one-tier structure) unless an exemption applies which may be the case in international groups (Sections 2:152-164a/262- 274a Dutch Companies Act).

The decision whether to choose a pure one- or two-tier-system or a modified one- or two-tier system should be made either in the national Companies Acts or otherwise the Companies Acts should authorize the companies to make the decision.

Regarding the role of the general meeting (and the division of responsibilities between shareholders and management), the positions in national law are very different. In a number of Member States the management board is exclusively responsible for the administration of the company's affairs. This is the case for example in Austria, Belgium, France, Germany, Hungary and Italy (for the public company). In Ireland and the UK, the role of the general meeting in principle is a matter of the company's constitution. In the Nordic countries, the general meeting has the ultimate power in the company and since dominant ownership is widespread even in publicly traded companies, shareholders can and do exercise considerable influence on the management.

A characteristic of the typical two-tier system is that it is not possible for the same person to have a dual role (i.e. be represented in both the management board and supervisory board). This is for example the case in Bulgaria, Finland, France, Germany, Italy, the Netherlands, Poland, Portugal and Slovakia. In systems like the Danish and the Swedish ones, it is possible to be represented on both boards.

Chapter 8 contains rules on board composition and function of the board. All Member States have rules on these matters but the rules differ in detail, see further in the comments to various sections in Chapter 8.

Director's duties and director's conflicts of interest are dealt with in Chapter 9. Chapter 10 contains the rules on directors' liability.

A major difference between the Member States' is that some countries include provisions on employee representation in their Companies Acts. This is the case for example in Austria, the Czech Republic, Denmark, Finland, Germany, Hungary, the Netherlands, Slovakia, Slovenia and Sweden. In other continental Europen countries, provisions on employee representation are to be found in the labour code (France, Luxembourg). Also, in Ireland, Lithuania and the UK, the question of employee influence on the company's affairs is a part of labour law and hence in most companies it has no direct influence on the corporate structure.

Even if there is employee representation on the company's boards, there are major differences in detail. The most extensive system is found in Germany where half of the members of the supervisory board in large companies (more than 2000 employees) must be employee representatives.

3. Considerations

According to Section 3 of Chapter 1 of the EMCA, a company may be public or private. Section 3 states that "*the shares of a private company may not be offered to the public*." A private company is thus any company that is not a public company.

Public companies, although there are far fewer of these than private companies, are very significant from an economic perspective. These companies are designed for larger enterprises which have access to all the capital markets for raising finance, both in terms of equity capital from shareholders and loan capital from bondholders. However, public companies are sometimes employed for the purpose of family businesses that may not seek access to the capital markets. Public companies may have a large number of shareholders but this is not necessarily the case.

Public companies are subject to far greater controls in such areas as mergers and creditor protection. In legal terms, the common characteristics of public companies include the free transferability of shares and securities, a detailed system of control and minority shareholder protection, control measures on raising and maintaining equity capital, the necessity to disclose information to members and to the public, and detailed rules regarding auditing and accounting. Because of the enactment of EU Directives, there is significant degree of similarity between the laws governing public companies in the various Member States of the EU.

According to the EMCA, a traded company is defined as a publicly traded company whose securities are listed or traded on a regulated market or a multilateral trading facility, cf. Section 2 of Chapter 1. Traded companies are not only subject to company law but also to securities regulation, which to some extent overlaps with company law. They tend to have dispersed ownership, or at least dispersed minority shareholders, and the markets on which their shares are traded provide an external disciplinary mechanism.

Private companies are usually thought to be suitable for small and medium-sized enterprises, which do not require access to public funding. Financing comes usually from contributions by the members themselves or alternatively by bank finance. However, private companies may be used for other purposes, especially as holding companies and subsidiaries. Often, large companies take the form of a private company. Private companies are subject less to the provisions of EU Directives than are public companies.

The EMCA Group agrees – in accordance with the Commission's Action Plan (2012) - that the Member States should be free to choose between different board structures according to the need of the company and national traditions. However, in practice, there is something of a convergence between the two basic systems. Thus, the UK one-tier system is divided in a way that some directors have executive functions and the others are acting on a non-executive basis, thereby having stronger supervisory positions. Thus, Chapter 8 is divided into four parts: Part 1 deals with the one-tier systems and Part 2 deals with two-tier systems and Part 3 contains rules common to all systems. The same structure can be found, as mentioned above, in the SE Regulation.

The rules on the company's management are in various ways different regarding private and public companies. Thus, Chapters 8 and 9 contain special provisions regarding private and public companies including publicly traded companies (see the EMCA Chapter 1, Section 2).

Regarding employee representation, which is found in Part 4, the national traditions on employee representation are very strong and the EMCA Group considers that it is not possible to develop a common rule in this area, see further in Section 31.

CHAPTER 9
DIRECTORS' DUTIES

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DIRECTORS' DUTIES

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General Comments[64]

1. EU law

This Chapter consists of two parts. Part I on general provisions contains the main principles of directors' duties including a general description on the duties of the board, the principle of duty of care and the duty of loyalty. Part II contains provisions on conflicts of interest.

According to the general principles expressed in Chapter 1, Section 11, a director of a company has a duty of care and a duty of loyalty.

There is no specific EU regulation defining the general duties of directors. However, the Commission has devoted significant time to corporate governance issues in recent years. Among other things, the Commission published in 2011 a Green Paper on the EU Corporate Governance Framework (COM(2011) 164 Final). Based on the Green Paper and the report from the Reflection Group on the Future of EU Company Law and the Action Plan 2012, the Commission intends to modernize the company law and corporate governance framework. The Action Plan stresses, "Effective corporate governance is of crucial importance, because well-run companies are likely to be more competitive and more sustainable in the long run". The Action Plan further stresses that the "effective oversight of the executive directors or the management board by the non-executive directors or supervisory boards leads to successful governance of the company." The Commission believes also that (supervisory) boards should give broader consideration to the entire range of risks faced by their companies. Extending the reporting requirements with regard to non-financial parameters would help in establishing a more comprehensive risk profile of the company, enabling more effective design of strategies to address those risks. The additional focus on non-financial aspects would encourage companies to adopt a sustainable and long-term strategic approach to their businesses.

Specific rules on directors' duties may be found in national corporate governance codes. All Member States have such codes. The contents of the codes vary considerably. Until now the Commission has not tried to develop a common EU Corporate Governance Code. However, the Commission has considered national corporate governance codes and especially the way these national codes apply the "comply or explain" principle. The Commission has indicated it will take an initiative, possibly in the form of a recommendation, to improve the quality of corporate governance reports, and in particular, the quality of explanations to be provided by companies that depart from the corporate governance codes.

With regard to Part 2 of the Chapter on conflicts of interest, there is no specific EU company law. An attempt was made in 1983 to amend the proposal for a 5th Company Law Directive, which dealt with conflicts of interest, among other things. However for several reasons, especially the question of employee representation, the Commission was unable to reach an agreement on the Directive. Hence, various EU company law Directives and recommendations deal with different aspects of conflicts of interest, and EU securities regulations contain rules on shareholder transparency, which have a preventive effect.

The Takeover Bids Directive (2004/25/EC) provides for a particular situation in which a conflict of interest may occur and must be avoided. In a takeover situation, the directors of a target company are obliged to advise the company's shareholders as to whether or not to accept a takeover bid. The directors have a duty to make a statement setting out their views on the bid and providing certain other key information. See further EMCA Chapter 13 on re-organization.

The Market Abuse Regulation (Regulation (EU) No 596/2014) governs companies whose securities are traded on a regulated market. It includes rules on the notification of transactions relating to a company's shares by persons with managerial responsibilities in the company. The Market Abuse Directive (2003/6/EC) which preceded it led to the implementation of similar rules in Member States including in Section 28a of the Danish Law on securities trading. Section 37(1) of the same Law requires companies whose shares are traded on a regulated market to draw up internal rules on their management members' dealing in the company's shares. The general prohibition of insider trading and market manipulation also applies to the company's management.

[64] The working group on Chapter 9 included Professor Brenda Hannigan (University of Southampton, UK) and Professor José Engrácia Antunes, (Catholic University of Portugal, Porto, Portugal).

It has been said that compensating directors by giving them stocks and stock options is a conspicuous encouragement of conflicts of interest. The EU Commission is certainly aware of this. Commission Recommendation 2009/385/EC concerns the remuneration of directors of listed companies. Recital 6 of the Recommendation says that the structure of directors' remuneration should promote the long-term sustainability of the company and ensure that remuneration is based on performance. The Recommendation contains various recommendations for avoiding conflicts of interest. These include the establishment of remuneration committees (cf. Commission Recommendation 2005/162/EC), and recommendations to ensure that the shareholders control the remuneration policy and individual compensation through shareholder approval (say-on-pay). Recommendation 2009/385/EC says that the establishment of remuneration committees plays an important role in preventing conflicts of interest by designing a company's remuneration policy, and it recommends that directors who hold shares in the company should be obliged to retain a part of their shares until the end of their mandates in order to prevent conflicts of interest. Remuneration committees are further considered in Section II (6.1.) in Recommendation 2005/162/EC. See more on remuneration and say on pay in Chapter 8.

There has been a strong movement for independent directors to be appointed to company boards. This movement started in the UK and was taken up by the Commission in Recommendation 2005/162/EC which recommends that a 'sufficient number' of independent directors be elected to the board. Preventing conflict of interests is one of the justifications for having independent directors. Also, the introduction of independent directors seeks to outweigh the voting power of shareholders with large blocks or even the majority of shares. A director is only considered to be independent if they are free of any family, business or other relationships with the company, its controlling shareholder or the management that creates a conflict of interest such as to impair their judgement. The EU has not developed a common corporate governance code, but in most Member States the issue of independent directors is dealt with in corporate governance codes, for example in the Danish Corporate Governance Code, Section 3.2., and the German Corporate Governance Code, Sec. 5.4.2. Both the Commission's 2011 Green Paper and its 2012 Action Plan point to conflicts of interest as an area where regulation should be improved, both regarding directors and proxy advisors, when proxy advisors also act as corporate governance consultants to investee companies. This latter area has been addressed in the proposed amendment of the Shareholders' Rights Directive agreed with the Parliament in December 2016.

2. National company law

2.1. Directors' duties

In all Member States, there is a wide range of duties with which the board must comply. As a common basis, however, the directors have to act with reasonable care, skill and diligence. Whereas the primary duties on an abstract level are all very similar throughout the EU, there are significant national differences when considering the specific duties, the applicable standards for measuring compliance, as well as the extent of any potential liability.

All Member States' Companies Acts have a provision which imposes on the board the ability, but also, the obligation to decide on the management of the company, the administration of its assets and the pursuance of the company's objects in general, see for example the German AktG Section 76, the Greek Companies Act Section 22, the Polish Commercial Companies Code Section 368 (regarding management board) and Section 382 (regarding supervisory board), the Portuguese Companies Act Section 405 (1), and the Spanish Companies Act Section 209. The Polish Commercial Companies Code states very concisely that "*the management board shall manage the affairs of the company and represent the company/the supervisory shall exercise permanent supervision over all areas of the activities of the company*". This is also the approach in the Netherlands, with the explicit provision that the management board and the supervisory board have to act in the best interest of the company and all its stakeholders (Companies Act Sections 2:129/239(5) and 2:140/250 (2)). The most comprehensive statement of directors' general duties is found in the UK's Companies Act 2006 Sections 171-177.

According to the provisions in EMCA Chapter 11 on general meetings, the general meeting makes decisions on company matters. The directors execute the decisions of the general meeting, see further below in Chapter 11.

2.2. Conflicts of interest

National law in the Member States has no common definition of conflicts of interest. However, under the generally accepted principle of the duty of loyalty, the management must act in good faith. This primarily means that the management must act in the company's best interests when taking management decisions. This includes the duty to avoid conflicts of interest.

There are substantial differences as to how the EU Member States regulate directors' conflict of interest.

In some Member States, there are general rules on conflicts of interest, as in Greece, the Netherlands, Poland (in the Corporate Governance Code), Slovakia, Spain, Ireland and the UK. In other Member States, a similar result seems to be achieved by referring to the general duty of loyalty, as in Denmark, Germany and Portugal.

Excluding persons from becoming directors on grounds of conflicts of interest

The appointment of executive directors is made by the supervisory board in companies with a supervisory board. In private companies with only a director, the appointment is made by the shareholders. In both cases, the supervisory board and the shareholders, respectively, should consider whether an appointment may give rise to a conflict of interest. Being a member of the executive board is normally a fulltime job. The contract of employment, if any, will normally include provisions requiring the director to devote all of his or her working time to the company. The contract will also usually contain provisions governing competing positions.

The supervisory board is appointed by the general meeting. Thus, the question is in which way the general meeting should consider whether members of the supervisory board are in positions of conflict or potential conflict.

No national rules exclude persons from becoming directors on the grounds of a conflict of interest. However, in France, no more than one third of the members of the board of directors can have a contract of employment with the company (this rules does not apply to the supervisory board). This only applies to companies with a one-tier system. In Portugal, no member of the board of directors may have a contract of employment with the company or with an affiliated company.

Generally, it is up to the supervisory board and the shareholders, who appoint the managing directors and the supervisory board respectively, to assess whether the candidates' business or personal relations may lead to a conflict of interest. Several Member States require the disclosure of information about the candidates' business or personal relations with the company which could cause a conflict of interests. This applies, for example, in France, Germany (for listed companies), and Greece. In the Netherlands, this applies to members of the supervisory board. Where the supervisory board appoints the managing director, it should not only assess the director's managerial qualities but also whether situations could arise where there could be a conflict of interest, and the contract of employment may include provisions regulating such issues.

In some Member States, such as Austria, Denmark, Lithuania (both management board and supervisory board) and the Netherlands, there is a duty to disclose to the general meeting information about the positions of the members of the supervisory board in other companies. This is obviously to give the shareholders the opportunity to consider whether there might be a potential conflict of interest and, if so, to decline to elect the member. See for example Section 120(3) of the Danish Companies Act.

In most of the Member States a director can be dismissed without cause at any time by those who have appointed them. This means that a director can be removed if they fail to avoid a conflict of interest. In Germany, this is true for private companies (see Limited Liability Corporation Act § 38), whereas in a public company members of the management board may only be removed by the supervisory board for good cause (Stock Corporation Act § 84). A vote of no-confidence by the shareholders meeting may constitute good cause for the supervisory board to dismiss members of the management board.

If executive directors, with a contract of employment, fail to avoid conflict of interest, they may be in breach of their contract. In this case, the director may be liable under the rules on liability.

Duty to avoid conflicts of interest

As mentioned, the UK Companies Act 2006 states that a director has a duty to avoid conflicts of interest. A failure to avoid a conflict of interest does not necessarily mean that a decision is contrary to the interest of the company, only that there is a risk of it being so. Section 175(1) of the UK Companies Act 2006 states that 'a director of a company must avoid a situation in which he has, or can have, a direct interest that conflicts, or possibly may conflict, with the interest of the company'. This Section states the general principle, and in the succeeding sections it is supplemented by provisions on typical situations of conflicts of interest. The Section covers both actual and potential conflicts.

Directors have a general and enduring duty to consider whether there may be a conflict of interest, and examples of such situations are given in the special provisions. If a director considers there is a possible conflict of interest, he or she must inform the other directors or the shareholders.

There are different ways to avoid a conflict of interest. According to Section 175 of the UK Companies Act, directors must always consider whether they are in a situation where a conflict of interest may occur. If so, they must disclose the risk of conflict and transfer the decision to the next level, either from management to the supervisory board, or from interested directors to disinterested directors, or from directors to the general meeting – depending on the board structure of the company.

Having considered whether there is a conflict of interest and having disclosed a conflict of interest to the other directors, a director will have satisfied his or her obligations. The decision then becomes a matter for the other directors or the general meeting, depending on the structure of the company's governance system. For example, if a private company only has a director and a general meeting, approval should be given by the general meeting.

Duty to disclose conflicts of interest

Several Member States have rules which require any conflict of interest relating to the company to be reported to the board or the general meeting : for example Section 22a(3)(b) of Greece's Companies Act, or Section 229(3) of the Spanish Companies Act. Section 171(2) of the German AktG requires the supervisory board to examine the company's annual report and report to the shareholders at the general meeting on how it has examined the management of the company which includes reporting if any conflicts of interest occurred and how they have been handled. The Dutch Corporate Governance Code which applies to listed companies also requires that conflicts of interest are reported (Chapter II.3 (management board) and III.6 (supervisory board)).

A number of Member States explicitly state that a director has a duty to disclose any conflict of interests to the other members of the management. This is the case in France (in certain situations), Germany, Ireland, Italy, Spain and the UK.

According to Sections 177(1) and 182(1) of the UK Companies Act, directors have a duty to disclose an interest in a proposed transactions or arrangements with the company. This catches situations such as where a newly appointed director has interests in the company's existing transactions or arrangements, for example because they are a shareholder in one of the company's suppliers.

According to Section 177 of the UK Companies Act, a director who has an interest in a proposed or existing transaction or arrangement with the company must declare the 'nature and extent' of that interest to the other directors before the company enters into the transaction or arrangement.

The conflict of interest can be direct or indirect. In an indirect transaction, the director need not be a party to the transaction; it is enough that they are a shareholder of a company or a member of a partnership that is a party to the transaction.

Section 177 of the UK Companies Act requires prior disclosure to the other directors where the transaction is with the company and the director has a direct or indirect conflict of interest. However, certain specific transactions require shareholder approval in addition to disclosure to the other directors. In Member States such as Denmark, Finland and Sweden, there are no specific rules on prior disclosure to the other directors but there are rules on prior authorization for special transactions between the company and the directors; see further below.

Competition with the company

The duty of loyalty sets limits as to how, or to what extent, a director may compete with their company. This problem arises both while a director is in office and after they have resigned. For executive directors, it is common to have a "non-compete clause" in the director's contract of employment. For non-executive directors and members of supervisory boards, it is up to the shareholders who elect them, or company law to decide the matter.

Several Member States have special rules that prohibit members of the management engaging in any trade or entering into any transaction in competition with the company. This is the case in the Czech Republic, Germany (AktG/Corporate Governance Code), Greece, Italy, Poland (Corporate Governance Code), Portugal, Slovakia and Spain (in the latter case, unless explicit authorization from the general meeting pursuant Section 230). Other Member States, such as Finland, France, Germany, the Netherlands and the UK, deal with this under the general duty of loyalty. Alternatively, or additionally, there can be a rule requiring the disclosure of directors' other managerial posts prior to election to the supervisory board; see Section 120(3) of the Danish Companies Act and below. Such a rule is particularly relevant for public limited companies.

Corporate opportunities

Several Member States have special rules prohibiting directors from taking advantage of the company's corporate opportunities. In the UK, Section 175(2) of the Companies Act prohibits the 'exploitation of any property, information or opportunity (regardless of whether the company could take advantage of the property, information or opportunity'. In Spain, Section 229(1)(d) of the Spanish Companies Act also prohibits directors to take advantage of corporate opportunities. A specific rule on corporate opportunities applies to Italian public companies as well. In other Member States such a prohibition is covered by the general duty of loyalty. This is the case in France, the Netherlands, Poland (Corporate Governance Code), Portugal and Slovakia. In Germany, corporate opportunities are also dealt with in the corporate governance code. In some important respects, the UK Companies Act extends liability to former directors (see Section 170(2)(a)).

The UK Companies Act has no definition of a corporate opportunity. The corporate opportunity doctrine was developed in US case law. The American Law Institute (ALI) Principles of corporate governance § 5.05(b) contains the following definition:

> "*(1) Any opportunity to engage in a business activity of which a director or senior executive becomes aware, either, In connection with the performance of functions as a director or senior executive, or under circumstances that should reasonable lead the director or senior executive to believe that the person offering the opportunity expects it to be offered to the corporation; or*
>
> *Through the use of corporate information or property, if the resulting opportunity is one that the director or senior executive should reasonably be expected to believe would be of interest to the corporation; or*
>
> *(2) Any opportunity to engage in a business activity of which a senior executive becomes aware, and knows is closely related to a business in which the corporation is engaged or expects to engage.*"

3. Considerations

3.1. Directors' duties

As mentioned above, the UK Companies Act contains the most comprehensive regulation on the general duties of the directors. This is the following:

- Duty to act within their powers (Section 171)
- Duty to promote the success of the company (Section 172)
- Duty to exercise independent judgement (Section 173)
- Duty to exercise reasonable care, skill and diligence (Section 174)

All the duties, other than the duty of care, skill and diligence in Section 174, are so-called fiduciary duties which reflects the common law of negligence.

The EMCA Group is of the opinion that the duties enumerated above are, and should be, accepted in EU Member States. Therefore, Part I is widely inspired by UK regulation. The statement of duties in Chapter 9, Part I is not exhaustive. It merely sets out the general duties. However, directors are subject to various other duties including duties with respect to specific conflicts of interest governed by Chapter 9, Part II, statutory duties (such as the duty to maintain accounting records and prepare accounts governed by accounting rules), and duties under the general law such as employment law or health and safety legislation.

The director's duties, as described in Chapters 8 and 9, are the fundamental basis for deciding director's liability.

3.2. Conflicts of interest

There is a link between directors' duties and directors' conflict of interest. The closest link is the relation between the general principle of directors´ loyalty and directors´ conflict of interest. Thus, according to Section 175 of the UK Companies Act 2006, directors are under a fiduciary duty not to place themselves in a position in which there might be a conflict between personal interest and their duty to the company. This rule is said to apply to any exploitation of any property, information or opportunity. It is immaterial whether the company could take advantage of the property, information or opportunity.

It is possible to deduce more specific rules on conflict of interest or develop case law from the principle of directors´ loyalty. However, the EMCA Group has found it useful for the EMCA to include provisions on typical examples of conflict of interest.

The following considerations only concern the directors' conflict of interest. See Chapter 11 on shareholders' conflict of interest. The EMCA Group is of the opinion that the EMCA should have some general rules on conflict of interest supplemented by a limited number of more specific rules.

The EMCA Group has discussed the choice between disclosure rules and substantive rules such as a prohibition on a director attending or voting at a board meeting where transactions between him or her and the company are discussed. Generally, the Group considers that directors should have a duty to disclose potential conflicts of interest to other (independent) members of the board in order to ensure unbiased decisions. Thus, the Group decided to include such a provision in the EMCA (Section 5 of this Chapter).

In connection with appointment and removal of directors, there should be a rule requiring proposed directors to disclose to the shareholders whether they hold other posts, thus giving the shareholders a possibility to assess whether there will be a conflict of interest now or in the future. See further in EMCA Chapter 8, Sections 2 and 6 on appointment and removal of directors and EMCA Chapter 10 on directors' liability.

The EMCA Group discussed the choice between a general provision limiting directors in voting in certain circumstances and specific rules which demand that certain types of decisions should be taken by the shareholders. On the one hand, it is simpler if a general provision on a limitation of voting can cover situations which may cause conflicts of interest. On the other hand, there is also a need to ensure that shareholders decide on important matters.

The balance between the above mentioned two provisions should, according to the EMCA Group, be achieved by a combination of a general rule on limitation of voting and a limited number of provisions requiring shareholder approval. The rule on limitation of voting is thus found in Section 9. The rules on shareholder approval are covered either by Section 9 or by special provisions on shareholder approval on Sections 5-7 and in Chapter 11 of the EMCA.

An example of a specific provision is the requirement to obtain shareholder approval regarding principles of directors' remuneration, see above.

The EMCA Group discussed whether the EMCA should include a specific rule on competition or whether rules on limitation of voting etc. in connection with the appointment of directors is enough. The Group decided to apply a special rule on competition specifying that shareholder approval is necessary, see Section 7.

From the principle of duty of loyalty follows the requirement that directors must not exploit the company's corporate opportunities. The EMCA Group also discussed the need for a special provision on corporate opportunities. Corporate opportunities may be protected either by case law applying the general duty of loyalty or by special provisions. As noted above, there is no legislative definition of corporate opportunities such as that given in the ALI Principles. It is difficult to give a legal definition of corporate opportunities which is both precise and not too comprehensive. In particular, it is difficult to determine when an opportunity is a 'corporate opportunity' and who might authorize a director to exploit such opportunity. The inclusion of provisions on corporate opportunities in companies' legislation may cause problems of interpretation and application, but it seems even more difficult to develop consistent and precise case law on this issue. However, in the light of the overall aim of fostering European convergence, the EMCA Group was of the opinion that rules on corporate opportunities should be included in the EMCA, see Section 6.

Even if the company law literature and the case law in the Member States consider benefits a breach of duty, the EMCA Group was of the opinion that it is preferable to create a common European rule on benefits. In the UK, the issue of benefits was separated from the main prohibition in Section 175 of the Companies Act 2006 presumably, to ensure that disinterested director authorization is not possible. A similar rule is found in the EMCA Section 8.

Regarding independent directors, the EMCA Group was of the opinion that this is an issue which should be regulated in the national corporate governance code, which is also the case in the majority of the Member States.

The EMCA Group considered the need for a special rule on conflict of interest regarding the duty to advise shareholders about a takeover bid. This issue is dealt with in Chapter 13.

CHAPTER 10
DIRECTORS' LIABILITY

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General Comments

1. EU law

The proposed, but never passed, 5th Directive was concerned with directors' liability but the draft was eventually withdrawn by the Commission. However, Article 6 of the Prospectus Directive (2003/71/EC)[67], which is in the process of being turned into a regulation, is relevant as it refers to some extent to the issue of directors' liability. The Directive states that any Member State should have rules on liability that apply to those persons responsible for the information given in a prospectus.

2. National Law

On a general level, the rules on the duties and liabilities of directors are very similar in the different Member States. However, taking a closer look reveals some differences, as shown for instance by a 2013 study of the London School of Economics (LSE) for the Commission.[68] There are many explanations for the great similarity between the Member States. One explanation is that the influence of American corporate law, such as the design of the Business Judgment Rule and the duty of loyalty of directors, is fairly significant.

Common to all Member States is the liability of directors based on the principle of fault, which is derived from civil law. Further, directors have different tasks and responsibilities in the company, which must be reflected in the diligence assessment.

In order to make an assessment of diligence, objective standards are used, in particular based on rules that can be found in the Companies Act and in the articles of association. The assessment must also consider the circumstances relating to the party causing the damage.

3. Considerations

When assessing liability, insufficient personal qualifications do not disqualify or reduce the responsibility of directors. Because Chapter 10 applies to companies of different sizes and different industries, it is difficult to find an acceptable minimum standard for such an assessment. However, national corporate governance codes demand that directors should have appropriate qualifications and commitment. Such demands may be taken into consideration. Since a person has taken up the position as a director voluntarily, it is reasonable to require that he or she leaves the business when it becomes clear that the personal qualifications are not sufficient.

US law includes the term "*an ordinary prudent person*". It means that a person need not have expertise or specific knowledge to sit on the Board but they must be a person "who has the capacity to perform a given corporate assignment". A similar standard may be used in the EMCA as a basis for assessing liability.

A rule that seems to apply, explicitly or implicitly, in most legal systems is the *"Business Judgment Rule"*. This requirement is also reflected in Section 1(2). The "*Business Judgment Rule*" should be formulated in such a way, that a director or managing director will not be deemed liable for their actions in cases where it is clear that they had a justifiable basis for making a decision and that they had an overview of the company's financial position.

U.S. law has influenced the content of the *"Business Judgment Rule"* in most legal systems in Europe. For example, in German law, liability may apply in cases where a harmful action is carried out which is not based on a sufficiently comprehensive, accurate and fundament decision, cf. Chapter 9, Section 2, according to which the supervisory board must receive all necessary information for the performance of their duties.

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[67] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

[68] See *Study on Directors' Duties and Liability,* prepared for the European Commission DG Mark*t* by: C. Gerner-Beuerle, P. Paech and E. P. Schuster (Department of Law, London School of Economics), London, April 2013. The study is available at http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf.

A principle that applies in most European legal systems is that the burden of proof lies with the injured party to show that an injury has resulted from negligence. One of the few exceptions to this principle can be found in German law under AktG § 93 (2) where the burden of proof for alleged negligence lies with the member of the management board or supervisory board. However, this position is not taken in the GmbH-Gesetz. In this regard, Spanish Companies Act (sect. 236.1) also provides that "*When the act is contrary to the law or the company-bylaws, guilt shall be presumed, until proven otherwise*" (i.e. proven by directors).

In those legal systems where the Companies Act provides for a hierarchical organization and where the general meeting may give binding instructions to the board, it is held that liability does not apply if the director has followed such an instruction or gathered the general meeting's consent to perform the action. The exemption from liability should not be effective if the instructions of the general meeting are not in conformity with applicable rules or regulations in the statutes.

In Poland and Spain, however, the exemption from liability applies regardless of whether the instructions are in conformity with law or the statutes or not. Contrary to the exemption based on consent from the general meeting, an approval from the supervisory board will not exclude liability.

On the contrary, in France and in Italy a vote of the general meeting cannot exempt the directors from their liability.

The company's claims for damages against directors must be passed by the general meeting according to EMCA Chapter 11, Section 38. Section 38 contains a rule on discharge regulating situations where the shareholders have not been provided with correct or complete information. Further, Chapter 11, Section 39 contains a rule on shareholders' derivative suits regarding liability for directors as well as shareholders.

JUDGMENT OF THE COURT (Second Chamber)

11 November 2010 *

In Case C-232/09,

REFERENCE for a preliminary ruling under Article 234 EC from the Augstākās Tiesas Senāts (Latvia), made by decision of 13 May 2009, received at the Court on 25 June 2009, in the proceedings

Dita Danosa

v

LKB Līzings SIA,

THE COURT (Second Chamber),

composed of J.N. Cunha Rodrigues, President of the Chamber, A. Arabadjiev, A. Rosas, A. Ó Caoimh (Rapporteur) and P. Lindh, Judges,

* Language of the case: Latvian.

Advocate General: Y. Bot,
Registrar: C. Strömholm, Administrator,

having regard to the written procedure and further to the hearing on 1 July 2010,

after considering the observations submitted on behalf of:

— Ms Danosa, by V. Liberte, zvērināta advokāte, and A. Rasa, zvērināta advokāta palīgs,

— LKB Līzings SIA, by L. Liepa, zvērināts advokāts, and by S. Kravale and M. Zalāns,

— the Latvian Government, by K. Drēviņa and Z. Rasnača, acting as Agents,

— the Greek Government, by M. Apessos, and by S. Trekli and S. Vodina, acting as Agents,

— the Hungarian Government, by R. Somssich, M. Fehér and K. Szíjjártó, acting as Agents,

— the European Commission, by A. Sauka and M. van Beek, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 2 September 2010,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Council Directive 92/85/EEC of 19 October 1992 on the introduction of measures to encourage improvements in the safety and health at work of pregnant workers and workers who have recently given birth or are breastfeeding (tenth individual Directive within the meaning of Article 16(1) of Directive 89/391/EEC) (OJ 1992 L 348, p. 1).

2 The reference has been made in the course of proceedings between Ms Danosa and LKB Līzings SIA ('LKB'), a limited liability company, concerning the decision taken at the LKB general meeting of shareholders to remove Ms Danosa from her post as a member of the company's Board of Directors.

Legal context

European Union ('EU') legislation

Directive 76/207/EEC

3 Article 2(1) of Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions (OJ 1976 L 39, p. 40), as amended by Directive 2002/73/EC of the European Parliament and of the Council of 23 September 2002 (OJ 2002 L 269, p. 15) ('Directive 76/207'), provides that 'the principle of equal treatment shall mean that there shall be no discrimination whatsoever on grounds of sex either directly or indirectly by reference in particular to marital or family status'.

4 Article 2(7) of Directive 76/207 provides that that directive 'shall be without prejudice to provisions concerning the protection of women, particularly as regards pregnancy and maternity'. In addition, it provides that less favourable treatment of a woman, related to pregnancy or maternity leave within the meaning of Directive 92/85, is to constitute discrimination within the meaning of Directive 76/207.

5 Under Article 3(1)(c) of Directive 76/207:

'Application of the principle of equal treatment means that there shall be no direct or indirect discrimination on the grounds of sex in the public or private sectors, including public bodies, in relation to:

…

(c) employment and working conditions, including dismissals …'

Directive 86/613/EEC

6 Article 1 of Council Directive 86/613/EEC of 11 December 1986 on the application of the principle of equal treatment between men and women engaged in an activity, including agriculture, in a self-employed capacity, and on the protection of self-employed women during pregnancy and motherhood (OJ 1986 L 359, p. 56), provides:

'The purpose of this Directive is to ensure, in accordance with the following provisions, application in the Member States of the principle of equal treatment as between

men and women engaged in an activity in a self-employed capacity, or contributing to the pursuit of such an activity, as regards those aspects not covered by Directives 76/207/EEC and [Council Directive 79/7/EEC of 19 September 1978 on the progressive implementation of the principle of equal treatment for men and women in matters of social security (OJ 1979 L 6, p. 24)].'

7 Self-employed workers are defined in Article 2(a) of Directive 86/613 as all persons pursuing a gainful activity for their own account, under the conditions laid down by national law, including farmers and members of the liberal professions.

8 Under Article 3 of Directive 86/613, the principle of equal treatment implies the absence of all discrimination on grounds of sex, either direct or indirect, by reference in particular to marital or family status.

9 Article 8 of that directive is worded as follows:

'Member States shall undertake to examine whether, and under what conditions, female self-employed workers and the wives of self-employed workers may, during interruptions in their occupational activity owing to pregnancy or motherhood,

— have access to services supplying temporary replacements or existing national social services, or

— be entitled to cash benefits under a social security scheme or under any other public social protection system.'

Directive 92/85

10 The 9th and 15th recitals in the preamble to Directive 92/85 are worded as follows:

'… the protection of the safety and health of pregnant workers, workers who have recently given birth or workers who are breastfeeding should not treat women on the labour market unfavourably nor work to the detriment of directives concerning equal treatment for men and women;

…

… the risk of dismissal for reasons associated with their condition may have harmful effects on the physical and mental state of pregnant workers, workers who have recently given birth or who are breastfeeding; … provision should be made for such dismissal to be prohibited.'

11 Article 2(a) of Directive 92/85 defines a pregnant worker as 'a pregnant worker who informs her employer of her condition, in accordance with national legislation and/or national practice.'

12 Article 10 of the directive is worded as follows:

'In order to guarantee workers [who are pregnant or who have recently given birth or are breastfeeding], within the meaning of Article 2, the exercise of their health and safety protection rights as recognised under this Article, it shall be provided that:

(1) Member States shall take the necessary measures to prohibit the dismissal of workers, within the meaning of Article 2, during the period from the beginning of their pregnancy to the end of the maternity leave referred to in Article 8(1), save in exceptional cases not connected with their condition which are permitted under national legislation and/or practice and, where applicable, provided that the competent authority has given its consent;

(2) if a worker, within the meaning of Article 2, is dismissed during the period referred to in point 1, the employer must cite duly substantiated grounds for her dismissal in writing;

(3) Member States shall take the necessary measures to protect workers, within the meaning of Article 2, from consequences of dismissal which is unlawful by virtue of point 1.'

National legislation

The Labour Code

13 Article 3 of the Latvian Labour Code (Darba likums, *Latvijas Vēstnesis*, 2001, No 105) defines a worker as any natural person who performs a particular job pursuant to an employment contract, under the direction of an employer and in return for an agreed wage.

14 Article 4 of that code defines an employer as any natural or legal person, or a partnership with legal capacity, employing at least one worker under an employment contract.

15 Article 44(3) of the Labour Code provides:

'An employment contract shall be concluded with the members of the executive body of a capital company only if they are not engaged under another civil contract. If the members of the Board of Directors of a capital company are engaged under an employment contract, the latter shall be concluded for a fixed term.'

16 Article 109 of the Labour Code, entitled 'Prohibitions and restrictions on dismissal', provides:

'(1) An employer is prohibited from terminating an employment contract with a woman while she is pregnant and in the year following the birth or, where applicable, during the whole of the period in which the woman is breastfeeding, unless the situations provided for in points 1, 2, 3, 4, 5 and 10 of Article 101(1) apply.'

The Commercial Code

17 Article 221 of the Latvian Commercial Code (Komerclikums, *Latvijas Vēstnesis*, 2000, No 158/160) is worded as follows:

'(1) The Board of Directors is the directorial body of a company, by which that company is managed and represented.

...

(5) The Board of Directors is under an obligation to provide information to the shareholders' meeting on transactions between the company and a shareholder, a member of the supervisory board or a member of the Board of Directors.

(6) The Board of Directors shall submit to the supervisory board, at least once in every quarter, a report on the company's business and financial situation, and shall inform the supervisory board without delay of any deterioration in the financial situation of the company or other essential circumstances in relation to the company's trading activities.

…

(8) The Board of Directors shall be entitled to remuneration commensurate with their responsibilities and the company's state of finance. The amount of the remuneration shall be determined by a decision of the supervisory board or, if no supervisory board has been established, by decision of the general meeting of shareholders.'

18 Article 224 of the Commercial Code, entitled 'Appointment and removal of Board Members', provides:

'(1) The members of the Board of Directors shall be appointed and removed by resolution of the general meeting of shareholders. It shall notify the commercial registry of the termination of the mandate of the members of the Board of Directors, the amendment of their rights of representation or the election of new members. A certified copy of the extract of the minutes of the general meeting at which the resolution concerned was passed shall be attached to that notification.

…

(3) The members of the Board of Directors shall be elected for a period of three years, unless the articles of association set a shorter period.

(4) The members of the Board of Directors may be removed by resolution of the shareholders. If the company has a supervisory board, that body may suspend the mandate of the members of the Board of Directors pending a general meeting, for a maximum period of two months.

…

(6) The articles of association may provide that members of the Board of Directors can be removed only if there are serious grounds. Such grounds shall include misuse of powers, failure to fulfil obligations, unfitness to manage the company, the prejudicing of the company's interests and loss of confidence.'

The Law on public social security

19 The Latvian law on public social security (Likums par valsts sociālo apdrošināšanu, *Latvijas Vēstnesis*, 1997, No 274/276), which lays down the fundamental principles of public social security and governs its financial and organisational structure, recognises members of the Board of Directors of a commercial company as workers (Article 1(c)).

The dispute in the main proceedings and the questions referred for a preliminary ruling

20 By decision of 21 December 2006, relating to the establishment of LKB, Latvijas Krājbanka AS — a public limited company — appointed Ms Danosa as sole member of LKB's Board of Directors ('valde').

21 By decision of 11 January 2007, LKB's supervisory board ('padome') set the remuneration of the members of the company's Board of Directors, together with other related conditions, and entrusted the chairman of the supervisory board with concluding the agreements necessary to ensure implementation of that decision.

22 According to the order for reference, no civil contract governing the performance of the duties of a member of the Board of Directors was concluded. LKB challenges that assertion and maintains that a contract of agency had been concluded with Ms Danosa. Ms Danosa would have liked to have had an employment contract but LKB preferred agency as the basis on which to entrust her with the tasks of a Board Member.

23 The general meeting of shareholders ('dalībnieku sapulce') of LKB decided on 23 July 2007 to remove Ms Danosa from her post as a member of the Board of Directors. On 24 July 2007, she was sent a certified copy of the extract of the minutes of that general meeting.

24 Taking the view that she had been unlawfully dismissed from her position, Ms Danosa brought an action against LKB before the Rīgas pilsētas Centra rajona tiesa (Riga Central District Court) on 31 August 2007.

25 Ms Danosa submitted before that court that, after her appointment, she had correctly discharged her professional duties as provided for in LKB's articles of association and the rules governing its Board of Directors. She also argued that, since she had received remuneration for her work and had been granted the right to take holidays, it was reasonable to assume the existence of an employment relationship. Given that she was 11 weeks pregnant at the time, her dismissal was in breach of Article 109 of the Labour Code, under which the dismissal of pregnant workers is prohibited. According to Ms Danosa, Article 224(4) of the Commercial Code, which authorises the general meeting of shareholders to dismiss a member of the Board of Directors at any time, conflicts with Article 109(1) of the Labour Code, which grants certain welfare guarantees to pregnant women.

26 As Ms Danosa's action was dismissed both at first instance and on appeal, she brought an appeal on a point of law before the referring court.

27 Before that court, Ms Danosa argued that she should be treated as a worker for the purposes of EU law, regardless of whether she is considered as such for the purposes of Latvian law. Also, in light of the prohibition on dismissal set out in Article 10 of Directive 92/85 and the main interest which that provision seeks to protect, the Latvian State should — in all types of legal relationships where the characteristics of an

employment relationship can be identified — endeavour to ensure by all means, including judicial remedies, that pregnant workers enjoy the legal and social guarantees laid down for their benefit.

28 LKB, on the other hand, argues that members of a capital company's Board of Directors do not perform their tasks under the direction of another person and cannot therefore be treated as workers for the purposes of EU law. It is entirely justifiable that different levels of protection be provided for workers, on the one hand, and members of a company's Board of Directors, on the other, in view of the relationship of trust necessary for the performance of the tasks entrusted to Board Members. EU law makes an express distinction between persons who carry out their tasks under the direction of an employer and those who have power to direct and are fundamentally representatives of the employer rather than subordinates.

29 According to the referring court, both the case-law of the Court on the concept of 'worker' and the objective pursued by Directive 92/85 of protecting pregnant women from dismissal support the inference that, where a member of a company's Board of Directors comes within the scope of that concept, Article 10 of Directive 92/85 applies to that person, notwithstanding the fact that Article 224(4) of the Latvian Commercial Code places no restriction on the dismissal of persons covered by that provision, whether or not the Board Member holds a contract of employment. According to the referring court, both Directive 76/207 and Directive 92/85 prohibit termination of the employment relationship in the case of a pregnant woman.

30 On the view that the case before it raised questions concerning the interpretation of EU law, the Augstākās Tiesas Senāts decided to stay proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

‘(1) Are the members of the directorial body of a capital company to be regarded as covered by the concept of “worker” within the meaning of Community law?

(2) Is Article 224(4) of the Latvian Commercial Code, under which a member of the Board of Directors of a capital company may be dismissed without any restriction, no account being taken specifically of the fact that she is pregnant, incompatible with Article 10 of Directive 92/85 … and the case-law of the Court of Justice?’

The questions referred to the Court

Preliminary observations

31 It should be noted at the outset that, at the hearing before the Court, the background to the dispute before the referring court gave rise to some controversy concerning, in essence, the reasons which led LKB to dismiss Ms Danosa from her position as a member of the Board of Directors of that company and the question whether LKB had been informed of Ms Danosa’s pregnancy and, if so, on what date it had been so informed.

32 While LKB maintained that Ms Danosa's pregnancy had not in any way influenced the decision by which she was dismissed and argued that Ms Danosa herself had not claimed that she had been dismissed because of her pregnancy, Ms Danosa contested LKB's version of the facts, claiming that she had been dismissed because of her pregnancy and seeking to clarify the circumstances surrounding the adoption of the dismissal decision.

33 It is for the national court to ascertain the facts which have given rise to the dispute before it and to establish the consequences which they have for the judgment which it is required to deliver (see, inter alia, Case C-435/97 *WWF and Others* [1999] ECR I-5613, paragraph 32).

34 In the division of jurisdiction between the Courts of the European Union and the national courts, it is in principle for the national court to determine whether the factual conditions triggering the application of a rule of EU law are satisfied in the case pending before it, while the Court, when giving a preliminary ruling, may, where appropriate, provide clarification to guide the national court in its interpretation (see, to that effect, Case C-424/97 *Haim* [2000] ECR I-5123, paragraph 58, and Joined Cases C-22/08 and C-23/08 *Vatsouras and Koupatantze* [2009] ECR I-4585, paragraph 23).

35 In the present case, as is apparent from the order for reference, the questions are based on the premiss that the removal of Ms Danosa from her post as a member of LKB's Board of Directors took place, or may have taken place, essentially because of her pregnancy. The referring court is uncertain as to the compatibility with EU law of national legislation which prohibits dismissal for reasons linked to pregnancy and yet does not attach any restriction to the dismissal of a member of a company's Board of Directors.

36 In these circumstances, it falls to the Court to answer the questions concerning the interpretation of EU law which have been referred for a preliminary ruling, whilst leaving to the referring court the task of establishing the specific elements of the case before it and, in particular, of determining whether the contested dismissal decision was adopted essentially because of Ms Danosa's pregnancy.

37 In so far as the position taken by the Latvian Government and the European Commission, in relation to the facts of the main proceedings, challenges the relevance of the questions to the outcome of the case before the referring court, it need merely be observed that there is nothing in the order for reference to suggest that the questions — the relevance of which, moreover, the referring court has explained — are manifestly hypothetical or unrelated to the actual facts of the main action or its purpose.

The first question

38 By its first question, the referring court essentially asks whether a member of the Board of Directors of a capital company who provides services to the company must be regarded as a worker within the meaning of Directive 92/85.

39 It is settled case-law that the concept of 'worker' for the purposes of Directive 92/85 may not be interpreted differently according to each national law and must be defined in accordance with objective criteria which distinguish the employment relationship by reference to the rights and duties of the persons concerned. The essential feature of an employment relationship is that, for a certain period of time, a person performs services for and under the direction of another person, in return for which he receives

remuneration (see, by analogy, in the context of freedom of movement for workers and the principle of equal pay for men and women, Case 66/85 *Lawrie-Blum* [1986] ECR 2121, paragraphs 16 and 17, and Case C-256/01 *Allonby* [2004] ECR I-873, paragraph 67; and, in the context of Directive 92/85, Case C-116/06 *Kiiski* [2007] ECR I-7643, paragraph 25).

40 The *sui generis* nature of the employment relationship under national law is of no consequence as regards whether or not a person is a worker for the purposes of EU law (see *Kiiski*, paragraph 26 and the case-law cited). Provided that a person meets the conditions specified in paragraph 39 above, the nature of that person's legal relationship with the other party to the employment relationship has no bearing on the application of Directive 92/85 (see, by analogy, in the context of freedom of movement for workers, Case 344/87 *Bettray* [1989] ECR 1621, paragraph 16, and Case C-357/89 *Raulin* [1992] ECR I-1027, paragraph 10).

41 Similarly, formal categorisation as a self-employed person under national law does not exclude the possibility that a person may have to be treated as a worker for the purposes of Directive 92/85 if that person's independence is merely notional, thereby disguising an employment relationship within the meaning of that directive (see, by analogy, *Allonby*, paragraph 71).

42 It follows that, contrary to the assertions made by LKB, neither the way in which Latvian law categorises the relationship between a capital company and the members of its Board of Directors nor the fact that there is no employment contract between the company and the Board Members can determine how that relationship falls to be treated for the purposes of applying Directive 92/85.

43 As is clear from the observations submitted to the Court, it is not disputed in the present case that Ms Danosa provided services to LKB, regularly and in return for remuneration, by performing the duties assigned to her, under the company's statutes and the rules of procedure of the Board of Directors, as sole Board Member. Contrary to the assertions made by that company, it is irrelevant in that regard that Ms Danosa was herself responsible for the establishment of those rules.

44 On the other hand, those observations differ on the question whether between Ms Danosa and LKB there exists the relationship of subordination, or even the degree of subordination, required under the case-law of the Court of Justice relating to the concept of 'worker' within the meaning of EU law in general and Directive 92/85 in particular.

45 LKB maintains, as do the Latvian and Hellenic Governments, that, in the case of members of the Board of Directors of a capital company, there is no relationship of subordination as required under the case-law of the Court of Justice. LKB and the Latvian Government argue that, as a general rule, a Board Member such as Ms Danosa performs his or her duties on the basis of a contract of agency, independently and without instructions. They state that the relationship between, on the one hand, the members of a capital company and/or, where appropriate, the supervisory board and, on the other hand, the members of the Board of Directors, must be based on trust, which means that it must be possible to terminate the working relationship between the parties if ever that trust is no longer forthcoming.

46 The answer to the question whether a relationship of subordination exists within the meaning of the above definition of the concept of 'worker' must, in each particular case, be arrived at on the basis of all the factors and circumstances characterising the relationship between the parties.

47 The fact that Ms Danosa was a member of the Board of Directors of a capital company is not enough in itself to rule out the possibility that she was in a relationship of subordination to that company: it is necessary to consider the circumstances in which the Board Member was recruited; the nature of the duties entrusted to that person; the context in which those duties were performed; the scope of the person's powers and the extent to which he or she was supervised within the company; and the circumstances under which the person could be removed.

48 First of all, as the Advocate General points out at points 77 to 84 of his Opinion, an examination of those factors in the case before the referring court shows, first and foremost, that Ms Danosa was appointed sole member of LKB's Board of Directors for a fixed period of three years; that she was made responsible for managing the company's assets, directing the company and representing it; and that she was an integral part of the company. It has not been possible to tell, from the reply given to a question raised by the Court during the hearing, by whom or by what body Ms Danosa had been appointed.

49 Next, even though Ms Danosa enjoyed a margin of discretion in the performance of her duties, she had to report on her management to the supervisory board and to cooperate with that board.

50 Lastly, according to the documents placed before the Court, a member of a Board of Directors may, under Latvian law, be removed from his or her duties by a decision of the shareholders, in some circumstances following suspension from those duties by the supervisory board. The dismissal decision in Ms Danosa's case was therefore adopted by a body which, by definition, she did not control and which was able at any time to take decisions contrary to her wishes.

51 While it cannot be ruled out that the members of a directorial body of a company, such as a Board of Directors, are not covered by the concept of 'worker' as defined in paragraph 39 above, in view of the specific duties entrusted to them, as well as the context in which those duties are performed and the manner in which they are performed, the fact remains that Board Members who, in return for remuneration, provide services to the company which has appointed them and of which they are an integral part, who carry out their activities under the direction or control of another body of that company and who can, at any time, be removed from their duties without such removal being subject to any restriction, satisfy prima facie the criteria for being treated as workers within the meaning of the case-law of the Court, as referred to above.

52 As regards the concept of 'pregnant worker', it should be borne in mind that this is defined in Article 2(a) of Directive 92/85 as 'a pregnant worker who informs her employer of her condition, in accordance with national legislation and/or national practice'.

53 With a view to the implementation of that directive, the EU legislature intended to give the concept of 'pregnant worker' its own independent meaning in EU law, even though, in respect of one element of that definition — namely that relating to the details of the procedure for informing the employer of her condition — it refers back to national legislation and/or national practice (*Kiiski*, paragraph 24).

54 With regard to the question as to whether, in the case before the referring court, LKB had been informed of Ms Danosa's pregnancy, it should be pointed out that, as is clear from paragraph 33 above, it is for the referring court to ascertain the relevant facts, not the Court of Justice.

55 Secondly, even though Article 2(a) of Directive 92/85 refers to national legislation and/or national practice so far as concerns the details of the procedure by which the worker is to inform the employer of her condition, the fact remains that those procedural requirements cannot divest of its substance the special protection for women provided for in Article 10 of that directive, which prohibits the dismissal of pregnant workers and workers who have recently given birth or are breastfeeding, save in exceptional cases for reasons unrelated to the condition of the worker in question. If, without having been formally informed by the worker in person, the employer learns of her pregnancy, it would be contrary to the spirit and purpose of Directive 92/85 to interpret the provisions of Article 2(a) of that Directive restrictively and to deny the worker concerned the protection against dismissal provided for under Article 10.

56 In view of the foregoing considerations, the reply to the first question is that a member of a capital company's Board of Directors, who provides services to that company and is an integral part of it, must be regarded as having the status of worker for the purposes of Directive 92/85, if that activity is carried out, for some time, under the direction or supervision of another body of that company and if, in return for those activities, the Board Member receives remuneration. It is for the national court to undertake the assessments of fact necessary to determine whether that is so in the case pending before it.

The second question

57 By its second question, the referring court essentially asks whether Article 10 of Directive 92/85 is to be interpreted as precluding national legislation, such as that at issue in the main proceedings, which permits the dismissal of a member of a capital

company's Board of Directors without restriction, and specifically without account being taken of the fact that the person concerned is pregnant.

58 As regards the scope of the prohibition on dismissal laid down in Article 10 of Directive 92/85, it should first be recalled that the objective of Directive 92/85 is to encourage improvements in the safety and health at work of pregnant workers and workers who have recently given birth or are breastfeeding.

59 Before Directive 92/85 came into force, the Court had already held that, by virtue of the principle of non-discrimination and, in particular, under the provisions of Directive 76/207, protection against dismissal must be granted to women not only during maternity leave, but also throughout pregnancy. According to the Court, a dismissal occurring during those periods affects only women and therefore constitutes direct discrimination on grounds of sex (see, to that effect, Case C-179/88 *Handels- og Kontorfunktionærernes Forbund* [1990] ECR I-3979, paragraph 13; Case C-394/96 *Brown* [1998] ECR I-4185, paragraphs 24 to 27; and Case C-460/06 *Paquay* [2007] ECR I-8511, paragraph 29).

60 It is precisely in view of the harmful effects which the risk of dismissal may have on the physical and mental state of women who are pregnant, have recently given birth or are breastfeeding, including the particularly serious risk that pregnant women may be prompted voluntarily to terminate their pregnancy, that, pursuant to Article 10 of Directive 92/85, the EU legislature provided for special protection for women, by prohibiting dismissal during the period from the beginning of pregnancy to the end of maternity leave (see *Paquay*, paragraph 30 and the case-law cited).

61 During that period, Article 10 of Directive 92/85 does not provide for any exception to, or derogation from, the prohibition on dismissing pregnant workers, save in exceptional cases not connected with their condition, provided that the employer gives substantiated grounds for the dismissal in writing (Case C-32/93 *Webb* [1994] ECR I-3567, paragraph 22; *Brown*, paragraph 18; Case C-109/00 *Tele Danmark* [2001] ECR I-6993, paragraph 27; and *Paquay*, paragraph 31).

62 In the event that the national court were to decide that, in the case before it, Ms Danosa falls within the concept of 'pregnant worker' for the purposes of Directive 92/85 and that the dismissal decision at issue in the main proceedings was taken for reasons essentially connected with her pregnancy, it should be pointed out that such a decision, whilst taken in accordance with provisions of national law permitting the unrestricted dismissal of a Board Member, is incompatible with the prohibition on dismissal laid down in Article 10 of that directive.

63 On the other hand, a dismissal decision taken during the period from the beginning of pregnancy to the end of the maternity leave for reasons unconnected with Ms Danosa's pregnancy would not be contrary to Article 10 of Directive 92/85, provided, however, that the employer gives substantiated grounds for dismissal in writing and that the dismissal of the person concerned is permitted under the relevant national legislation and/or practice, in accordance with Article 10(1) and (2) of that directive.

64 In the event that the referring court decides that, in the case before it, given the nature of the activity pursued by Ms Danosa and the context within which that activity is pursued, protection against the dismissal of a member of a capital company's Board of Directors cannot be inferred from Directive 92/85, since the person concerned is

not a 'pregnant worker' for the purposes of that directive, it would be necessary to consider whether Ms Danosa could possibly rely on the protection against discrimination on grounds of sex granted under Directive 76/207, a legislative act which the referring court did not mention in its questions but to which the referring court and certain interested parties which submitted observations to the Court alluded.

65 In that respect, it should be noted that, under Article 3(1)(c) of Directive 76/207, '[a]pplication of the principle of equal treatment means that there shall be no direct or indirect discrimination on the grounds of sex in the public or private sectors, including public bodies, in relation to … employment and working conditions, including dismissals …'.

66 As is clear from paragraph 59 above, by virtue of the principle of non-discrimination and, in particular, under the provisions of Directive 76/207, protection against dismissal must be afforded to women not only during maternity leave, but also throughout the period of pregnancy. According to the Court, the dismissal of a worker on account of pregnancy, or essentially on account of pregnancy, can affect only women and therefore constitutes direct discrimination on grounds of sex (see *Paquay*, paragraph 29 and the case-law cited).

67 Clearly, where an agency agreement is unilaterally terminated by the principal, before the agreed expiry date, on account of the agent's pregnancy, or essentially on account of her pregnancy, only women can be affected. Even supposing that Ms Danosa was not a 'pregnant worker' in the broad sense used by Directive 92/85, to accept that a company can remove from her post a member of its Board of Directors perform-

ing tasks such as those described in the main proceedings would be contrary to the protective aim of Article 2(7) of Directive 76/207, to the extent that the removal was essentially on account of her pregnancy.

68 As the Court has already pointed out, the objective pursued by the rules of EU law governing equality between men and women is, with regard to the rights of pregnant women and women who have given birth, to protect those women before and after they give birth (see Case C-191/03 *McKenna* [2005] ECR I-7631, paragraph 42).

69 That objective, which informs both Directive 92/85 and Directive 76/207, could not be achieved if the protection against dismissal granted to pregnant women under EU law were to depend on the formal categorisation of their employment relationship under national law or on the choice made at the time of their appointment between one type of contract and another.

70 As is stated in paragraph 33 above, it is for the national court to determine the relevant facts of the dispute before it and to ascertain whether, as is assumed in the questions referred, the dismissal decision was brought about essentially on account of Ms Danosa's pregnancy. If so, it is of no consequence whether Ms Danosa falls within the scope of Directive 92/85 or of Directive 76/207, or — to the extent that the referring court categorises her as 'a self-employed person' — within the scope of Directive 86/613, which applies to self-employed persons and which, as is stated in Article 1 of that directive, supplements Directive 76/207 as regards the application of the principle of equal treatment for those workers, prohibiting, like Directive 76/207, any discrimination whatsoever, whether direct or indirect, on grounds of sex. Whichever directive applies, it is important to ensure, for the person concerned, the protection

granted under EU law to pregnant women in cases where the legal relationship linking her to another person has been severed on account of her pregnancy.

71 That conclusion is supported, moreover, by the principle of equality between men and women enshrined in Article 23 of the Charter of Fundamental Rights of the European Union, in accordance with which that equality must be ensured in all areas, including employment, work and pay.

72 Lastly, it should be borne in mind, as regards the burden of proof applicable in circumstances such as those at issue in the main proceedings, that it is a matter for the referring court to apply the relevant provisions of Council Directive 97/80/EC of 15 December 1997 on the burden of proof in cases of discrimination based on sex (OJ 1998 L 14, p. 6) which, in accordance with Article 3(1)(a) of that directive, applies to situations covered by Directive 76/207 and to situations covered by Directive 92/85 in so far as discrimination on grounds of sex is concerned.

73 In that regard, it is apparent from Article 4(1) of Directive 97/80 that, where persons who consider themselves wronged because the principle of equal treatment has not been applied to them establish, before a court or other competent authority, facts from which it may be presumed that there has been direct or indirect discrimination, it is for the other party to prove that there has been no breach of the principle of equal treatment.

74 In the light of the foregoing, the answer to the second question is that Article 10 of Directive 92/85 is to be interpreted as precluding national legislation, such as that at issue in the main proceedings, which permits a member of a capital company's Board of Directors to be removed from that post without restriction, where the person concerned is a 'pregnant worker' within the meaning of that directive and the decision to remove her was taken essentially on account of her pregnancy. Even if the Board Member concerned is not a 'pregnant worker' within the meaning of Directive 92/85, the fact remains that the removal, on account of pregnancy or essentially on account of pregnancy, of a member of a Board of Directors who performs duties such as those described in the main proceedings can affect only women and therefore constitutes direct discrimination on grounds of sex, contrary to Article 2(1) and (7) and Article 3(1)(c) of Directive 76/207.

Costs

75 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the referring court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Second Chamber) hereby rules:

1. **A member of a capital company's Board of Directors who provides services to that company and is an integral part of it must be regarded as having the status of worker for the purposes of Council Directive 92/85/EEC of 19 October 1992 on the introduction of measures to encourage improvements in the**

safety and health at work of pregnant workers and workers who have recently given birth or are breastfeeding (tenth individual Directive within the meaning of Article 16(1) of Directive 89/391/EEC), if that activity is carried out, for some time, under the direction or supervision of another body of that company and if, in return for those activities, the Board Member receives remuneration. It is for the national court to undertake the assessments of fact necessary to determine whether that is so in the case pending before it.

2. **Article 10 of Directive 92/85 is to be interpreted as precluding national legislation, such as that at issue in the main proceedings, which permits a member of a capital company's Board of Directors to be removed from that post without restriction, where the person concerned is a 'pregnant worker' within the meaning of that directive and the decision to remove her was taken essentially on account of her pregnancy. Even if the Board Member concerned is not a 'pregnant worker' within the meaning of Directive 92/85, the fact remains that the removal, on account of pregnancy or essentially on account of pregnancy, of a member of a Board of Directors who performs duties such as those described in the main proceedings can affect only women and therefore constitutes direct discrimination on grounds of sex, contrary to Article 2(1) and (7) and Article 3(1)(c) of Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions, as amended by Directive 2002/73/EC of the European Parliament and of the Council of 23 September 2002.**

[Signatures]

Reports of Cases

JUDGMENT OF THE COURT (First Chamber)

9 July 2015 *

(Reference for a preliminary ruling — Directive 98/59/EC — Article 1(1)(a) — Collective redundancies — Concept of 'worker' — Member of the board of directors of a limited liability company — Person working under a scheme for training and reintegration into the labour market and benefitting from a public training grant but not receiving remuneration from the employer)

In Case C-229/14,

REQUEST for a preliminary ruling under Article 267 TFEU from the Arbeitsgericht Verden (Germany), made by decision of 6 May 2014, received at the Court on 12 May 2014, in the proceedings

Ender Balkaya

v

Kiesel Abbruch- und Recycling Technik GmbH,

THE COURT (First Chamber),

composed of A. Tizzano, President of the Chamber, S. Rodin (Rapporteur), A. Borg Barthet, E. Levits and M. Berger, Judges,

Advocate General: Y. Bot,

Registrar: A. Calot Escobar,

having regard to the written procedure,

after considering the observations submitted on behalf of:

— E. Balkaya, by M. Barton, Rechtsanwalt,

— Kiesel Abbruch- und Recycling Technik GmbH, by P. Wallenstein, Rechtsanwalt,

— the Estonian Government, by N. Grünberg, acting as Agent,

— the Polish Government, by B. Majczyna, acting as Agent,

— the European Commission, by M. Kellerbauer and J. Enegren, acting as Agents,

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

* Language of the case: German.

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Article 1(1)(a) of Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies (OJ 1998 L 225, p. 16).

2 The request has been made in proceedings between Mr Balkaya and Kiesel Abbruch- und Recycling Technik GmbH ('Kiesel Abbruch') concerning the lawfulness of a dismissal on economic grounds announced by the latter, upon the closure of an establishment, no notification of the projected collective redundancies having being given to the Bundesagentur für Arbeit (German Federal Employment Agency) before that dismissal.

Legal context

EU legislation

3 Article 1(1) of Directive 98/59 provides:

'1. For the purposes of this Directive:

(a) "collective redundancies" means dismissals effected by an employer for one or more reasons not related to the individual workers concerned where, according to the choice of the Member States, the number of redundancies is:

(i) either, over a period of 30 days:

— at least 10 in establishments normally employing more than 20 and less than 100 workers,

— at least 10% of the number of workers in establishments normally employing at least 100 but less than 300 workers,

— at least 30 in establishments normally employing 300 workers or more,

(ii) or, over a period of 90 days, at least 20, whatever the number of workers normally employed in the establishments in question;

(b) "workers' representatives" means the workers' representatives provided for by the laws or practices of the Member States.

For the purpose of calculating the number of redundancies provided for in the first subparagraph of point (a), terminations of an employment contract which occur on the employer's initiative for one or more reasons not related to the individual workers concerned shall be assimilated to redundancies, provided that there are at least five redundancies.'

4 Article 3 of Directive 98/59 provides:

'1. Employers shall notify the competent public authority in writing of any projected collective redundancies.

…

2. Employers shall forward to the workers' representatives a copy of the notification provided for in paragraph 1.

The workers' representatives may send any comments they may have to the competent public authority.'

5 Article 4(1) and (2) of the directive provides:

'1. Projected collective redundancies notified to the competent public authority shall take effect not earlier than 30 days after the notification referred to in Article 3(1) without prejudice to any provisions governing individual rights with regard to notice of dismissal.

Member States may grant the competent public authority the power to reduce the period provided for in the preceding subparagraph.

2. The period provided for in paragraph 1 shall be used by the competent public authority to seek solutions to the problems raised by the projected collective redundancies.'

6 According to Article 5 of the directive:

'This Directive shall not affect the right of Member States to apply or to introduce laws, regulations or administrative provisions which are more favourable to workers or to promote or to allow the application of collective agreements more favourable to workers.'

German law

7 Paragraph 17 of the Law on protection against unfair dismissal (Kündigungsschutzgesetz, 'KSchG'), which lays down the requirement to give a collective redundancies notice, is worded as follows:

'(1) The employer is under an obligation to notify the Employment Agency before it makes redundant:

1. more than 5 workers in establishments normally employing more than 20 and less than 60 workers;

…

over a period of 30 calendar days. Any other termination of an employment relationship brought about by the employer shall be assimilated to redundancy.

(2) If the employer contemplates making redundancies that are subject to the obligation to issue a notification under subparagraph 1 it shall promptly provide the works council with the appropriate information and notify it in writing, in particular, of:

1. the reasons for the projected redundancies;

2. the number and professional categories of workers to be made redundant;

3. the number and professional categories of workers normally employed;

4. the period over which the redundancies are expected to take place;

5. the proposed criteria for selecting the workers to be made redundant;

6. the proposed criteria for calculating any redundancy payments.

…

(3) The employer must simultaneously forward to the Employment Agency a copy of the notice given to the works council; this must contain at least the details stated in points 1 to 5 of the first sentence of subparagraph 2.

…

(5) The following shall not be regarded as workers for the purposes of this paragraph:

1. in establishments of one legal person, the members of the body that is responsible for the legal representation of that person;

2. in unincorporated associations without a legal personality, the persons entitled under the law, the statutes or by the articles of association to represent that association;

3. company directors, managers of the establishment and other persons holding analogous managerial posts, in so far as they are themselves authorised to take decisions relating to the recruitment and dismissal of workers.'

8 Paragraph 6 of the Law on limited liability companies (Gesetz betreffend die Gesellschaft mit beschränkter Haftung, 'GmbHG'), concerning the status of director, provides:

'(1) The company shall have one or more directors.

(2) Only a natural person with full legal capacity may be a director.

…

(3) Shareholders or any other persons may be appointed as directors. The appointment shall be made either in the company's articles of association or in accordance with the provisions of the third chapter of this law.

…'

9 Paragraph 35 of the GmbHG provides:

'(1) The company shall be represented in legal proceedings and in other matters by its directors.

(2) Where several directors have been appointed, they are only authorised to represent the company jointly, unless the articles of association provide otherwise …

…'

10 Paragraph 37 of the GmbHG, headed 'Limitation on the power of representation', provides:

'(1) The directors are required to respect, as regards the company, the limitations imposed on their power of representation by the articles of association or, unless otherwise stated in the articles of association, by the decisions of the shareholders.

(2) The limitations on the directors' power of representation may not be relied on against third parties. That shall be the case, in particular, when the representation is limited to certain legal acts or categories of legal act, or to certain circumstances, or to a certain period, or to certain named places or, furthermore, when the consent of the shareholders or of a body of the company is required for certain acts.'

11 Paragraph 38 of the GmbHG, concerning the removal of directors, provides:

'(1) The directors may be removed at any time, without prejudice to any claim for damages that may arise under existing contracts.

(2) The articles of association may limit the power to remove a director to cases in which there are serious reasons justifying that decision. Such reasons include, inter alia, serious breach of duty or lack of fitness to conduct the business of the company properly.'

12 Paragraph 43 of the GmbHG on directors' liability provides:

'(1) The directors must conduct the company's business using the care due of a prudent businessman.

(2) Directors who breach their obligations shall be jointly and severally liable to the company for the damage that they have caused.

...'

13 Paragraph 46 of the GmbHG, headed 'Powers of the shareholders', is worded as follows:

'The following shall be subject to the decision of the shareholders:

1. the adoption of the annual accounts and the distribution of the profits;

1a. decisions concerning the publication of the financial statements in accordance with international accounting standards … and concerning the approval of the annual accounts drawn up by the directors;

1b. approval of the consolidated accounts prepared by the directors;

2. the calling in of contributions;

3. the repayment of additional contributions;

4. the division, consolidation or redemption of shares;

5. the appointment, removal or discharge of directors;

6. the measures for the review and supervision of management;

7. the appointment of persons having power of attorney and representatives authorised to carry out generally business operations on behalf of the company;

8. the conduct of the company's claims for damages against the directors or the shareholders, as a result of the formation of the company or its management, and the representation of the company in proceedings brought against its directors.'

The dispute in the main proceedings and the questions referred for a preliminary ruling

14 Kiesel Abbruch, a limited liability company incorporated under German law, employed Mr Balkaya, with effect from 1 April 2011, as a technician. Mr Balkaya was appointed to work within the company and with its clients.

15 Kiesel Abbruch terminated, with effect from 15 February 2013, all of the contracts of employment of its employees, including Mr Balkaya, and ceased all its business, which had become loss-making, on the site at Achim (Germany). Mr Balkaya was given notice of dismissal by letter of 7 January 2013.

16 It is not disputed that Kiesel Abbruch did not give notification of the projected collective redundancies to the Bundesagentur für Arbeit before giving notice of Mr Balkaya's dismissal.

17 Mr Balkaya relies on that omission to challenge, before the referring court, the validity of his dismissal. He submits that, as the number of workers normally employed by Kiesel Abbruch in its establishment in Achim was above the threshold of 20 persons provided for in Paragraph 17(1)(1) of the KSchG, the employer was required, under that provision, to give such notification before giving notice of dismissal.

18 As is apparent from the order for reference, it is not disputed that 18 people, including Mr Balkaya, were amongst the workers normally employed by Kiesel Abbruch in that establishment at the date on which notice of the dismissal was given.

19 However, the parties in the main proceedings disagree as to the question whether, in addition, three other persons who were also employed by Kiesel Abbruch must be counted in that category, in order to determine whether the threshold of 20 persons, laid down in Paragraph 17(1)(1) of the KSchG, was attained.

20 First, that question relates to Mr S, who was employed as a draftsman and had terminated his own contract of employment with effect from 7 December 2012.

21 Second, Kiesel Abbruch employed, at the date of the dismissals of which notice was given, Mr L. as a director. Mr L. did not hold any shares in Kiesel Abbruch and it was only jointly with another director that he was entitled to act on behalf of the company.

22 Third, at that same date, Kiesel Abbruch employed Ms S., who was undergoing training within the company to re-qualify as an office assistant, funded by the Jobcenter im Landkreis Diepholz (the public employment office for the district of Diepholz). A grant, which was equivalent to the whole of the remuneration due to Ms S for her work done in the context of her training, was paid to her directly by the Bundesagentur für Arbeit.

23 It is clear from the order for reference that the referring court considers it to be proven that Mr S. falls within the category of workers normally employed that must be taken into account in accordance with Paragraph 17(1)(1) of KSchG, which transposed Article 1(1)(a) of Directive 98/59 into German law. Thus, the number of 19 workers within that category is reached.

24 Therefore, the question arises as to whether it is appropriate also to include in that category of employed workers, within the meaning of those provisions, a director, such as Mr L., and a person undergoing requalification training, such as Ms S., with the result that, in the main proceedings, more than 20 workers were normally employed by Kiesel Abbruch within its establishment at the date of the dismissal in question.

25 In that regard, the referring court specifies, in the first place, as regards Mr L., that, under Paragraph 17(5)(1) of the KSchG, members of the body of a legal person which is responsible for the legal representation of that person are deemed not to be workers or employees for the purposes of that provision. The numerically most significant group of those members is that of directors of limited liability companies ('Gesellschaften mit beschränkter Haftung').

26 Furthermore, the referring court notes, as regards the relationship between the director and such a company, that German law clearly distinguishes the status of director as an officer, on the one hand, from the rights and obligations of the director vis-à-vis the company, on the other hand. While that status is acquired upon the appointment of the director by a general meeting of the shareholders, the most powerful body in the company, the rights and obligations of the director as regards that company are governed by the director's service contract. That contract is a contract for services in the form of a business management contract and does not constitute, according to German case-law, an employment contract.

27 In that context, the referring court raises a question, in particular, as to the interpretation of the criterion — established by the judgment in *Danosa* (C-232/09, EU:C:2010:674) for determining whether a member of a board of a company has the status of worker within the meaning of EU law — of carrying out an activity under the direction or supervision of another body of such a company.

28 In the second place, as regards a person such as Ms S., who has the status of 'trainee', performing real work within a company in order to acquire or improve skills or following vocational training, the referring court observes that, whereas, normally, recognised vocational training leads to the conclusion of a contract for that purpose between the company providing the training and the trainee and to the payment of remuneration by that company, the training provided to Ms S. was not the subject of such a contract and Kiesel Abbruch did not pay her a salary.

29 Therefore, the referring court is unsure as to the relevant criteria to be used to assess whether persons who are undergoing such vocational training or internships are workers, for the purposes of Article 1(1)(a) of Directive 98/59, and, in particular, as to the relevance in that regard of remuneration paid directly by the employer.

30 In those circumstances the Arbeitsgericht Verden decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

'(1) Is applicable EU law, in particular Article 1(1)(a) of Directive 98/59, to be interpreted as precluding national legislative provisions or practices which do not take into account a member of the board of directors of a limited liability company in the calculation provided for by that provision of the number of workers employed, even where he performs his duties under the direction and subject to the supervision of another body of that company, receives remuneration in return for the performance of his duties and does not himself own any shares in the company?

(2) Is applicable EU law, in particular Article 1(1)(a) of Directive 98/59, to be interpreted as making it mandatory also to regard as workers, in the calculation provided for by that provision of the number of workers employed, persons who, while not receiving remuneration from the employer, perform real work within the undertaking, with financial support from, and the recognition of, the public authority responsible for the promotion of employment, in order to acquire or improve skills or to complete vocational training ('trainees'), or are Member States permitted to lay down national legislative provisions or practices in that regard?'

The questions referred

The first question

31 By its first question, the referring court asks, in essence, whether Article 1(1)(a) of Directive 98/59 must be interpreted as meaning that it precludes a national law or practice that does not take into account, in the calculation provided for by that provision of the number of workers employed, a member of the board of directors of a capital company, such as the director in question in the main proceedings, who performs his duties under the direction and subject to the supervision of another body of that company, receives remuneration in return for the performance of his duties and does not himself own any shares in the company.

32 In order to reply to this question, it must be recalled, first of all, that by harmonising the rules applicable to collective redundancies, the EU legislature intended both to ensure comparable protection for workers' rights in the different Member States and to harmonise the costs which such protective rules entail for European Union undertakings (see, inter alia, judgments in *Commission* v *Portugal*, C-55/02, EU:C:2004:605, paragraph 48, and *Commission* v *Italy*, C-596/12, EU:C:2014:77, paragraph 16).

33 Therefore, contrary to the submission of Kiesel Abbruch, the concept of 'worker', referred to in Article 1(1)(a) of Directive 98/59, cannot be defined by reference to the legislation of the Member States but must be given an autonomous and independent meaning in the EU legal order (see, by analogy, judgment in *Commission* v *Portugal*, C-55/02, EU:C:2004:605, paragraph 49). Otherwise, the methods for calculation of the thresholds laid down in that provision, and therefore the thresholds themselves, would be within the discretion of the Member States, which would allow the latter to alter the scope of that directive and thus to deprive it of its full effect (see, to that effect, judgment in *Confédération générale du travail and Others*, C-385/05, EU:C:2007:37, paragraph 47).

34 It is apparent, next, from the settled case-law of the Court that that concept of 'worker' must be defined in accordance with objective criteria which distinguish the employment relationship by reference to the rights and duties of the persons concerned. In that regard, the essential feature of an employment relationship is that, for a certain period of time, a person performs services for and under the direction of another person, in return for which he receives remuneration (see judgment in *Commission* v *Italy*, C-596/12, EU:C:2014:77, paragraph 17, citing, by analogy, the judgment in *Danosa*, C-232/09, EU:C:2010:674, paragraph 39).

35 It that regard, in so far as the referring court emphasises the fact that the employment relationship of a director such as the one in question in the main proceedings is governed, inter alia, by a service contract to act as director, which is not, according to German case-law, a contract of employment, it must be observed, first, that it is clear from the settled case-law of the Court that the nature of the employment relationship under national law is of no consequence as regards whether or not a person is a worker for the purposes of EU law (see, to that effect, judgment in *Kiiski*, C-116/06, EU:C:2007:536, paragraph 26 and case-law cited).

36 It follows that, provided that a person meets the conditions specified in paragraph 34 above, the nature of that person's legal relationship with the other party to the employment relationship has no bearing on the application of Directive 98/59 (see, by analogy, judgment in *Danosa*, C-232/09, EU:C:2010:674, paragraph 40).

37 In the second place, in so far as the referring court is unsure, in particular, as to the existence, in the main proceedings, of a relationship of subordination, in accordance with the case-law of the Court regarding the concept of 'worker', because the degree of dependency or subordination of a director, such as the one in question in the main proceedings, in the exercise of his functions is of a lesser

intensity than that of a worker within the usual meaning under German law, it must be observed that whether such a relationship of subordination exists must, in each particular case, be assessed on the basis of all the factors and circumstances characterising the relationship between the parties (see, to that effect, judgment in *Danosa* C-232/09, EU:C:2010:674, paragraph 46).

38 In that regard, it is apparent from the case-law of the Court, which is applicable in connection with Directive 98/59, the fact that a person is a member of the board of directors of a capital company is not enough in itself to rule out the possibility that that person is in a relationship of subordination to that company (see, to that effect, judgments in *Danosa* C-232/09, EU:C:2010:674, paragraph 47, and *Commission* v *Italy*, C-596/12, EU:C:2014:77, paragraphs 14, 17 and 18). It is necessary to consider the circumstances in which the board member was recruited; the nature of the duties entrusted to that person; the context in which those duties were performed; the scope of the person's powers and the extent to which he or she was supervised within the company; and the circumstances under which the person could be removed (see judgment in *Danosa* C-232/09, EU:C:2010:674, paragraph 47).

39 Thus, the Court has already held that a member of a board of directors of a capital company who, in return for remuneration, provides services to the company which has appointed him and of which he is an integral part, who carries out his activities under the direction or supervision of another body of that company and who can, at any time, be removed from his duties without such removal being subject to any restriction, satisfies, prima facie, the criteria for being treated as a 'worker' within the meaning of EU law (see, to that effect, judgment in *Danosa*, C-232/09, EU:C:2010:674, paragraphs 51 and 56).

40 In the present case, it must be held that it is apparent from the order for reference that a director of a capital company, such as the director in question in the main proceedings, is appointed by the general meeting of shareholders of that company, which may revoke his mandate at any time against the will of the director. Furthermore, that director is, in the exercise of his functions, subject to the direction and supervision of that body, and, in particular, to the requirements and restrictions that are imposed on him in that regard. Moreover, although it is not by itself a decisive factor in that context, it must be observed that a director, such as the one in the main proceedings, does not hold any shares in the company for which he carries out his functions.

41 In those circumstances, it must be found that, even if such a board member of a capital company enjoys a degree of latitude in the performance of his duties that exceeds, in particular, that of a worker within the meaning of German law, who may be directed by the employer, as the national court has observed, as to the specific tasks that he must complete and the manner in which they must be carried out, the fact remains that the board member is in a relationship of subordination vis-à-vis that company within the meaning of the case-law cited at paragraphs 38 and 39 above (see, to that effect, the judgment in *Danosa*, C-232/09, EU:C:2010:674, paragraph 49 to 51).

42 Furthermore, it is common ground that a director, such as the one in the main proceedings, receives remuneration in return for the services he provides.

43 Having regard to the foregoing considerations, it must, therefore, be held that a member of the board of directors of a capital company, such as the director in question in the main proceedings, must be regarded as a 'worker' within the meaning of Article 1(1)(a) of Directive 98/59 and, consequently, be taken into account in the calculation of the thresholds laid down in that article.

44 That interpretation is also borne out by the objective of that directive which is, as is apparent from recital 2 in the preamble thereto, inter alia, to afford greater protection to workers in the event of collective redundancies. In accordance with that objective, a narrow definition cannot be given to the concepts that define the scope of that directive, including the concept of 'worker' in Article 1(1)(a) of

the directive (see, to that effect, judgments in *Athinaïki Chartopoïïa*, C-270/05, EU:C:2007:101, paragraphs 25 and 26, and, by analogy, *Union syndicale Solidaires Isère*, C-428/09, EU:C:2010:612, paragraph 22).

45 Finally, the Court rejects the submission made by Keisel Abbruch and the Estonian government that a director such as the one in question in the main proceedings does not need the protection afforded by Directive 98/59 in the event of collective redundancies.

46 In that regard, it must be held, first, that there is nothing to suggest that an employee who is a board member of a capital company, in particular, a small or medium sized company such as that at issue in the main proceedings, is necessarily in a different situation from that of other persons employed by that company as regards the need to mitigate the consequences of his dismissal, and, inter alia, to alert, for that purpose, the competent public authority so that it is able to seek solutions to the problems raised by all the projected collective redundancies (see, to that effect, judgment in *Junk*, C-188/03, EU:C:2005:59, paragraph 48, and in *Claes and Others*, C-235/10 to C-239/10, EU:C:2011:119, paragraph 56).

47 Second, it must be observed that a national law or practice, such as that at issue in the main proceedings, which does not take into account the board members of a capital company in the calculation provided for in Article 1(1)(a) of Directive 98/59 of the number of workers employed, is liable not only to affect the protection afforded by that directive to those members, but, above all, to deprive all the workers employed by certain establishments, normally employing more than 20 workers, of the rights which they derive from that directive and thus undermines its effectiveness (see, to that effect, judgment in *Confédération générale du travail and Others*, C-385/05, EU:C:2007:37, paragraph 48).

48 Having regard to all the foregoing considerations, the answer to the first question is that Article 1(1)(a) of Directive 98/59 must be interpreted as meaning that it precludes a national law or practice that does not take into account, in the calculation provided for by that provision of the number of workers employed, a member of the board of directors of a capital company, such as the director in question in the main proceedings, who performs his duties under the direction and subject to the supervision of another body of that company, receives remuneration in return for the performance of his duties and does not himself own any shares in the company.

The second question

49 By its second question, the referring court asks, in essence, whether Article 1(1)(a) of Directive 98/59 must be interpreted as meaning that it is necessary to regard as a worker for the purposes of that provision a person, such as the one in question in the main proceedings, who, while not receiving remuneration from his employer, performs real work within the undertaking in the context of a traineeship — with financial support from, and the recognition of, the public authority responsible for the promotion of employment — in order to acquire or improve skills or complete vocational training.

50 In that regard, it must be recalled, in the first place, that it is clear from the Court's well-established case-law that the concept of 'worker' in EU law extends to a person who serves a traineeship or periods of apprenticeship in an occupation that may be regarded as practical preparation related to the actual pursuit of the occupation in question, provided that the periods are served under the conditions of genuine and effective activity as an employed person, for and under the direction of an employer. The Court has stated that that conclusion cannot be invalidated by the fact that the productivity of the person concerned is low, that he does not carry out full duties and that, accordingly, he works only a small number of hours per week and thus receives limited remuneration

(see, to that effect, inter alia, judgments in *Lawrie-Blum*, 66/85, EU:C:1986:284, paragraphs 19 to 21; *Bernini*, C-3/90, EU:C:1992:89, paragraphs 15 and 16; *Kurz*, C-188/00, EU:C:2002:694, paragraphs 33 and 34, and *Kranemann*, C-109/04, EU:C:2005:187, paragraph 13).

51 In the second place, it is also clear from the Court's case-law that neither the legal context of the employment relationship under national law, in the framework of which the vocational training or internship is carried out, nor the origin of the funds from which the person concerned is remunerated and, in particular, in the present case, the funding of that remuneration through public grants, can have any consequence in regard to whether or not the person is to be regarded as a worker (see, to that effect, inter alia, judgments in *Bettray*, 344/87, EU:C:1989:226, paragraphs 15 and 16; *Birden*, C-1/97, EU:C:1998:568, paragraph 28, and *Kurz*, C-188/00, EU:C:2002:694, point 34).

52 Accordingly, and in the light of the considerations set out, in particular, in paragraphs 33, 34 and 44 of this judgment, the answer to the second question is that Article 1(1)(a) of Directive 98/59 must be interpreted as meaning that it is necessary to regard as a worker for the purposes of that provision a person, such as the one in question in the main proceedings, who, while not receiving remuneration from his employer, performs real work within the undertaking in the context of a traineeship — with financial support from, and the recognition of, the public authority responsible for the promotion of employment — in order to acquire or improve skills or complete vocational training.

Costs

53 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (First Chamber) hereby rules:

1. **Article 1(1)(a) of Directive 98/59/EC of 20 July 1998, on the approximation of the laws of the Member States relating to collective redundancies, must be interpreted as meaning that it precludes a national law or practice that does not take into account, in the calculation provided for by that provision of the number of workers employed, a member of the board of directors of a capital company, such as the director in question in the main proceedings, who performs his duties under the direction and subject to the supervision of another body of that company, receives remuneration in return for the performance of his duties and does not himself own any shares in the company.**

2. **Article 1(1)(a) of Directive 98/59 must be interpreted as meaning that it is necessary to regard as a worker for the purposes of that provision a person, such as the one in question in the main proceedings, who, while not receiving remuneration from his employer, performs real work within the undertaking in the context of a traineeship — with financial support from, and the recognition of, the public authority responsible for the promotion of employment — in order to acquire or improve skills or complete vocational training.**

[Signatures]

Reports of Cases

JUDGMENT OF THE COURT (Grand Chamber)

18 July 2017*

(Reference for a preliminary ruling — Free movement of workers — Principle of non-discrimination — Election of workers' representatives to the supervisory board of a company — National legislation restricting the right to vote and to stand as a candidate to employees of establishments located in the national territory)

In Case C-566/15,

REQUEST for a preliminary ruling under Article 267 TFEU from the Kammergericht (Berlin Higher Regional Court, Germany), made by decision of 16 October 2015, received at the Court on 3 November 2015, in the proceedings

Konrad Erzberger

v

TUI AG,

intervening parties:

Vereinigung Cockpit e.V.,

Betriebsrat der Tui AG/Tui Group Services GmbH,

Frank Jakobi,

Andreas Barczewski,

Peter Bremme,

Dierk Hirschel,

Michael Pönipp,

Wilfried H. Rau,

Carola Schwirn,

Anette Stempel,

Ortwin Strubelt,

* Language of the case: German.

Marcell Witt,

Wolfgang Flintermann,

Stefan Weinhofer,

ver.di -Vereinte Dienstleistungsgewerkschaft,

THE COURT (Grand Chamber),

composed of K. Lenaerts, President, A. Tizzano, Vice-President, R. Silva de Lapuerta, M. Ilešič and J.L. da Cruz Vilaça, Presidents of Chambers, A. Borg Barthet, J. Malenovský, E. Levits (Rapporteur), J.-C. Bonichot, A. Arabadjiev, C. Vajda, S. Rodin and F. Biltgen, Judges,

Advocate General: H. Saugmandsgaard Øe,

Registrar: K. Malacek, Administrator,

having regard to the written procedure and further to the hearing on 24 January 2017,

after considering the observations submitted on behalf of:

– Mr Erzberger, by J. Brandhoff, C. Behme and S. Richter, Rechtsanwälte,

– **TUI** AG, by C. Arnold and M. Arnold, Rechtsanwälte,

– the Vereinigung Cockpit e.V., by M. Fischer, Rechtsanwältin,

– the Betriebsrat der **TUI** AG/**TUI** Group Services GmbH and Others, by M. Schmidt, Rechtsanwältin,

– the German Government, by J. Möller and T. Henze, acting as Agents,

– the French Government, by R. Coesme, acting as Agent,

– the Luxembourg Government, by P. Kinsch, avocat,

– the Netherlands Government, by H. Stergiou, acting as Agent,

– the Austrian Government, by G. Eberhard, acting as Agent,

– the European Commission, by M. Kellerbauer and D. Martin, acting as Agents,

– the EFTA Surveillance Authority, by M. Moustakali and C. Zatschler, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 4 May 2017,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Articles 18 and 45 TFEU.

2 The request has been made in proceedings between Mr Konrad Erzberger and TUI AG, established in Germany, of which he is a shareholder, regarding the composition of the supervisory board, more particularly, concerning the right to vote and to stand as a candidate in elections of workers' representatives to that board.

Legal context

3 Paragraph 96 of the Aktiengesetz (Law on public limited companies) of 6 September 1965 (BGBl. 1965 I, p. 1089), provides:

'(1) The supervisory board shall be composed

in the case of companies subject to the Law on employee participation, of members representing the shareholders and members representing the employees,

…

in the case of other companies, of members representing the shareholders alone.

…'

4 Paragraph 1 of the Gesetz über die Mitbestimmung der Arbeitnehmer (Law on employee participation) of 4 May 1976 (BGBl. 1976 I, p. 1153) ('the MitbestG'), entitled ''Undertakings affected', states:

'(1) In undertakings

1. established in the form of a joint stock company, a limited partnership with shares, a limited liability company or a cooperative, and

2. which normally employ more than 2 000 persons,

this Law shall confer on employees a right of participation.

…'

5 Paragraph 3(1)(1) of the MitbestG provides:

'The following shall be regarded as employees within the meaning of this Law

1. persons designated in Paragraph 5(1) of the Law on industrial relations …'

6 The first sentence of Paragraph 5(1) of the MitbestG states:

'Where an … undertaking is the dominant undertaking within a group …, the employees of the group shall be treated as employees of the dominant undertaking for the purposes of the application of this Law.'

7 Paragraph 7 of the MitbestG states:

'(1) The supervisory board of an undertaking

…

3. with normally more than 20 000 employees shall be composed of 10 members representing the shareholders and 10 members representing the employees.

…

(2) The members of the supervisory board representing the employees shall include

…

3. in a supervisory board containing 10 employees' representatives, seven employees of the undertaking and three trade union representatives.

…'

8 Paragraph 10 of the MitbestG is worded as follows:

'(1) In each establishment of the company, the employees shall elect delegates by secret ballot.

(2) Employees of the undertaking who are 18 years of age or over shall be entitled to vote in the election of delegates, …

(3) Employees referred to in the first sentence of subparagraph 2 who satisfy the conditions for eligibility to stand for election laid down in Paragraph 8 of the Law on industrial relations shall be eligible for election as delegates.

…'

9 Paragraph 8 of the Betriebsverfassungsgesetz (Law on industrial relations) (BGBl. 2001 I, p. 2518) provides:

'(1) All employees with voting rights who have been employed in or principally worked for the establishment as homeworkers for six months shall be eligible for election. The said period of six months shall be deemed to include any immediately preceding period during which the employee was employed in another establishment belonging to the same company or group of companies …

(2) If the establishment has been in existence for less than six months, such employees as are employed in the establishment and fulfil the other conditions for eligibility at the announcement of the election for the works council shall be eligible, as an exception to the requirement of six months' service under subparagraph 1.'

The dispute in the main proceedings and the questions referred for a preliminary ruling

10 Mr Erzberger is a shareholder of TUI, which is the parent company of a group of companies ('the TUI group'), operating in the tourism sector.

11 The TUI group is a global operator. In the European Union, that group employs around 50 000 persons, of which slightly more than 10 000 work in Germany.

12 **Since TUI falls within the scope of application of the MitbestG, that company is managed by two organs, namely the management board, responsible for running the company, and the supervisory board, whose task is to supervise the management board with the participation of the workers. That supervisory board includes 20 members. Half of that board consists of shareholder representatives and half of representatives appointed by the employed workers.**

13 The referring court notes that, according to the majority opinion among German legal writers and in the case-law, the concept of worker, for the purpose of the application of the MitbestG, covers solely workers of undertakings located in the national territory. According to that majority opinion, the workers of a subsidiary of a group located outside the territory of Germany, inter alia in another Member State, are deprived of the right to vote and to stand as a candidate in elections of representatives to the supervisory board of the parent company of the group concerned. Moreover, any worker of the TUI group who carries out tasks within the supervisory board of the parent company of that group must give up those tasks where he takes up a post within one of the subsidiaries of that group located in a State other than the Federal Republic of Germany.

14 That approach is based not on the terms of the MitbestG but on the 'principle of territoriality', according to which the German social order cannot extend to the territory of other States, and on the origins of that law.

15 Mr Erzberger considers, by contrast, that TUI's supervisory board is not properly constituted. Preventing workers employed by a subsidiary of the TUI group located in a Member State other than the Federal Republic of Germany, who it can be assumed are in general not German citizens, from participating in the composition of TUI's supervisory board, infringes Article 18 TFEU. Moreover, the loss of membership in the supervisory board, in the case of a transfer to a Member State other than the Federal Republic of Germany, is, he claims, likely to dissuade workers from exercising their right to free movement throughout the territory of the Member States, provided for by Article 45 TFEU.

16 **Since TUI disputes that opinion, Mr Erzberger exercised his right, provided for under national legislation, to bring an action before a court in the event of a dispute as to the statutory provisions applicable to the composition of the supervisory board.**

17 The Landgericht Berlin (Berlin Regional Court, Germany) dismissed the latter's action. There was neither discrimination on the grounds of nationality nor restriction of the freedom of movement of workers, since the loss of the right to vote in the case of a transfer is not decisive for the decision of workers to take a post in a Member State other than the Federal Republic of Germany.

18 On appeal, the Kammergericht (Berlin Higher Regional Court, Germany) held that there might be an infringement of EU law. According to that court, it is possible that the German legislation on employee participation gives rise to discrimination against employees based on nationality and restricts freedom of movement for workers.

19 First, unlike workers employed in Germany, those who are employed in another Member State, in this case approximately 80% of the employees of the TUI group, are not represented on TUI's supervisory board.

20 Secondly, according to the Kammergericht (Berlin Higher Regional Court), risk of losing their membership on the supervisory board in the case of a transfer is likely to dissuade workers from applying for posts which are actually on offer in a Member State other than the Federal Republic of Germany and, to that end, from moving freely within the territory of the Union.

21 The referring court cannot identify any sufficient justification in that regard. In those circumstances, the Kammergericht (Berlin Higher Regional Court) decided to stay proceedings and to refer the following question to the Court of Justice for a preliminary ruling:

'Is it compatible with Article 18 TFEU … and Article 45 TFEU … for a Member State to grant the right to vote and to stand as a candidate for election as the workers' representatives in the supervisory body of a company only to those workers who are employed in establishments of the company or in affiliated companies that are within the national territory?'

Consideration of the question referred

Preliminary remarks

22 In order to give a useful reply to the question posed by the referring court, it is necessary to take into account the range of situations affecting the different workers employed by a company belonging to the TUI group.

23 It should also be noted, as the representative of TUI stated at the hearing, that, outside Germany, the TUI group only has establishments with separate legal personality.

The workers of the TUI group employed in a subsidiary established in a Member State other than the Federal Republic of Germany

24 The referring court asks, first of all, in essence, whether Articles 18 and 45 TFEU must be interpreted as precluding Member State legislation, such as that at issue in the main proceedings, which provides that the employees of a group of companies employed in a subsidiary located in the territory of another Member State do not have the right to vote and to stand as a candidate in elections of workers' representatives to the supervisory board of the parent company of that group.

25 According to settled case-law, noted by the Advocate General in point 39 of his Opinion, Article 18 TFEU, which enshrines the general principle of non-discrimination on grounds of nationality, is intended to apply independently only to situations governed by EU law in respect of which the Treaty lays down no specific prohibition of discrimination (judgment of 4 September 2014, *Schiebel Aircraft*, C-474/12, EU:C:2014:2139, paragraph 20 and the case-law cited).

26 Article 45(2) TFEU provides, in favour of employees, for specific rules governing non-discrimination on the basis of nationality in respect of employment conditions.

27 It follows that the situation of employees referred to in paragraph 24 of the present judgment must be examined solely on the basis of Article 45 TFEU.

28 In that regard, it should be noted that, according to settled case-law, the Treaty rules governing freedom of movement for persons cannot be applied to activities which have no factor linking them with any of the situations governed by EU law. Therefore, those rules are not applicable to workers who have never exercised their freedom to move within the Union and who do not intend to do so (see, to that effect, judgment of 1 April 2008, *Government of the French Community and Walloon Government*, C-212/06, EU:C:2008:178, paragraphs 33, 37 and 38).

29 As the Advocate General pointed out in points 49 and 55 of his Opinion, the fact that the subsidiary which employs the workers at issue is controlled by a parent company established in a Member State other than that in which that subsidiary is established is not relevant in order to establish a link with either of the situations contemplated by Article 45 TFEU.

30 It follows that the situation of employees referred to in paragraph 24 of the present judgment does not fall within the scope of Article 45 TFEU.

The workers of the TUI group employed in Germany who leave that employment in order to be employed in a subsidiary belonging to the same group established in another Member State

31 Next, the referring court asks, in essence, whether Articles 18 and 45 TFEU must be interpreted as precluding legislation of a Member State, such as that at issue in the main proceedings, according to which the workers employed in the establishments of a group located in the territory of that Member State are deprived of the right to vote and to stand as a candidate in elections of workers' representatives to the supervisory board of the parent company of that group, established in that Member State, and, as the case may be, the right to act or to continue to act as a representative on that board, where those workers leave their employment in such an establishment and are employed by a subsidiary belonging to the same group established in another Member State.

32 This refers to the situation of workers who, within the TUI group, make use of their right under Article 45 TFEU. Therefore, as the Advocate General pointed out in point 68 of his Opinion and as follows from paragraphs 25 and 26 of the present judgment, Article 18 TFEU does not apply to that situation.

33 According to the Court's settled case-law, all the provisions of the Treaty on freedom of movement for persons are intended to facilitate the pursuit by Union nationals of occupational activities of all kinds throughout the EU, and preclude measures which might place Union nationals at a disadvantage when they wish to pursue an activity in the territory of a Member State other than their Member State of origin. In that context, nationals of the Member States have in particular the right, which they derive directly from the Treaty, to leave their Member State of origin to enter the territory of another Member State and reside there in order to pursue an activity there. As a result, Article 45 TFEU precludes any national measure which is capable of hindering or rendering less attractive the exercise by Union nationals of the fundamental freedoms guaranteed by that article (see, to that effect, judgments of 1 April 2008, *Government of the French Community and Walloon Government*, C-212/06, EU:C:2008:178, paragraphs 44 and 45, and of 10 March 2011, *Casteels*, C-379/09, EU:C:2011:131, paragraphs 21 and 22).

34 However, primary EU law cannot guarantee to a worker that moving to a Member State other than his Member State of origin will be neutral in terms of social security, since, given the disparities between the Member States' social security schemes and legislation, such a move may be more or less advantageous for the person concerned in that regard (see, by analogy, judgments of 26 April 2007, *Alevizos*, C-392/05, EU:C:2007:251, paragraph 76 and the case-law cited, and of 13 July 2016, *Pöpperl*, C-187/15, EU:C:2016:550, paragraph 24).

35 Therefore, as the Advocate General in essence stated in points 75 and 78 of his Opinion, Article 45 TFEU does not grant to that worker the right to rely, in the host Member State, on the conditions of employment which he enjoyed in the Member State of origin under the national legislation of the latter State.

36 In that regard, it should be added that, in the absence of harmonisation or coordination measures at Union level in the field concerned, the Member States remain, in principle, free to set the criteria for defining the scope of application of their legislation, to the extent that those criteria are objective and non-discriminatory.

37 In that context, EU law does not, in the field of representation and collective defence of the interests of workers in the management or supervisory bodies of a company established under national law, a field which, to date, has not been harmonised or even coordinated at Union level, prevent a Member State from providing that the legislation it has adopted be applicable only to workers employed by establishments located in its national territory, just as it is open to another Member State to rely on a different linking factor for the purposes of the application of its own national legislation.

38 In the present case, the participation mechanism established by the MitBestG, which seeks to involve workers, by means of elected representatives, in the decision-making and strategic bodies of the company, is subject, in this respect, both to German company law and to German labour relations law, the scope of application of which the Federal Republic of Germany is entitled to limit to workers employed by establishments located in its territory, since such a delimitation is based on an objective and non-discriminatory criterion.

39 In the light of the above, the loss of the rights at issue in the main proceedings, incurred by the workers referred to in paragraph 31 of the present judgment, cannot be held to constitute an impediment to the free movement of workers guaranteed by Article 45 TFEU.

40 As regards in particular workers who, after having been granted a mandate as representative, during their period of employment in an establishment located in Germany, to the supervisory board of a German company, leave Germany in order to be employed by a company established in the territory of another Member State, the fact that those workers are required, in such circumstances, to give up the exercise of their mandate in Germany is merely the consequence of the Federal Republic of Germany's legitimate choice to limit the application of its national legislation in the field of participation to workers employed by an establishment located in German territory.

41 In the light of the foregoing considerations, the answer to the question referred is that Article 45 TFEU must be interpreted as not precluding legislation of a Member State, such as that at issue in the main proceedings, under which the workers employed in the establishments of a group located in the territory of that Member State are deprived of the right to vote and to stand as a candidate in elections of workers' representatives to the supervisory board of the parent company of that group, which is established in that Member State, and as the case may be, of the right to act or to continue to act as representative on that board, where those workers leave their employment in such an establishment and are employed by a subsidiary belonging to the same group established in another Member State.

Costs

42 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

Article 45 TFEU must be interpreted as not precluding legislation of a Member State, such as that at issue in the main proceedings, under which the workers employed in the establishments of a group located in the territory of that Member State are deprived of the right to vote and to stand as a candidate in elections of workers' representatives to the supervisory board of the parent company of that group, which is established in that Member State, and as the case may be, of the right to act or to continue to act as representative on that board, where those workers leave their employment in such an establishment and are employed by a subsidiary belonging to the same group established in another Member State.

[Signatures]

Reports of Cases

JUDGMENT OF THE COURT (Seventh Chamber)

5 May 2022 *

(Reference for a preliminary ruling – Social policy – Directive 2008/94/EC – Protection of employees in the event of their employer's insolvency – Article 2(2) – Concept of 'employee' – Article 12(a) and (c) – Limitations on the responsibility of the guarantee institutions – Person exercising, on the basis of a contract of employment entered into with a trading company, the functions of a management board member and chief executive officer of that company – Concurrent exercise of functions – National case-law refusing that person the benefit of the guarantees laid down by that directive)

In Case C-101/21,

REQUEST for a preliminary ruling under Article 267 TFEU from the Nejvyšší správní soud (Supreme Administrative Court, Czech Republic), made by decision of 11 February 2021, received at the Court on 18 February 2021, in the proceedings

HJ

v

Ministerstvo práce a sociálních věcí,

THE COURT (Seventh Chamber),

composed of J. Passer, President of the Chamber, F. Biltgen (Rapporteur) and N. Wahl, Judges,

Advocate General: J. Richard de la Tour,

Registrar: A. Calot Escobar,

having regard to the written procedure,

after considering the observations submitted on behalf of:

– the Czech Government, by M. Smolek and J. Vláčil, acting as Agents,

– the Spanish Government, by M.J. Ruiz Sánchez, acting as Agent,

– the European Commission, by J. Hradil and B.-R. Killmann, acting as Agents,

* Language of the case: Czech.

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Article 2(2) and Article 12(a) and (c) of Directive 2008/94/EC of the European Parliament and of the Council of 22 October 2008 on the protection of employees in the event of the insolvency of their employer (OJ 2008 L 283, p. 36), as amended by Directive (EU) 2015/1794 of the European Parliament and of the Council of 6 October 2015 (OJ 2015 L 263, p. 1) ('Directive 2008/94').

2 The request has been made in proceedings between HJ, the applicant in the main proceedings, and the Ministerstvo práce a sociálních věcí (Ministry of Labour and Social Affairs, Czech Republic) concerning a request for payment of remuneration not paid by a company in a state of insolvency.

Legal context

European Union law

3 In accordance with recital 7 of Directive 2008/94, Member States may set limitations on the responsibility of the guarantee institutions. Those limitations must be compatible with the social objective of the directive and may take into account the different levels of claims.

4 Article 1 of that directive states:

'1. This Directive shall apply to employees' claims arising from contracts of employment or employment relationships and existing against employers who are in a state of insolvency within the meaning of Article 2(1).

2. Member States may, by way of exception, exclude claims by certain categories of employee from the scope of this Directive, by virtue of the existence of other forms of guarantee if it is established that these offer the persons concerned a degree of protection equivalent to that resulting from this Directive.

3. Where such provision already applies in their national legislation, Member States may continue to exclude domestic servants employed by a natural person from the scope of this Directive.'

5 Article 2(2) of Directive 2008/94 provides:

'This Directive is without prejudice to national law as regards the definition of the terms "employee", "employer", "pay", "right conferring immediate entitlement" and "right conferring prospective entitlement".

However, the Member States may not exclude from the scope of this Directive:

(a) part-time employees within the meaning of [Council] Directive 97/81/EC [of 15 December 1997 concerning the Framework Agreement on part-time work concluded by UNICE, CEEP and the ETUC (OJ 1998 L 14, p. 9)];

(b) employees with a fixed-term [employment] contract within the meaning of [Council] Directive 1999/70/EC [of 28 June 1999 concerning the framework agreement on fixed-term work concluded by ETUC, UNICE and CEEP (OJ 1999 L 175, p. 43)];

(c) employees with a temporary employment relationship within the meaning of Article 1(2) of [Council] Directive 91/383/EEC [of 25 June 1991 supplementing the measures to encourage improvements in the safety and health at work of workers with a fixed-duration employment relationship or a temporary employment relationship (OJ 1991 L 206, p. 19)].'

6 The first paragraph of Article 3 of Directive 2008/94 states:

'Member States shall take the measures necessary to ensure that guarantee institutions guarantee, subject to Article 4, payment of employees' outstanding claims resulting from contracts of employment or employment relationships, including, where provided for by national law, severance pay on termination of employment relationships.'

7 Article 12 of Directive 2008/94 is worded as follows:

'This Directive shall not affect the option of Member States:

(a) to take the measures necessary to avoid abuses;

…

(c) to refuse or reduce the liability referred to in the first paragraph of Article 3 or the guarantee obligation referred to in Article 7 in cases where the employee, on his or her own or together with his or her close relatives, was the owner of an essential part of the employer's undertaking or business and had a considerable influence on its activities.'

Czech law

Law No 118/2000

8 Zákon č. 118/2000 Sb., o ochraně zaměstnanců při platební neschopnosti zaměstnavatele a o změně některých zákonů (Law No 118/2000 on the protection of employees in the event of the employer's insolvency and amending certain laws) transposes Directive 2008/94 into Czech law.

9 In accordance with Paragraph 2(3) of Law No 118/2000, the latter does not apply to an employee who was, during the period concerned, an employee of an insolvent employer and who was, at the same time, the statutory body or a member thereof during the period concerned and who held at least a 50% ownership interest in that employer.

10 Under Paragraph 3(a) of Law No 118/2000, the term 'employee' means, for the purposes of that law, 'an individual with whom an employer has agreed on an employment relationship, an agreement for the performance of work … or an agreement on a work activity, on the basis of which he was entitled to claim payment of a salary for the period concerned and which was not paid to him by the employer'.

The Labour Code

11 Under Paragraph 2 of the zákon č. 262/2006 Sb., zákoník práce (Law No 262/2006 establishing the Labour Code) ('the Labour Code'):

'(1) Dependent work is work carried out in the context of a relationship of superiority of the employer and subordination of the employee, on behalf of the employer and in accordance with the employer's instructions, and performed by the employee in person.

(2) Dependent work must be performed in return for a salary, payment or remuneration for the work carried out, at the employer's expense and under the responsibility of the employer, during a defined time frame and at a workplace of the employer or possibly at another agreed place.'

12 Paragraph 4 of that code is worded as follows:

'The employment relationship is governed by the present law; where this law cannot be applied, the employment relationship shall be governed by the Civil Code, always in accordance with the fundamental principles governing employment relationships.'

13 Paragraph 6 of that code states:

'An employee is an individual who has undertaken to perform dependent work within a basic employment relationship.'

The Law on trading companies and cooperatives

14 Paragraph 59(1) and (2) of zákon č. 90/2012 Sb., o obchodních společnostech a družstvech (Law No 90/2012 on trading companies and cooperatives) provides:

'(1) The rights and obligations between a commercial company and the member of its elected body shall be governed, *mutatis mutandis*, by the provisions of the Civil Code relating to the mandate, unless otherwise provided by law or by a contract concerning the performance of duties, where it has been entered into. The provisions of the Civil Code relating to the management of property of others shall not apply.

(2) In a capital company, the service contract shall be concluded in writing and must be approved, including amendments thereto, by the supreme body of the company; in the absence of such approval, the contract shall not produce effects. …'

15 Paragraph 60 of that law states:

‘In a capital company a contract for the performance of the duties must also contain the following information:

(a) the definition of all components of remuneration which accrues or may accrue to a member of an elected body, including any benefit in kind, the payment of contributions to the pension scheme or other benefits;

…’

16 Paragraph 435(3) of that law provides:

‘The management board of a public limited company shall be governed by the principles and guidelines approved by the general meeting, provided that they comply with the rules and statutes. However, no one shall be authorised to issue directions to the management board concerning business management.’

The facts in the main proceedings and the question referred for a preliminary ruling

17 While working for AA, a trading company, since 2010 as an architect on the basis of a contract of employment, the applicant in the main proceedings was elected, in September 2017, as chairman of the management board of that company and for that purpose entered into a contract with that company in which it was stated that he was not entitled to remuneration for the performance of that function.

18 Subsequently, an addendum to his original contract of employment was concluded, stating that, as an employee, he was entitled to a salary. That addendum stated that he had, since October 2017, occupied the position of CEO of AA.

19 Following AA’s insolvency in 2018, the applicant in the main proceedings submitted to the Úřad práce České republiky – krajská pobočka pro hl. m. Prahu (Labour Office – Regional Branch for the Capital City of Prague, Czech Republic) an application on the basis of Law No 118/2000 for payment of his remuneration for the months of July to September 2018 (‘the period in question’).

20 That application was denied on the ground that the applicant in the main proceedings could not be regarded as an employee as defined by Paragraph 3(a) of Law No 118/2000.

21 The complaint lodged by the applicant in the main proceedings was rejected by the Ministry of Labour and Social Affairs. The latter held that, during the period in question, the applicant in the main proceedings had performed, in the course of his duties as chairman of the management board and CEO of AA, one single and identical form of work, namely the business management of that company, and that he could not therefore be regarded as being linked by an employment relationship with that company.

22 The action brought before the Městský soud v Praze (Prague City Court, Czech Republic) was also dismissed by judgment of 11 June 2020. That court held, in accordance with the national case-law relating to the ‘concurrent exercise of functions’, that, in so far as, during the period in question, the applicant in the main proceedings had performed concurrently the duties of CEO and

chairman of that company's management board, there was no superior relationship or any relationship of subordination with that company, and he could therefore not be regarded as an employee within the meaning of Law No 118/2000.

23 In addition, that court rejected the arguments of the applicant in the main proceedings alleging that, during the period in question, he did not carry out solely the business management of AA, but that he also worked as a construction manager and project manager. It found that the applicant in the main proceedings had been elected chairman of the management board in order to avert a financial situation adverse to the company, such as insolvency. However, it pointed out, the purpose of Law No 118/2000 is not to remedy harm that members of an insolvent employer's statutory body sustain due to their own unsuccessful business management.

24 The applicant in the main proceedings lodged an appeal before the referring court on a point of law against that judgment.

25 The referring court observes that, according to the national case-law relating to the concurrent exercise of functions, which is the subject of debate between the Czech courts, in particular between the Nejvyšší soud (Supreme Court, Czech Republic) and the Ústavní soud (Constitutional Court, Czech Republic), a contract of employment entered into between a trading company and a person, which provides that that person is to perform concurrently the functions of a member of a statutory body and CEO of that company, is valid under the Labour Code. However, a person in such a position cannot be regarded as an employee within the meaning of Law No 118/2000. Even if there is a contract of employment, a member of a statutory body who manages the trading company's activities cannot perform his or her duties in the context of a relationship of subordination, with the result that there is no employment relationship between that member and that company.

26 The referring court is unsure whether Article 2(2) and Article 12(a) and (c) of Directive 2008/94 preclude such national case-law.

27 It points out in this respect that, as the Court of Justice has consistently held, Directive 2008/94 pursues a social objective which seeks to guarantee a minimum level of protection for all employees in the event of the employer's insolvency (see, to that effect, judgments of 10 February 2011, *Andersson*, C-30/10, EU:C:2011:66, paragraph 25, and of 5 November 2014, *Tümer*, C-311/13, EU:C:2014:2337, paragraph 37), and that Member States can therefore exclude certain persons from this protection only in specific cases determined by that directive (see, to that effect, judgments of 16 December 1993, *Wagner Miret*, C-334/92, EU:C:1993:945, paragraph 14; of 17 November 2011, *van Ardennen*, C-435/10, EU:C:2011:751, paragraph 39; and of 5 November 2014, *Tümer*, C-311/13, EU:C:2014:2337, paragraph 37). Furthermore, any exclusion of a right must be objectively justified and must constitute a measure necessary to avoid abuse (judgment of 21 February 2008, *Robledillo Núñez*, C-498/06, EU:C:2008:109, paragraph 44).

28 In those circumstances, the Nejvyšší správní soud (Supreme Administrative Court, Czech Republic) decided to stay the proceedings and to refer the following question to the Court for a preliminary ruling:

'Does Article 2 of Directive [2008/94], in conjunction with Article 12(a) and (c) thereof, preclude national case-law according to which a CEO of a trading company is not deemed to be an "employee" for the purpose of the satisfaction of pay claims pursuant to Directive [2008/94], for the sole reason that the CEO as an employee is, at the same time, a member of the statutory body of the same trading company?'

Consideration of the question referred

29 By its question, the referring court asks, in essence, whether Article 2(2) and Article 12(a) and (c) of Directive 2008/94 must be interpreted as precluding national case-law according to which a person who, on the basis of a contract of employment, performs concurrently the duties of CEO and member of a statutory body of a company cannot be regarded as an employee and, consequently, cannot benefit from the guarantees provided for by that directive.

30 As a preliminary point, it should be noted that, according to Article 1(1) of Directive 2008/94, that directive is to apply to employees' claims arising from contracts of employment or employment relationships and existing against employers who are in a state of insolvency within the meaning of Article 2(1) of that directive. In addition, Article 3 of that directive establishes an obligation to pay employees' outstanding claims. It follows that employees, within the meaning of that directive, come within the scope of Directive 2008/94.

31 It should be added that the situations which the national case-law at issue in the main proceedings excludes from the benefit of Law No 118/2000 are not covered by the exceptions laid down in Article 1(2) and (3) of that directive. First, although Article 1(2) of Directive 2008/94 authorises Member States, by way of exception, to exclude claims by certain categories of employee from the scope of that directive, this is subject to the condition that there are other forms of guarantee which offer the persons concerned a degree of protection equivalent to that resulting from that directive. In the present case, however, it is apparent from the order for reference that the national case-law at issue in the main proceedings does not grant such equivalent protection to persons who are members of a statutory body of a company and who also, on the basis of a contract of employment, perform the duties of CEO of that company. Secondly, Article 1(3) of Directive 2008/94 concerns domestic servants employed by a natural person, which is not the case with the persons referred to in the national case-law at issue in the main proceedings.

32 In order to provide the referring court with a useful answer, it is necessary, in the first place, to examine whether national case-law such as that at issue in the main proceedings is compatible with Article 2(2) of Directive 2008/94.

33 In this respect, it should be noted that Directive 2008/94 does not itself define the concept of 'employee' and provides, in the first subparagraph of Article 2(2), that it is without prejudice to national law as regards the definition of that term, provided that certain categories of employee, set out in the second subparagraph of Article 2(2) thereof, which are not relevant for the purposes of the present case, are not excluded.

34 However, it is clear from the Court's case-law that the discretion enjoyed by the Member States in defining that concept is not unlimited. Thus, it follows from that case-law that the first subparagraph of Article 2(2) of Directive 2008/94 must be interpreted in the light of the social objective of that directive, which is to guarantee all employees a minimum of protection at EU level in the event of the employer's insolvency through payment of outstanding claims resulting from contracts of employment or employment relationships and relating to pay for a specific period. Member States therefore cannot define at will the term 'employee' in such a way as to undermine the social objective of that directive (see, by analogy, judgment of 5 November 2014, *Tümer*, C-311/13, EU:C:2014:2337, paragraph 42).

35 Furthermore, the Court has already held that, in view of that social objective of Directive 2008/94 and the terms of Article 1(1) thereof, the definition of the term 'employee' necessarily refers to an employment relationship that gives rise to a right, held vis-à-vis the employer, to receive payment for work done (see, by analogy, judgment of 5 November 2014, *Tümer*, C-311/13, EU:C:2014:2337, paragraph 44). It is thus contrary to that social objective to deny the protection provided for under that directive in the event of the employer's insolvency to individuals to whom national legislation generally attributes the status of employees and who, by virtue of that legislation, have wage claims vis-à-vis their employer arising from contracts of employment or employment relationships, as referred to in Article 1(1) and the first paragraph of Article 3 of that directive (see, by analogy, judgment of 5 November 2014, *Tümer*, C-311/13, EU:C:2014:2337, paragraph 45).

36 It follows that the fact that a person performing the duties of CEO of a trading company is also a member of the statutory body of that company does not, in itself, allow for the presumption or exclusion of the existence of an employment relationship or the classification of that person as an employee within the meaning of Directive 2008/94.

37 Accordingly, the first subparagraph of Article 2(2) of Directive 2008/94 must be interpreted as precluding national case-law, such as that at issue in the main proceedings, according to which a person who, on the basis of a contract of employment, performs concurrently the duties of CEO and of a member of a statutory body of a trading company cannot be regarded as an employee within the meaning of that directive.

38 In the present case, it is apparent from the order for reference that the applicant in the main proceedings performed concurrently the duties of CEO and chairman of AA's management board on the basis of a contract of employment entered into with that company and that, on that basis, he received remuneration. Since, according to the referring court, such a contract of employment is valid under the Labour Code, it cannot be ruled out that the applicant in the main proceedings may be regarded as being an employee within the meaning of the first subparagraph of Article 2(2) of Directive 2008/94, this, however, being a matter to be ascertained by the referring court.

39 In the second place, with regard to the compatibility of national case-law, such as that at issue in the main proceedings, with Article 12(a) of Directive 2008/94, it should be remembered that that provision enables Member States to take the measures necessary to avoid abuses.

40 In so far as it establishes an exception to a general rule, that provision must be interpreted restrictively. In addition, it must be interpreted in a manner compatible with the social objective of Directive 2008/94 (see, by analogy, judgment of 11 September 2003, *Walcher*, C-201/01, EU:C:2003:450, paragraph 38 and the case-law cited).

41 It must also be borne in mind that the abuses referred to in Article 12(a) of Directive 2008/94 are abusive practices that adversely affect the guarantee institutions by artificially giving rise to a claim for salary, thereby illegally triggering a payment obligation on the part of those institutions. The measures that the Member States are authorised to take under that provision are, accordingly, those that are necessary to prevent such practices (see, by analogy, judgment of 11 September 2003, *Walcher*, C-201/01, EU:C:2003:450, paragraphs 39 and 40).

42 In the present case, it is apparent from the order for reference that the national case-law at issue in the main proceedings seeks to prevent a situation in which persons who perform concurrently the duties of CEO and of management board member of a trading company are able to obtain payment of outstanding claims on account of the insolvency of that company, since they may be partly responsible for that insolvency. Therefore, it follows the logic behind Article 12(a) of Directive 2008/94.

43 However, that case-law establishes a non-rebuttable presumption according to which such a person does not exercise his or her functions in the context of a relationship of subordination but, in actual fact, leads the trading company concerned and that, consequently granting him or her the benefit of the guarantees provided for in Directive 2008/94 would constitute an abuse within the meaning of Article 12(a) thereof. However, a general presumption of the existence of abuse, which cannot be rebutted in the light of all the characteristic elements of each particular case, cannot be permitted (see, by analogy, judgments of 4 March 2004, *Commission* v *France*, C-334/02, EU:C:2004:129, paragraph 27, and of 25 October 2017, *Polbud – Wykonawstwo*, C-106/16, EU:C:2017:804, paragraph 64, as well as the Opinion of Advocate General Kokott in *Grenville Hampshire*, C-17/17, EU:C:2018:287, point 65).

44 Therefore, national case-law such as that at issue in the main proceedings cannot be justified on the basis of Article 12(a) of Directive 2008/94.

45 As regards, in the third place, the compatibility of national case-law, such as that at issue in the main proceedings, with Article 12(c) of Directive 2008/94, that provision authorises Member States to refuse or reduce the liability referred to in the first paragraph of Article 3 of that directive or the guarantee obligation referred to in Article 7 thereof in cases where the employee, on his or her own or together with his or her close relatives, was the owner of an essential part of the employer's undertaking or business and had a considerable influence on its activities, both conditions being cumulative.

46 That provision is based, among other things, on an implicit assumption that an employee who, simultaneously, owned an essential shareholding in the undertaking concerned and had a considerable influence on its activities could, thereby, be partly responsible for its insolvency (judgment of 10 February 2011, *Andersson*, C-30/10, EU:C:2011:66, paragraph 24).

47 In the present case, although the national case-law at issue in the main proceedings might, depending on the circumstances, be justified by the fact that a person who exercises concurrently the functions of CEO and of management board member of a trading company is likely to exercise considerable influence over the activities of that company, the fact remains that that case-law contains no reference to the first condition laid down in Article 12(c) of Directive 2008/94, namely that the employee had to own, on his or her own or together with his or her close relatives, an essential part of that company.

48 It follows that Article 12(a) and (c) of Directive 2008/94 precludes national case-law, such as that at issue in the main proceedings, which establishes a non-rebuttable presumption according to which a person who, even on the basis of a valid contract of employment under national law, performs concurrently the duties of CEO and of a member of a statutory body of a trading company cannot be regarded as an employee within the meaning of that directive and, therefore, cannot benefit from the guarantees provided for by that directive.

49 Consequently, the answer to the question referred for a preliminary ruling is that Article 2(2) and Article 12(a) and (c) of Directive 2008/94 must be interpreted as precluding national case-law according to which a person who, on the basis of a valid contract of employment under national law, performs concurrently the duties of chief executive officer and of a member of a statutory body of a trading company cannot be regarded as an employee within the meaning of that directive and, therefore, cannot benefit from the guarantees provided for by that directive.

Costs

50 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Seventh Chamber) hereby rules:

Article 2(2) and Article 12(a) and (c) of Directive 2008/94/EC of the European Parliament and of the Council of 22 October 2008 on the protection of employees in the event of the insolvency of their employer, as amended by Directive (EU) 2015/1794 of the European Parliament and of the Council of 6 October 2015, must be interpreted as precluding national case-law according to which a person who, on the basis of a valid contract of employment under national law, performs concurrently the duties of chief executive officer and of a member of a statutory body of a trading company cannot be regarded as an employee within the meaning of that directive and, therefore, cannot benefit from the guarantees provided for by that directive.

[Signatures]

4th assignment (Role of Shareholders in Companies)

After completing this seminar, students should have acquired knowledge in the following main issue of the topic:

Shareholders & Liability – Shareholders may have full, limited, or no liability depending on the type of company. They are considered residual owners of the company, meaning they have a claim on assets after all other obligations are settled.

Separation of Ownership & Management – Shareholders hold ownership, while management makes business decisions, leading to a separation of ownership and control in the company.

Shareholders' Rights & Minority Protection – Shareholders have rights to vote, receive dividends and access to information. Minority shareholders are specifically protected under law, with rights to challenge decisions, request meetings and more.

General Meeting & Decision-making – Business decisions are made at the general meeting, where quorum requirements must be met for valid decisions. These meetings may be ordinary or extraordinary, depending on the nature of the decisions.

Shareholders' Duties & Derivative Lawsuits – Shareholders have duties to act in good faith towards the company. In cases of mismanagement, they can file derivative lawsuits to protect the company's interests.

Compulsory readings materials:

- EMCA: Role of Shareholders in Companies

Related case studies (facultative reading):

- C-112/05 Volkswagen case
- C-282/04 "KPN NV and TPG NV"
- C-326/07 "Commission vs. Italy"
- C-171/08 Portugal Telecom

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ROLE OF SHAREHOLDERS IN COMPANIES

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1

Shareholder of a company I.

Funded by the European Union

- Contribution into the company (monetary/non-monetary) in "exchange" of business share/share (and limited liability)



2

Shareholder of a company II.

Funded by the European Union

- **Shareholders**
  - they are residual owners of the company
  - they cannot claim the return of the contribution
  - in the case of insolvency of the company they are last on the payment order (creditors, state, employees, …)
- **Liability of shareholders**
  - private limited company – up to their unpaid contributions into the share capital (registered in the commercial/company registry)
  - public limited company – no liability
  - **Exception: piercing the corporate veil**

3

Shareholder of a company III.

Funded by the European Union

- **As company has a separate legal personality**
  - assets of shareholder are shielded from the creditors of company
  - assets of company are shielded form the creditors of shareholders
  - asset shielding
- **Separation of ownership and management**
  - usually, separate persons are managing the company (directors and managers) and separate people are owning the company (shareholders)
  - **in continental Europe** – due to centralized ownership, this separation is not that present, shareholders are usually involved in the management of the company
  - **in the US and in UK** – due to dispersed ownership, this separation is present
- Loyalty of shareholders to the company? Is there any?

4

Shareholders' rights I.

Funded by the European Union

- **Attend** general meeting + **vote** on the general meeting
- **Information rights**
- Decide about the **major changes of the company** which may have impact on their ownership
  a. Winding up
  b. Transformation of company
  c. Changes in articles of association
  d. Sale of enterprise
  e. Nomination, election, removal, remuneration of the board of directors
  f. Right to profit (dividend)
  g. Right to liquidation share (the last to be paid, residual owners)
  h. Other (?)

5

Shareholders' rights I.

Funded by the European Union

- **Right to file a lawsuit**
  - **actio pro socio** - in partnerships to claim the fulfilment of obligation from the other shareholder/partner in the business
  - **derivative suite** – if directors breach their duties, they will not file a lawsuit against themselves in the name of the company

- **Other rights**
  - Pre-emption rights in case that a shareholder wants to sell his / her shares
  - other contractual rights as tag-along drag-along rights

6

Minority shareholders – special rights?

Funded by the European Union

- May be **oppressed** by majority shareholders – law is balancing out their **lack of power**
  - Challenge the general meeting resolution
  - Right to call an extraordinary general meeting
  - Right to file a lawsuit (*actio pro socio*, derivative claim)
  - Threshold needed for the exercise of these rights?

7

Elimination of minority shareholders?

Funded by the European Union

Squeeze-out/sell-out:

1. **Squeeze-out**
   - Majority shareholder - acquisition of at least **90–95%** of target's capital or voting rights (Member States decide exact % within this range)
   - **Right:** Majority shareholder can **compel minority shareholders** to sell their remaining shares for fair price
   - **Purpose:** enable **full control and integration** of the target company

2. **Sell-out**
   - When a bidder holds **90–95%** of shares – minority shareholder holds 5%-10%
   - **Right:** minority can **demand the majority** to purchase their shares at a **fair price**
   - **Purpose: prevent oppression** of minority investors post-takeover

8

Shareholders' duties

Funded by the European Union

- Pay the contribution to the share capital
- Not to abuse their rights
- Other rights? Based on what? Constitutional documents, shareholders agreement?
- Can a right be turned into a duty? For example, in connection with an obligation to attend general meeting and to vote in a certain way? (It is common for many shareholders agreements to have such clauses)

9

General meeting I.

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- Ordinary general meeting (at least once a year)
- Extraordinary general meeting
- Who calls general meeting ?
  - Statutory body (Board of directors)
  - Supervisory board
  - Shareholders
  - Minority shareholders

10

General meeting II.

Funded by the European Union

- GM is called by an **invitation** within a notice period (30 days in public companies, 0-15 days on private companies)
- **Invitation** (Volkswagen: https://www.volkswagen-group.com/en/publications/more/invitation-to-the-agm-2023-2135):
  - **Date, time, venue**
  - **Agenda items**
  - **Voting procedures**
  - **Proxy voting** and **electronic participation options, if possible**
- **Shareholder Rights:**
  - Right to **add items to the agenda** (if holding required % of shares)
  - Right to **ask questions** and receive responses during the meeting
  - Right to **vote in person, by proxy, or electronically**

11

General meeting III.

Funded by the European Union

- Voting
  - One share one vote/one shareholder having multiple votes (possible in Slovakia)
  - Proxy voting

- Quorum
  1. **Quorum to hold a general meeting**
     - How many shareholders need to come to have a valid general meeting (1, 50%, all?)
  2. **Quorum to pass decisions**
     - Super majority
     - Regular majority

12

Competence to take business decisions in public limited companies

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1. **German model**
2. **Nordic model**
3. **UK model**

13

German model

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- management board has the exclusive competencies with respect to the administration of the company and neither the general meeting nor the supervisory board may pass resolutions regarding the management of the company
- the general meeting may only take business decisions
  a. on fundamental decisions regarding the corporation
  b. at the request of the management board general meeting is prohibited from giving instructions to the board

14

Nordic model

Funded by the European Union

- neither the supervisory board nor the management board has exclusive competence.

15

UK model

Funded by the European Union

- all powers of management are primarily vested in the board, BUT:
  - Statutes can reserve matters to the general meeting
  - General meeting can give directions to the directors an *ad hoc* basis, BUT a 75% vote
- simple majority can dismiss the directors without cause
- board will not seek to exercise a power contrary to the wishes of a majority of the shareholders

16

Competence to take business decisions in private companies

Funded by the European Union

- a freedom to organize the competence between the general meeting and the board
- the competence of the general meeting is unrestricted
- the general meeting may take business decisions

17

Decisions of the general meeting (example from Slovak law)

Funded by the European Union

a. the approval of the conduct of persons acting in the name of the company before its incorporation,
b. the approval of individual annual financial statements and individual extraordinary financial statements, and decisions on the distribution of profit or payment of losses,
c. the approval of the articles of association and changes thereto, unless the law stipulates otherwise,
d. decisions on changing the agreement of association, provided that such decisions are entrusted to the powers of the general meeting by the law or agreement of association,
e. decisions on increasing or reducing the registered capital, and decisions on non-monetary contributions,
f. the appointment, removal and remuneration of executive officers,
g. the appointment, removal and remuneration of members of the supervisory board,
h. decisions on winding up the company or changing its legal form, if permitted by the agreement of association,
i. decisions on the approval of a contract on sale of an enterprise or a contract on sale of a part of an enterprise,

18

Exit form companies

Funded by the European Union

- Private companies
  - hard to find a buyer
  - no market
  - can be excluded?
- Public companies
  - free transferability of shares (can be limited, can be excluded?)
  - listed companies: market
- Squeeze-out sell-out rights
  - shareholders are pushed from the company despite the fact they want to stay
  - threshold is needed

19

Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies (Shareholder Rights Directive)

Funded by the European Union

- Provisions on
  - shareholders' voting rights, including proxy voting rights and cross-border voting rights
  - shareholders' rights to put items on the agenda of the general meeting, to ask questions and
- Provisions on companies' rights
  - the right to use electronic means to communicate with the shareholders and to enable electronic voting at the general meeting

20



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21

EUROPEAN MODEL COMPANIES ACT (EMCA)

2017

1ST EDITION

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GENERAL MEETING AND MINORITY PROTECTION

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General Comments

1. EU law

There is an on-going international debate on the role of shareholders in companies. One of the main aims of the European Commission's 2003 Action Plan (COM (2003) 284 final) was to strengthen the position of shareholders in the company.[69] Following this aim, Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies (i.e. companies whose shares are admitted to trading on a regulated market), the 'Shareholder Rights Directive', has been adopted and implemented in Member States. In addition, in 2012 the Commission published a new Action Plan (COM (2012) 740 final) on the EU Corporate Governance Framework which stipulates that shareholders should be encouraged to be more active on corporate governance issues. Among others, shareholders should be offered more possibilities to oversee remuneration policy and related party transactions, and shareholder cooperation to this end should be made easier. The Directives highlight a number of measures in order to ensure that shareholders are able to play an active role in the company's decision-process as well as being able to hold the management accountable for running the company.

Generally, Chapter 11 of the EMCA is in line with the Shareholder Rights Directive and the thoughts of the Commission's 2012 Action Plan.

The Shareholder Rights Directive of 2007 takes the view that there is a need to enhance shareholder rights in listed companies. It follows an international trend to foster *active shareholders*. Generally, the preamble stresses *"effective shareholder control is a pre-requisite to sound corporate governance and should therefore be facilitated and encouraged."* Thus, the Directive includes provisions on shareholder voting rights, including proxy voting rights and cross-border voting rights, on shareholders' rights to put items on the agenda of the general meeting, to ask questions and, for companies, the right to use electronic means to communicate with the shareholders and to enable electronic voting at the general meeting. As mentioned before, certain provisions are also applicable to non-listed companies, but other provisions should only apply to listed companies because of the special need to inform and protect shareholders in companies with shares admitted to trading on the market.

In 2014, the Commission published a proposal for a new Directive amending the Shareholder Rights Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EC as regards certain elements of the Corporate Government Statement (COM (2014) 213 final). The amending directive has been adopted in 2017 (but not yet published in the EU Official Journal at the time of publication of the EMCA).

The 2017 directive for the amended Shareholder Rights Directive encourages shareholders to engage more in the companies in which they invest, and to take a longer perspective of their investment.

The proposal identifies five specific objectives:

- Increase the level and quality of engagement of asset owners and asset managers with their investee companies
- Create a better link between pay and performance of company directors
- Enhance transparency and shareholder oversight of related party transactions
- Ensure reliability and quality of advice of proxy advisors
- Facilitate transmission of cross-border information (including voting) across the investment chain in particular through shareholder identification.

From a company law perspective, it should be noted that not all of the mentioned objectives require company law regulation. Thus the directive (Article 3 f-3 h) increases the transparency of institutional investors and asset managers. The articles mention that 'Member States shall ensure that institutional investors develop an "engagement policy" (Article 3 f), "Investment Strategy" (Article 3 q) etc.'.

[69] K. Hopt, *European Company Law and Corporate Governance: Where Does the Action Plan of the European Commission Lead?*, ECGI Working Paper- No. 52/2005, p.3

The relevant regulation is not company law, but the (different) national law regulating institutional investors and asset managers.

The directive's Article 9 a and 9 b require listed companies to publish detailed and user-friendly information on the remuneration policy and on the individual remuneration of directors. The articles give shareholders the right to approve the remuneration policy and to vote on the remuneration report. Therefore, the report facilitates the exercise of shareholders rights and ensures the accountability of directors. This is clearly a matter for company law regulation, see further below.

The directive's Article 9 c requires listed companies to submit material transactions with related parties' transactions to the approval of the general meeting or the administrative or supervisory body. This is also a matter for company law regulation, see further below.

The directive's Article 3 i requires proxy advisors to adopt and implement adequate measures to guarantee that their voting recommendations are accurate and reliable. The relevant regulation is not company law but national regulation concerning proxy advisors.

The directive's Article 3 a-3 e include rules on identification of shareholders, transmission of information and facilitation of exercise of shareholders rights.

Article 3 a-3 e affect a number of company law issues as well as regulations regarding institutional investors and proxy advisors, see further below.

The Commission has put forward in 2014 a proposal for a Directive on single-member private limited liability companies, creating the *Societas Unius Personae* or SUP (see EMCA Introduction, Point 7). The proposal aims to make it easier and less costly to set up companies across the EU. In particular, it aims to encourage SMEs including individual entrepreneurs to carry out their activities in other Member States. It should also benefit groups by allowing them to set up single-member subsidiaries according to the same main requirements across the EU. The proposal aims to address some of the obstacles that SMEs face by facilitating the setting up of companies with a single shareholder across the EU (in light of the Commission's withdrawal of the SPE proposal in its REFIT exercise (IP/13/891).The Juri Committee of the European Parliament has been split over the proposal despite amendments to take into account concerns. Thus an agreement on the proposal seems far in the future, but not impossible.

The formal requirements applying to the holding of general meetings and especially the rules on minority protection are based on the assumption that a majority of shareholders is present at the general meeting.

There is no EU regulation on the shareholders position and general meetings in private companies or non-listed public companies. However, most of the fundamental principles regarding shareholders' rights in listed companies are also applicable in non-listed companies.

2. National law

Chapter 11 is divided into three parts.

Part I comprises the rules on general meetings, including the competence of the general meeting, how general meetings are conducted, and the rules on shareholders' rights at general meetings.

There are different positions in the Member States as to the competence to take business decisions. The situation is also different in public and private companies. Generally, there are two opposite positions regarding *public companies*: In Czech, German and Polish law the management board has the exclusive competencies with respect to the administration of the company and neither the general meeting nor the supervisory board may pass resolutions regarding the management of the company. In Germany, the general meeting may only take business decisions at the request of the management board (*Vorstand*) (cf. German Stock Corporation Act §§ 11 and 119). According to the Polish Commercial Companies Code, the general meeting is prohibited from giving instructions to the board (cf. Section 375). In the Nordic countries the opposite is the case: Neither the supervisory board nor the management board has exclusive competence. This is a consequence of the conception of the company as being a strong shareholders' democracy and also belonging to shareholders which should therefore be able to exercice direct power. The balance struck in the UK in all companies is that all powers of management are vested in the board, subject to the statute and the articles which can reserve matters to the general meeting, and subject to any directions given by the general meeting to the directors but that requires a 75 % vote. Overall then, most powers reside with the board, some are withheld by statute or the articles to the shareholders, and the option is there for the shareholders, on an ad hoc basis, if they can reach a 75 % vote, to instruct the board as to how to proceed. Equally, since a simple majority can dismiss the directors without cause, in practice, the board will not seek to exercise a power contrary to the wishes of a majority of the shareholders, so it is rare for a 75 % direction to be given.

The situation in *private companies* is different in the Member States, as there is usually a controlling shareholder. Therefore, the distinction between shareholders and management is reduced and this affects the legal organisation. Generally, there is a freedom to organize the competence between the general meeting and the board. The competence of the general meeting is unrestricted and the general meeting may take business decisions.

A modified model between the two positions can be found in Dutch Law. The Dutch rule regarding instructions reads as follows (cf. Section 2:239(4) of the Dutch Civil Code (Book 2)):

> *"The articles of association may stipulate that the management board has to follow the instructions of another body of the company. The management board has to follow these instructions, unless these are in conflict with the interests of the company or the enterprise connected with it."*

Section 9 of EMCA Chapter 15 on Groups also recognises the right of the shareholders, subject to certain conditions and limitations, to give binding instructions, to the management body of a company.

Following this approach, article 23 (Shareholder's instructions) of the 2014 proposal of directive on the single-member private limited liability company, creating the SUP, established a right of the single shareholder to issue instructions :

> *« 1. The single-member shall have the right to give instructions to the management body.*
> *2. Instructions given by the single-member shall not be binding for any director insofar as they violate the articles of association or the applicable national law. »*

Part II includes the different minority rights which are divided into five areas;

Firstly, there are provisions which demand that a super majority is reached in order to make different decisions. Provisions on super majority, or even unanimity, of course secure the interests of the minority or even a single shareholder (minority protection/individual rights). Provisions on super majority are found in various chapters of the EMCA, for example the chapters on capital increase and decrease, merger and divisions and liquidation. In this Chapter on general meetings, the EMCA includes the very important provision on alteration of the articles of association. All Member States have provisions on alteration of the articles of associations demanding super majority. The majority requirement in public companies, however, is different with the main distinction being between a 75 % or a 2/3 majority. For example, in Germany (AktG § 179) and the UK (Companies Act 2006 Section 21(1), cf. 283(1)) the majority must not be less than 75 %, in Denmark (Section 106), France (Article L. 225-96 of the Commercial Code), Finland (Companies Act, Chapter 5, Section 30) and Sweden (Chapter 7, Section 42) a 2/3 majority of both the votes cast and represented at the meeting is required. Unanimity is sometimes required in exceptional circumstances (e.g. change of nationality, increasing the obligations of shareholders, etc...).

Secondly, Part II contains provisions on shareholder exit. In traded companies minority shareholders or individual shareholders are, in principle, always able to leave the company by selling their shares if they feel oppressed by the majority. Even the threat of leaving the company ("vote with one's feet") may force the majority not to misuse their position. Thus, in traded companies, exit is a powerful means to protect shareholders against misconduct by majorities. In non-traded companies and even more significantly in private companies (and closed companies which are public) exit rights are also effective regarding protection of minorities. Exit rights may oblige the company to redeem the shareholders' shares or require other shareholders (the majority) to redeem the shareholders' shares.

Provisions which force the majority shareholders to redeem shares of the minority in case of abuse are found, for example, in Denmark (Companies Act Section 362 (2)), Finland (Chapter 18) and Sweden (Chapter 29, Section 4). On the other hand, there are also provisions which force an abusive shareholder to sell his shares to the other shareholders or to the company. Such a provision is found, for example, in the Danish Companies Act Section 362(3).

A number of Member States' Companies Acts also include general provisions on squeeze-out/sell-out rights which are not conditional on abusive conduct. Thus, for example, the Danish Companies Act Section 69-73 contain provisions according to which shareholders who own more than 90 % of the capital and the votes may demand the other shareholders to let their shares be purchased/sold by that shareholder. The minority has a corresponding right. Similar provisions are found in Finland (Chapter 18) and in Sweden (Chapter 22, Section 1 and the following Sections). Even if the purpose of squeeze-out/sell out rights also goes further than minority protection - for example to facilitate restructuring of companies – squeeze-out/sell-out rights may also be seen as a part of minority protection. Other Member States, such as France and Italy, do not recognize such right and allow only damages or nullification of a decision to protect minority shareholders. The EMCA Group considers that sell-out right is a modern and powerful protection tool for minority shareholders in closed companies. Therefore, in the EMCA, a minority may use the sell-out right for protection without having to prove actual misuse by the majority. Therefore, the provisions on squeeze-out/sell-out rights are included in Chapter 11. The sell-out right is also part of the regulation of groups (See Chapter 15).

The rules on squeeze-out/sell-out rights regarding takeovers, which are found in Article 15 and 16 of the Takeover Directive are in most Member States implemented by securities regulation. However, a number of Member States have also implemented rules on squeeze out/sell out in the Companies Acts in connection with traded companies, e.g. the Danish Companies Act Section 70 and following sections. Several Member States apply the squeeze-out/sell-out right to public as well as private companies. Thus, squeeze-out can be performed by a shareholder, who holds securities representing at least 90 % of the capital carrying voting rights of a company and 90 % of the voting rights in the offeree company. This is the case in a number of Member States, among them Denmark, Finland, Sweden and the UK. In other Member States like Belgium, France, Germany, Italy and the Netherlands, the required majority is 95 % of the capital carrying voting rights of a company. In Belgium, France and Italy, the rules on squeeze out apply only to listed companies. In most Member States, also the minority has a right to sell out. However, this is not possible in Germany and the Netherlands. To sum up, the national rules on squeeze out/sell out rights vary substantially.

Thirdly, there are in the EMCA provisions on shareholders' derivative suits. It is up to the general meeting to decide on a director's possible liability towards the company. Often, the general meeting decides on discharge, meaning that the general meeting considers that there is no reason for director's liability. However, the minority may disagree. A number of Member States' Companies Acts contain provisions on derivative suits which allow a minority of shareholders to sue the directors on behalf of the company. Derivative suits are thus included in the Companies Act, for example in Denmark, France, Germany, Italy, Luxembourg (since 2016), Sweden and in the UK. Also the US Model Business Corporation Act (MBCA) has provisions on derivative suits in Chapter 7, Subchapter D.

Fourthly, provisions on special examiners, which are a powerful protection tool for minority shareholders, are found in a number of Member States' Companies Acts, such as the Danish Companies Act Section 150, the Finnish Companies Act Chapter 7, Section 7 and the Swedish Companies Act Chapter 10, Sections 21-23.

Finally, provisions on dissolution in connection with misuse of majority power are found in Part II. Dissolution is an ultimate sanction in case of majority misconduct. The provision on dissolution is however included in Chapter 14 on liquidation.

Part III contains provisions on shareholder liability.

3. Considerations

1. Generally the EMCA Group shares the view that company law, including the Chapter on general meetings, should encourage the shareholders to be active and improve their possibilities to act as the company's highest decision-making body. This is also stated in the EMCA in the general principle of shareholder democracy, in Chapter 1, Section 12. The approach of the EMCA is that the general meeting must take important decisions which concern the company. This is expressed by mandatory provisions in the Chapter on general meeting as well as in other chapters of the EMCA. Further, the articles of association may decide that certain decisions may only be taken by the general meeting. Shareholders should have the right to set any other issues on the agenda of extraordinary meetings.

The EMCA does not intend to challenge the governance system of those Member States which follow the German-oriented system whereby the competence of the general meeting is limited in that the general meeting cannot give instructions to the management board in public companies or deal with management decisions not required by the management board; see further below.

In order for shareholders to play an active role in the company, they must have the opportunity to participate in the general meeting. Older Companies Acts assumed that shareholders would be physically present. By means of an increased internationalization of ownership, this precondition is almost non-existent any more in large companies. Incentives are needed to ensure and facilitate that shareholders participate actively at the general meetings. Improvements should be made by the EMCA to ensure that shareholders have and take the opportunity to attend and vote at the meetings by allowing for electronic general meetings, use of proxies, etc.

Especially in large companies with many shareholders there is the risk of opportunistic behaviors from the board, such as undeserved golden-parachutes. The 2008 financial crisis has demonstrated that shareholders have not been able to hinder opportunistic behavior, especially related to directors' pay (remuneration). This situation demonstrates that there is a need to provide shareholders with the opportunity to comment or approve on directors' pay. The amended Shareholder Rights Directive, Article 9a-9b, introduces "say on pay" rules. A "say on pay" rule is already found in the EMCA, Chapter 8, Section 25.

In recent years there has been a big discussion about the role of institutional investors. Institutional investors are often the most powerful group of shareholders. They exercise their power at the general meeting. It has been discussed if the institutional investors should be obliged to use their votes and if the institutional investors' voting policy should be transparent. New editions of a number of national corporate governance codes, among them the UK Stewardship Code and the Dutch Eumedion best practices, recommend institutional investors to be transparent about the way they exercise their ownership/stewardship responsibilities, which in particular includes information about voting and engagement.

The Group has considered which way should be the most appropriate to enhance investors' role as active shareholders. According to the proposed amendments to the Shareholder Rights Directive there is clear evidence that the current level of monitoring of investee companies and engagement by institutional investors is sub-optimal. Therefore, the proposal encourages the institutional investors to be more active and long-term investors.

In that respect the EMCA Group has considered whether Chapter 11 on general meetings should include provisions especially on the role of institutional investors. Among other things, mandatory rules necessitate a precise definition of "institutional investors". On a European level this is extremely difficult. A way forward might be provisions in the legislation (law or other regulation) which applies to the institutional investors demanding them to disclose their voting policy etc. on comply or explain basis. According to the EU proposal above amending the Shareholder Rights Directive, articles 3 f(1) and 3 g(1) Member States shall ensure that institutional investors develop an engagement policy and disclose their investment strategy. The EMCA Group considers that these duties should be implemented in national law by special regulation regarding institutional investors. The impact on company law is, however, that the duties to be active shareholders presuppose that the shareholder's position at the general meeting makes it possible.

2. Typically, there are substantial differences between the governance systems in private, public and traded companies. In private companies and public companies where the shareholders are engaged in running the company, the general meeting (shareholders) is much more involved in the company's business than shareholders typically are in traded companies. There is a need for private companies (and some public companies) for shareholders to be able to act in the daily business, and also to be able to take decisions without a large formal and bureaucratic system. In traded companies there is a need for more formal regulation which secures the interests of shareholders, at least allowing them to take decisions of great importance for the company and be informed of the company's affairs. The rules in Chapter 11 on general meeting comprise private, public as well as traded companies but the rules should be adjusted to the need in each of the mentioned categories of companies. Especially, it should be mentioned that the Shareholder Rights Directive only applies to companies whose shares are traded on a regulated market. However, the EMCA Group considers that the special provisions on traded companies should also apply to companies with shares admitted to trading on alternative markets (e.g. AIM London, Nasdaq OMX…).

3. In some Member States the Companies Acts include special provisions on public companies with only one shareholder. This is for example the case in Poland. There are a number of special issues regarding general meeting in such companies. The formal requirements on general meetings including notice, agenda, conduct of the meeting etc. are obviously of no importance. The Group has considered whether the EMCA should contain special provisions regarding companies with only shareholder ? The Group is of the opinion that such provisions are not needed in general. Most of the provisions in the EMCA Chapter on general meetings do not apply to companies with only one shareholder. Especially regarding the proposal on the SUP company the EMCA Group is of the opinion that time has not come to implement special provisions on single-member companies in the EMCA.

4. As mentioned under national law there are different positions in the Member States regarding the competence of the general meeting in private, public and traded companies. En brief, according to the Companies Acts in some Member States, the position in public companies is that the general meeting may take any decisions and may also give instructions to the board. The opposite position is that the general meeting may not interfere with the boards' business decisions and may not give instructions to the board. Further, in some Member States (for example in the German AktG § 122(2)) there are restrictions regarding the shareholders' access to set issues on the agenda of the general meeting. In practice, however, the difference between the two positions has minimized in so far as the shareholders may dismiss the board at any time. The latter is the position of the EMCA; see above, Chapter 8, Sections 6 and 14.

In private companies, however, there is no similar distinction regarding the competence of the general meeting. Thus, for example, the German GmbHG § 46 includes a catalogue of decisions which should be taken by the general meeting unless the articles decide otherwise. However, the catalogue is not exhaustive. The general meeting has a fundamental competence to decide on all company matters.

Generally, the EMCA Group is of the opinion that for more reasons in public companies there should be *a division of work* between the general meeting and the company organs running the company's business. This is especially important in large (traded) companies. However, in the light of the recent developments, including the considerations in the Commission's Action Plan of 2012 and the amended Shareholder Rights Directive, there is a need to improve the shareholders' position versus the board – without eliminating the board's duties to run the company. However, the two positions – if pushed to extremes – are quite incommensurable. Therefore, Section 1 below contains alternative provisions.

Since the EMCA Chapter 11 comprises general meetings in all companies, i.e. private, public as well as traded companies, the rules are made flexible in order to secure shareholders' interest in formal general meetings and at the same time allow shareholders to decide on company matters without unnecessary bureaucracy. One of the most important means is to allow general meetings to take place without complying with the requirements of form and notice, see below in Section 2.

5. General meetings are a forum for shareholders' decisions but also for the company's (the board's) dialogue with the shareholders. Many companies with a large number of shareholders regularly invite their shareholders to attend "shareholder meetings" for information purposes only. Such meetings may be useful for the necessary dialogue with the shareholders, but the meetings are not a forum where decisions are taken. There may also be other types of shareholder meetings. For example, the German AktG § 127a contains a provisions on "shareholder's forum" which is a forum where shareholders or shareholders' associations invite other shareholders for the purpose of exercising their voting rights at a shareholders' meeting.

The need for dialogue with the shareholders is stressed in many Corporate Governance Codes. The EMCA Group agrees that shareholder meetings or shareholder meetings called by the company or the shareholders are useful means for dialogue. However, the Group is of the opinion that recommendations on such meetings should be left to the national Corporate Governance Codes. Besides, it is up to the company to decide, if a shareholder meeting – which is not a general meeting – should be established or the company for example prefers to communicate with the shareholders on the company's website; see below in Section 22.

6. The Group has considered which means for minority protection should be included in the EMCA. Chapter 11 part II should include provisions on decisions which should be taken with a super majority or even unanimously, see below in sections 27-29. A special problem in this regard arises because of the difference between systems. In one system the shareholders may demand that any item should be included on the agenda of the general meeting, and the general meeting may take any decision on company matters. This is the case, for example, in Nordic company law. In other systems, individual shareholders have no right to add items to the agenda and the general meeting is limited regarding which decisions the general meeting may take. See for example the German AktG §§ 122(2) and 119(2). An example of the consequences of this difference is the discussion whether there should be a provision defining certain important decisions which always should be made by the general meeting. This problem is illustrated by the well-known German *Holzmüller*-case, according to which, a decision on transferring business to a subsidiary should be taken by the general meeting. In some Member States the *Holzmüller*-case has initiated a discussion as to whether there should be a principle stating that extraordinary decisions, e.i. decisions which are not mentioned in the company law as situations where a decision by the general meeting is mandatory, must be made by the general meeting. The Group considers that it is important to secure the shareholders' influence, as mentioned. However, the Group is of the opinion that it should be as clear as possible when it is mandatory for the general meeting to make the decision. The balance may be obtained by a provision defining the meaning of very important decisions, see Section 29 below.

Further, the Group considers that the EMCA should include squeeze-out/sell-out rights, not only related to securities regulation but also to general provisions, see below in sections 35 and 36. The EMCA Group considers that squeeze out/sell out rights which are not contingent on proved misuse of the power of the majority represent useful tools to protect the minority.

A number of Member States have provisions on derivative suits. This is for example the case for Italy, for public companies in France (Article L. 225-252 of the Commercial Code), Germany (AktG § 148), Lithuania (Companies Act Article 16 Part 1 Item 5), the Nordic countries (Danish Companies Act § 364(3) and Sweden (Chapter 29, Section 9), Poland (CA Article 295), and the UK (CA Sections 260 and the following). The experiences in Member States, whose Companies Acts have provisions on derivative suits, vary. There are different explanations for this. The Group is of the opinion that an assessment of the rules should consider both the more and less complicated structure of the rules on derivative suits and the number of court cases. The Group has chosen to include simple rules on derivative suits – also taking into account that such rules should not only be judged upon the number of court cases but also upon the preventive effect of the rules.

The EMCA Group also stresses the protective effects of a rule which allow minority shareholders to ask for special examiners and in extreme situations a right of dissolution or liquidation. Therefore, the EMCA includes such provisions; see below Section 32.

JUDGMENT OF THE COURT (Grand Chamber)

23 October 2007 *

In Case C-112/05,

ACTION for failure to fulfil obligations under Article 226 EC, brought on 4 March 2005,

Commission of the European Communities, represented by F. Benyon and G. Braun, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Federal Republic of Germany, represented by M. Lumma and A. Dittrich, acting as Agents, assisted by H. Wissel, Rechtsanwalt,

defendant,

* Language of the case: German.

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann (Rapporteur), C.W.A. Timmermans, A. Rosas, K. Lenaerts and L. Bay Larsen, Presidents of Chambers, J.N. Cunha Rodrigues, R. Silva de Lapuerta, K. Schiemann, J. Makarczyk, E. Levits, A. Ó Caoimh and P. Lindh, Judges,

Advocate General: D. Ruiz-Jarabo Colomer,
Registrar: B. Fülöp, Administrator,

having regard to the written procedure and further to the hearing on 12 December 2006,

after hearing the Opinion of the Advocate General at the sitting on 13 February 2007,

gives the following

Judgment

1 By its application, the Commission of the European Communities asks the Court for a declaration that Paragraphs 2(1) and 4(1) and (3) of the Law of 21 July 1960 on the privatisation of equity in the Volkswagenwerk limited company (Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränk-

ter Haftung in private Hand, BGBl. 1960 I, p. 585, and BGBl. 1960 III, p. 641-1-1), in the version applicable to the present proceedings ('the VW Law'), infringe Articles 43 EC and 56 EC.

Legal context

The Law on public limited companies

2 Paragraph 134(1) of the Law on public limited companies (Aktiengesetz) of 6 September 1965 (BGBl. 1965 I, p. 1089; 'the Law on public limited companies'), as amended by the Law on the monitoring and transparency of companies (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich) of 27 April 1998 (BGBl. 1998 I, p. 786), provides:

'Voting rights shall be exercised by reference to the par value of shares or, in the case of no par value shares ('Stückaktien'), the number of shares held. In the case of unquoted companies, where one shareholder holds a large number of shares, the articles of association may restrict its voting rights by an absolute or progressive ceiling. ...'

3 Paragraph 101(2) of the Law on public limited companies provides:

'The right to appoint representatives to the supervisory board shall be laid down in the articles of association and such rights may be granted only to specified shareholders or to the holders of specified shares. In the case of the latter, the right of representation is granted only where the shares are par value and where their

transfer is subject to approval by the company. The shares of the shareholders having this right shall not belong to a specific category. In aggregate, the rights of representation granted shall not exceed one third of the number of members of the supervisory board appointed by the shareholders in accordance with the law or the articles of association. Paragraph 4(1) of the [VW Law] shall remain unchanged.'

The VW Law

4 Paragraph 1(1) of the VW Law states that the limited liability company, Volkswagenwerk, is to be converted into a public limited company ('Volkswagen').

5 Paragraph 2(1) of the VW Law, concerning the exercise of voting rights and the limitations on that right, provides:

'The voting rights of a shareholder whose par value shares represent more than one fifth of the share capital shall be limited to the number of votes granted by the par value of shares equivalent to one fifth of the share capital.'

6 Paragraph 3(5) of the VW Law, concerning representation for the exercise of voting rights, provides:

'At the general meeting, no person may exercise a voting right which corresponds to more than one fifth of the share capital.'

7 Paragraph 4 of the VW Law, headed 'The company's articles of association', is worded as follows:

'1. The Federal Republic of Germany and the Land of Lower Saxony may each appoint two members to the supervisory board on condition that they hold shares in the company.

...

3. Resolutions of the general meeting which, under the Law on public limited companies, require the favourable vote of at least three quarters of the share capital represented at the time of their adoption, shall require the favourable vote of more than four fifths of the share capital represented at the time of that adoption.'

The pre-litigation procedure

8 After giving the Federal Republic of Germany formal notice to submit to it its observations on Paragraphs 2(1) and 4(1) and (3) of the VW Law, the Commission delivered, on 1 April 2004, a reasoned opinion stating that those provisions of national law constituted restrictions on the free movement of capital and on the freedom of establishment guaranteed by Articles 56 EC and 43 EC respectively. Since that Member State did not adopt the measures necessary to comply with that opinion within the prescribed period, the Commission brought the present action, and submits in support of that action that, by maintaining those provisions in force, the Federal Republic of Germany is in breach of Articles 56 EC and 43 EC.

The action

9 The Commission asserts, in essence, that, first, by limiting, in derogation from the general law, the voting rights of every shareholder to 20% of Volkswagen's share capital, secondly, by requiring a majority of over 80% of the shares represented for resolutions of the general assembly, which, according to the general law, require only a majority of 75%, and thirdly, by allowing, in derogation from the general law, the Federal State and the Land of Lower Saxony each to appoint two representatives to the company's supervisory board, the disputed provisions of the VW Law are liable to deter direct investment and for that reason constitute restrictions on the free movement of capital within the meaning of Article 56 EC.

10 The Commission does not advance any particular argument for the purpose of establishing a breach of Article 43 EC.

11 The Federal Republic of Germany contests the merits of the Commission's plea alleging breach of Article 56 EC.

12 Since the Commission has not set out any views whatsoever on the plea alleging breach of Article 43 EC, the Federal Republic of Germany infers from this that that plea has become devoid of purpose.

Breach of Article 43 EC

13 According to settled case-law, national provisions which apply to holdings by nationals of the Member State concerned in the capital of a company established in

another Member State, giving them definite influence on the company's decisions and allowing them to determine its activities, come within the substantive scope of the provisions of the EC Treaty on freedom of establishment (see, inter alia, Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22; Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 31; and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paragraph 27).

14 In the present case, it is apparent from the file, in particular, from the Federal Republic of Germany's arguments in defence, that the provisions of the VW Law in dispute in the present proceedings address, at least in part, the situation of a possible takeover of Volkswagen by a shareholder seeking to exercise a controlling influence over the undertaking.

15 It must be stated, however, that the Commission did not advance any specific line of argument in support of any restriction on the freedom of establishment, either in its application or in its reply, or even at the hearing.

16 Accordingly, the Court must dismiss the action in so far as it is based on a breach of Article 43 EC.

Breach of Article 56 EC

17 According to consistent case-law, Article 56(1) EC generally prohibits restrictions on movements of capital between Member States (see, inter alia, Joined Cases C-282/04 and C-283/04 *Commission* v *Netherlands* [2006] ECR I-9141, paragraph 18 and the case-law cited).

18 In the absence of a Treaty definition of 'movement of capital' within the meaning of Article 56(1) EC, the Court has previously recognised the nomenclature set out in Annex I to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [article repealed by the Treaty of Amsterdam] (OJ 1988 L 178, p. 5) as having indicative value. Movements of capital within the meaning of Article 56(1) EC therefore include direct investments, that is to say, as that nomenclature and the related explanatory notes show, investments of any kind undertaken by natural or legal persons and which serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity (see, to that effect, Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, paragraphs 179 to 181, and Case C-157/05 *Holböck* [2007] ECR I-4051, paragraphs 33 and 34). As regards shareholdings in new or existing undertakings, as those explanatory notes confirm, the objective of establishing or maintaining lasting economic links presupposes that the shares held by the shareholder enable him, either pursuant to the provisions of the national laws relating to companies limited by shares or in some other way, to participate effectively in the management of that company or in its control (see *Test Claimants in the FII Group Litigation*, paragraph 182, and *Holböck*, paragraph 35; see also C-367/98 *Commission* v *Portugal* [2002] ECR I-4731, paragraph 38; Case C-483/99 *Commission* v *France* [2002] ECR I-4781, paragraph 37; Case C-503/99 *Commission* v *Belgium* [2002] ECR I-4809, paragraph 38; Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, paragraph 53; Case C-98/01 *Commission* v *United Kingdom* [2003] ECR I-4641, paragraph 40; Case C-174/04 *Commission* v *Italy* [2005] ECR I-4933, paragraph 28; and *Commission* v *Netherlands*, paragraph 19).

19 Concerning this form of investment, the Court has stated that national measures must be regarded as 'restrictions' within the meaning of Article 56(1) EC if they are liable to prevent or limit the acquisition of shares in the undertakings concerned or to deter investors of other Member States from investing in their capital (see *Commission* v *Portugal*, paragraph 45; *Commission* v *France*, paragraph 41; *Commission* v *Spain*, paragraph 61; *Commission* v *United Kingdom*, paragraph 47; *Commission* v *Italy*, paragraphs 30 and 31; and *Commission* v *Netherlands*, paragraph 20).

20 In the present case, the Federal Republic of Germany submits, in essence, that the VW Law is not a national measure within the meaning of the case-law referred to in the preceding three paragraphs. It also states that the disputed provisions of that Law, taken separately or as a whole, are not restrictions within the meaning of that case-law either.

21 The arguments put forward by the Commission in support of its plea alleging breach of Article 56 EC must be examined in the light of the above considerations.

The existence of a national measure

Arguments of the parties

22 The Federal Republic of Germany observes that the VW Law is based on an agreement which was entered into in 1959 between individuals and groups which, during the 1950s, had claimed rights in respect of the limited company Volkswagenwerk. At that time, the trade unions and the workers, on the one hand, and the Federal State and the Land of Lower Saxony, on the other, claimed rights in respect of that company. Under that agreement, the workers and the trade unions, in return for relinquishing their claim to a right of ownership over the company, secured the assurance of protection against any large shareholder which might gain control of the company.

23 The Federal Republic of Germany explains that the agreement was first expressed by the conclusion of a contract ('Staatsvertrag'), on 12 November 1959, between the

Federal State and the Land of Lower Saxony, and subsequently by the adoption, on the basis of that contract, of the Law of 9 May 1960 on the regulation of the legal situation of the Volkswagenwerk limited company (Gesetz über die Regelung der Rechtsverhältnisse bei der Volkswagenwerk Gesellschaft mit beschränkter Haftung, BGBl. 1960 I, p. 301), followed by the adoption, on 6 July 1960, of Volkswagen's articles of association, and finally, of the VW Law, which reproduced the rules already contained in those articles of association.

24 According to the Federal Republic of Germany, when it created and privatised the public limited company Volkswagen, the VW Law was merely expressing the will of the shareholders and all the other persons and all other groups which had laid claim to private rights over that undertaking. In relation to the free movement of capital, the Law in question should therefore be treated in the same way as an agreement between unit-holders. In accordance with the maxim *pacta sunt servanda*, this agreement, it submits, continues to be of the same value today.

25 The Commission takes the view that those historical considerations are irrelevant. Its criticism of the Federal Republic of Germany does not concern the reasons behind that Member State's legislative activity in 1960, but rather its current failure to legislate, inasmuch as the VW Law has for a long time fallen foul of the requirements of the free movement of capital.

Findings of the Court

26 Even if, as the Federal Republic of Germany submits, the VW Law does no more than reproduce an agreement which should be classified as a private law contract, it must be stated that the fact that this agreement has become the subject of a Law suffices for it to be considered as a national measure for the purposes of the free movement of capital.

27 The exercise of legislative power by the national authorities duly authorised to that end is a manifestation *par excellence* of State power.

28 The Court must point out, in addition, that the provisions of the Law at issue can no longer be amended solely at the will of the parties to the initial agreement, since any modification requires that a new Law be voted in in accordance with the constitutional law procedures of the Federal Republic of Germany.

29 That being so, the Court must reject the argument of the Federal Republic of Germany that the VW Law is not a national measure for the purposes of the free movement of capital.

The existence of restrictions

30 Having regard to the parties' arguments in relation to the first two complaints, and the cumulative effects of the two provisions of the VW Law which those complaints call in question, it is appropriate for the Court to examine the latter together.

The first and second complaints, based on the fact that the voting rights are capped at 20% and the blocking minority is fixed at 20%

— Arguments of the parties

31 As regards, first, the capping of the voting rights of every shareholder at 20% of Volkswagen's share capital, as laid down in Paragraph 2(1) of the VW Law, the

Commission maintains that this rule is at variance with the requirement that there be a correlation between shareholding and the related voting rights. Even if the capping of voting rights is a common instrument of company law, also used in other Member States, there is a considerable difference between the State making it possible to insert such an instrument into a company's articles of association, as is the case in German law for non-quoted public companies, and the State adopting, in its capacity of legislator, a provision to this end for one undertaking alone, and ultimately, for its own benefit, as is the case with Paragraph 2(1) of the VW Law.

32 The Federal Republic of Germany observes that, when Volkswagen was established, voting rights were capped at 0.01% for all shareholders, with the exception of the Federal State and the Land of Lower Saxony, which were entitled to exercise their rights in proportion to the 20% interest which each held. However, in 1970, this exceptional status in favour of the Federal State and the Land of Lower Saxony was abolished and the ceiling on voting rights was raised to 20%, to be applied without distinction to all shareholders. The Federal Republic of Germany goes on to state that, since then, the disputed provision of the VW Law has been applicable without distinction to all shareholders in Volkswagen. This legal framework can be distinguished, in this regard, from those which were at issue in the case-law to which the Commission refers for the purpose of establishing the existence of restrictions on the free movement of capital in the present case (*Commission* v *Portugal*, paragraph 36 and 44; *Commission* v *France*, paragraph 35 and 40; *Commission* v *Belgium*, paragraph 36; *Commission* v *Spain*, paragraphs 51 and 56; *Commission* v *United Kingdom*, paragraphs 38 and 43; and *Commission* v *Italy*, paragraph 26). This case-law, it is argued, concerned special rights established for the benefit of the State. According to the Federal Republic of Germany, any extension of the protection of the free movement of capital beyond the special rights of the State would stretch the scope of that freedom to infinity.

33 Disputing the view that there should be a correlation between the holding in a company's share capital and the voting rights of that company's shareholders, the Federal Republic of Germany submits that the national legislature is free to legislate

in the field of national company law and to lay down rules applicable to certain groups of companies, or indeed to one company alone, provided that such legislation does not give rise to any impediment.

34 As regards, secondly, fixing the blocking minority at 20%, the Commission maintains that, by requiring a majority of more than 80% of the capital represented for decisions of the general assembly which, according to general company law, require only a majority of at least 75%, Paragraph 4(3) of the VW Law enables the Land of Lower Saxony to block such decisions on the basis of the interest of approximately 20% which it has held since Volkswagen was privatised. According to the Commission, the requirement of a threshold in excess of 80%, while formally not appearing to be discriminatory, was created for the exclusive benefit of the public authorities.

35 The Commission accepts that the Law on public limited companies allows the percentages required to pass the resolutions referred to to be fixed at over 75%, but submits that this is a freedom which is left to shareholders, who can decide whether or not to avail themselves of it. By contrast, the threshold of 80% required under Paragraph 4(3) of the VW Law was imposed on Volkswagen's shareholders by the legislature in order to procure for itself, as the principal shareholder at the time, a blocking minority.

36 As a preliminary point, the Federal Republic of Germany argues that, as with the provision on the capping of voting rights at 20%, the provision of the VW Law at issue applies without distinction to all shareholders in Volkswagen. It considers therefore that, as the provision at issue does not confer any special rights on the State, it does not amount to a restriction on the free movement of capital.

37 The Federal Republic of Germany adds that neither the Law on public limited companies nor the relevant Community rules provide for a limit on the fixing of a blocking minority. The situation of the Land of Lower Saxony, as regards its ability to form a blocking minority, reflects the normal situation of a shareholder of its size. The Federal Republic of Germany states in this regard that, although the Land of Lower Saxony currently holds an interest of around 20% in Volkswagen's capital, that interest is the result of investments made on the market as a private investor.

— Findings of the Court

38 As the Federal Republic of Germany has observed, the capping of voting rights is a recognised instrument of company law.

39 It is common ground, moreover, that, while the first sentence of Paragraph 134(1) of the Law on public limited companies lays down the principle that voting rights must be proportionate to the share of capital, the second sentence thereof allows a limitation on the voting rights in certain cases.

40 However, as the Commission has correctly noted, there is a difference between a power made available to shareholders, who are free to decide whether or not they wish to use it, and a specific obligation imposed on shareholders by way of legislation, without giving them the possibility to derogate from it.

41 In addition, the parties are in agreement that the first sentence of Paragraph 134(1) of the Law on public limited companies, as amended by the Law on the control and transparency of companies, removed the possibility of inserting a limitation on

voting rights in the articles of association of listed companies. As the Commission has submitted, without being contradicted on this point by the German Government, since Volkswagen is a listed company, a ceiling on the voting rights cannot for that reason normally be inserted into its articles of association.

42 The Federal Republic of Germany submits that the limitation laid down in Paragraph 2(1) of the VW Law, since it applies without distinction to all shareholders, may be seen both as an advantage and as a disadvantage. While on the one hand there is the restriction on voting rights to which a shareholder holding more than 20% of the share capital is subject, on the other there is a corresponding protection against the influence of other possible shareholders having significant holdings, and thus, the guarantee of effective participation in the company's management.

43 Prior to assessing this argument, it is appropriate to examine the effects of the cap on voting rights alongside the requirement contained in Paragraph 4(3) of the VW Law of a majority of over 80% of the share capital in order to pass certain resolutions of the general assembly of Volkswagen's shareholders.

44 As the Commission has argued, without being contradicted by the Federal Republic of Germany, such resolutions include amendment of the company's articles of association, capital or financial structures, for which the Law on public limited companies fixes the required majority at a minimum of 75% of the share capital.

45 As the Federal Republic of Germany has observed, the percentage of 75% of the share capital provided for in the Law on public limited companies may be increased and fixed at a higher level by the particular company's articles of association. However, as the Commission has correctly noted, it is open to shareholders to

decide whether or not to make use of that power. Conversely, the fact that the threshold of the required majority has been fixed by Paragraph 4(3) of the VW Law at more than 80% of the capital results, not from the will of the shareholders, but, as was held in Paragraph 29 of the present judgment, from a national measure.

46 This requirement, derogating from general law, and imposed by way of specific legislation, thus affords any shareholder holding 20% of the share capital a blocking minority.

47 Admittedly, as the Federal Republic of Germany has stated, this power applies without distinction. In the same way as the cap on voting rights, it may operate both to the benefit and to the detriment of any shareholder in the company.

48 However, it is apparent from the file that, when the VW Law was adopted in 1960, the Federal State and the Land of Lower Saxony were the two main shareholders in Volkswagen, a recently privatised company, and each held 20% of its capital.

49 According to the information provided to the Court, while the Federal State has chosen to part with its interest in the capital of Volkswagen, the Land of Lower Saxony, for its part, still retains an interest in the region of 20%.

50 Paragraph 4(3) of the VW Law thus creates an instrument enabling the Federal and State authorities to procure for themselves a blocking minority allowing them to oppose important resolutions, on the basis of a lower level of investment than would be required under general company law.

51 By capping voting rights at the same level of 20%, Paragraph 2(1) of the VW Law supplements a legal framework which enables the Federal and State authorities to exercise considerable influence on the basis of such a reduced investment.

52 By limiting the possibility for other shareholders to participate in the company with a view to establishing or maintaining lasting and direct economic links with it which would make possible effective participation in the management of that company or in its control, this situation is liable to deter direct investors from other Member States.

53 This finding cannot be undermined by the argument advanced by the Federal Republic of Germany to the effect that Volkswagen's shares are among the most highly-traded in Europe and that a large number of them are in the hands of investors from other Member States.

54 As the Commission has argued, the restrictions on the free movement of capital which form the subject-matter of these proceedings relate to direct investments in the capital of Volkswagen, rather than portfolio investments made solely with the intention of making a financial investment (see *Commission* v *Netherlands*, paragraph 19) and which are not relevant to the present action. As regards direct investors, it must be pointed out that, by creating an instrument liable to limit the ability of such investors to participate in a company with a view to establishing or maintaining lasting and direct economic links with it which would make possible effective participation in the management of that company or in its control, Paragraphs 2(1) and 4(3) of the VW Law diminish the interest in acquiring a stake in the capital of Volkswagen.

55 This finding is not affected by the presence, among Volkswagen's shareholders, of a number of direct investors, which, according to the Federal Republic of Germany, is

similar to such a presence among the shareholders of other large undertakings. This circumstance is not such as to cast doubt on the fact that, because of the disputed provisions of the VW Law, direct investors from other Member States, whether actual or potential, may have been deterred from acquiring a stake in the capital of that company in order to participate in it with a view to establishing or maintaining lasting and direct economic links with it which would make possible effective participation in the management of that company or in its control, even though they were entitled to benefit from the principle of the free movement of capital and the protection which that principle affords them.

56 It must therefore be held that the combination of Paragraphs 2(1) and 4(3) of the VW Law constitutes a restriction on the movement of capital within the meaning of Article 56(1) EC.

The third complaint, based on the right to appoint two representatives to Volkswagen's supervisory board

— Arguments of the parties

57 The Commission submits that Paragraph 4(1) of the VW Law, allowing the Federal State and the Land of Lower Saxony each to appoint two representatives to the supervisory board of Volkswagen, on condition that they are shareholders in the company, derogates from the rule laid down in Paragraph 101(2) of the Law on public limited companies, to the effect that such a right may be inserted only into the articles of association and may concern only one third of the members of the supervisory board appointed by the shareholders, that is, three representatives in the case of Volkswagen. According to the Commission, by limiting the ability of the other shareholders to participate effectively in the management and control of that company, Paragraph 4(1) constitutes a restriction on the free movement of capital.

58 The Federal Republic of Germany submits that the supervisory board is merely a monitoring body and not a decision-making body. It goes on to state that the number of representatives on the supervisory board of Volkswagen is in proportion to the Federal Republic's holding in Volkswagen's capital, and that, in that respect, the Land of Lower Saxony's level of representation is lower than its holding in the capital. It claims that Paragraph 4(1) of the VW Law is also of no practical relevance to investment-related decisions.

— Findings of the Court

59 Under Paragraph 4(1) of the VW Law, the Federal State and the Land of Lower Saxony are each entitled, on condition that they are shareholders in the company, to appoint two representatives as members of the supervisory board of Volkswagen, that is, a total of four persons.

60 Such an entitlement constitutes a derogation from general company law, which restricts the rights of representation conferred on certain shareholders to one third of the number of the shareholders' representatives on the supervisory board. As the Commission has argued without being contradicted on this point, in the case of Volkswagen, the supervisory board of which comprises 20 members, 10 of whom are appointed by the shareholders, the number of representatives who may be appointed by the Federal State and the Land of Lower Saxony may not exceed a maximum of three according to general company law.

61 This right of appointment is therefore a specific right, which derogates from general company law and is laid down by a national legislative measure for the sole benefit of the Federal and State authorities.

62 The right of appointment conferred on the Federal State and the Land of Lower Saxony thus enables them to participate in a more significant manner in the activity of the supervisory board than their status as shareholders would normally allow.

63 Even if, as the Federal Republic of Germany has observed, the right of representation of that Land is not disproportionate to the interest which it currently holds in the share capital of Volkswagen, the fact remains that both that Land and the Federal State have the right to appoint two representatives to the supervisory board of Volkswagen on condition that they hold shares in that company, irrespective of the extent of their holdings.

64 Paragraph 4(1) of the VW Law thus establishes an instrument which gives the Federal and State authorities the possibility of exercising influence which exceeds their levels of investment. As a corollary, the influence of the other shareholders may be reduced below a level commensurate with their own levels of investment.

65 The fact that the supervisory board, as the Federal Republic of Germany submits, is not a decision-making body, but a simple monitoring body, is not such as to undermine the position and influence of the Federal and State authorities concerned. While German company law assigns to the supervisory board the task of monitoring the company's management and of providing reports on that management to the shareholders, it confers significant powers on that body, such as the appointment and dismissal of the members of the executive board, for the purpose of performing that task. Furthermore, as the Commission has pointed out, approval by the supervisory board is necessary for a number of transactions, including, in addition to the setting-up and transfer of production facilities, the establishment of branches, the sale and purchase of land, investments and the acquisition of other undertakings.

66 By restricting the possibility for other shareholders to participate in the company with a view to establishing or maintaining lasting and direct economic links with it such as to enable them to participate effectively in the management of that company or in its control, Paragraph 4(1) of the VW Law is liable to deter direct investors from other Member States from investing in the company's capital.

67 For the same reasons as those set out in paragraphs 53 to 55 of this judgment, this finding cannot be undermined by the Federal Republic of Germany's argument that there is a keen investment interest in Volkswagen shares on the international financial markets.

68 In the light of the foregoing, it must be held that Paragraph 4(1) of the VW Law constitutes a restriction on the movement of capital within the meaning of Article 56(1) EC.

69 The question of whether or not the Federal State and the Land of Lower Saxony make use of their right under Paragraph 4(1) is entirely irrelevant. It need merely be stated in this regard that the specific right, which derogates from the general law, conferred on those Federal and State authorities, to appoint representatives to the supervisory board of Volkswagen continues to exist in the German legal system.

Possible justification for the restrictions

Arguments of the parties

70 In the alternative, the Federal Republic of Germany submits that the provisions of the VW Law criticised by the Commission are justified by overriding reasons in the

general interest. That Law, which is part of a particular historical context, established an 'equitable balance of powers' in order to take into account the interests of Volkswagen's employees and to protect its minority shareholders. The Law thus pursues a socio-political and regional objective, on the one hand, and an economic objective, on the other, which are combined with objectives of industrial policy.

71 According to the Commission, which disputes the relevance of those historic considerations, the VW Law does not address requirements of general interest, since the reasons relied on by the Federal Republic of Germany are not applicable to every undertaking carrying on an activity in that Member State, but seek to satisfy interests of economic policy which cannot constitute a valid justification for restrictions on the free movement of capital (*Commission* v *Portugal*, paragraphs 49 and 52).

Findings of the Court

72 The free movement of capital may be restricted by national measures justified on the grounds set out in Article 58 EC or by overriding reasons in the general interest to the extent that there are no Community harmonising measures providing for measures necessary to ensure the protection of those interests (see *Commission* v *Portugal*, paragraph 49; *Commission* v *France*, paragraph 45; *Commission* v *Belgium*, paragraph 45; *Commission* v *Spain*, paragraph 68; *Commission* v *Italy*, paragraph 35; and *Commission* v *Netherlands*, paragraph 32).

73 In the absence of such Community harmonisation, it is in principle for the Member States to decide on the degree of protection which they wish to afford to such legitimate interests and on the way in which that protection is to be achieved. They may do so, however, only within the limits set by the Treaty and must, in particular, observe the principle of proportionality, which requires that the measures adopted

be appropriate to secure the attainment of the objective which they pursue and not go beyond what is necessary in order to attain it (see *Commission* v *Portugal*, paragraph 49; *Commission* v *France*, paragraph 45; *Commission* v *Belgium*, paragraph 45; *Commission* v *Spain*, paragraph 68; *Commission* v *Italy*, paragraph 35; and *Commission* v *Netherlands*, paragraph 33).

74 As regards the protection of workers' interests, invoked by the Federal Republic of Germany to justify the disputed provisions of the VW Law, it must be held that that Member State has been unable to explain, beyond setting out general considerations as to the need for protection against a large shareholder which might by itself dominate the company, why, in order to meet the objective of protecting Volkswagen's workers, it is appropriate and necessary for the Federal and State authorities to maintain a strengthened and irremovable position in the capital of that company.

75 In addition, as regards the right to appoint representatives to the supervisory board, it must be stated that, under German legislation, workers are themselves represented within that body.

76 Consequently, the Member State's justification based on the protection of workers cannot be upheld.

77 The same applies to the justification which the Federal Republic of Germany seeks to base on the protection of minority shareholders. While the desire to provide protection for such shareholders may also constitute a legitimate interest and justify legislative intervention, in accordance with the principles referred to in paragraphs 72 and 73 above, even if it were also liable to constitute a restriction on the free movement of capital, it must be held that, in the present case, such a desire cannot justify the disputed provisions of the VW Law.

78 It should be recalled, in this regard, that those provisions form part of a legal framework giving the Federal State and the Land of Lower Saxony the ability to exercise a greater level of influence than would normally be linked to their investment. However, the Federal Republic of Germany has not shown why, in order to protect the general interests of minority shareholders, it is appropriate or necessary to maintain such a position for the benefit of the Federal and State authorities.

79 It cannot be ruled out that, in certain special circumstances, the Federal and State authorities in question may use their position in order to defend general interests which might be contrary to the economic interests of the company concerned, and therefore, contrary to the interests of its other shareholders.

80 Finally, to the extent to which the Federal Republic of Germany contends that the activity of an undertaking as large as Volkswagen may have such an impact on the general interest that it justifies the existence of statutory guarantees which go beyond the control measures provided for under general company law, it must be pointed out that, even if this argument were well founded, that Member State has failed to explain, beyond setting out general considerations as to the risk that shareholders may put their personal interests before those of the workers, why the provisions of the VW Law criticised by the Commission are appropriate and necessary to preserve the jobs generated by Volkswagen's activity.

81 In the light of all the foregoing, the complaints relied on by the Commission alleging breach of Article 56(1) EC must be upheld.

82 Consequently, it must be held that, by maintaining in force Paragraph 4(1), as well as Paragraph 2(1) in conjunction with Paragraph 4(3), of the VW Law, the Federal Republic of Germany has failed to fulfil its obligations under Article 56(1) EC.

Costs

83 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has applied for costs to be awarded against the Federal Republic of Germany and the latter has, in essence, been unsuccessful, the Federal Republic of Germany must be ordered to pay the costs.

On those grounds, the Court (Grand Chamber) hereby:

1. **Declares that, by maintaining in force Paragraph 4(1), as well as Paragraph 2(1) in conjunction with Paragraph 4(3), of the Law of 21 July 1960 on the privatisation of equity in the Volkswagenwerk limited company (Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand), in the version applicable to the present dispute, the Federal Republic of Germany has failed to fulfil its obligations under Article 56(1) EC;**

2. **Dismisses the remainder of the action;**

3. **Orders the Federal Republic of Germany to pay the costs.**

[Signatures]

JUDGMENT OF THE COURT (First Chamber)

28 September 2006 *

In Joined Cases C-282/04 and C-283/04,

ACTIONS for failure to fulfil obligations pursuant to Article 226 EC, brought on 30 June and 1 July 2004 respectively,

Commission of the European Communities, represented by H. Støvlbæk, A. Nijenhuis and S. Noë, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Kingdom of the Netherlands, represented by H. G. Sevenster, J. van Bakel and M. M. de Grave, acting as Agents,

defendant,

* Language of the case: Dutch.

THE COURT (First Chamber),

composed of P. Jann (Rapporteur), President of Chamber, K. Schiemann, N. Colneric, K. Lenaerts and E. Juhász, Judges,

Advocate General: M. Poiares Maduro,
Registrar: R. Grass,

having heard the Opinion of the Advocate General at the sitting on 6 April 2006,

gives the following

Judgment

1 By its actions, the Commission of the European Communities asks the Court to hold that, by maintaining in the memorandum and articles of association of Koninklijke KPN NV and TPG NV certain provisions providing that the capital of those companies is to include a special share held by the Netherlands State, which confers on the latter special rights to approve certain decisions of the competent organs of those companies, the Kingdom of the Netherlands has failed to fulfil its obligations under Articles 56 EC and 43 EC.

Legal context

2 Under Article 2:8 of the Netherlands Civil Code (Burgerlijk Wetboek; 'the Burgerlijk Wetboek'), the exercise of the rights held by the holder of a special share is governed by the principles of reason and fairness. According to that provision:

'1. A legal person and those involved in its organisation by virtue of the law or its memorandum or articles of association must act towards each other in accordance with the requirements of the principles of reason and fairness.

2. A rule applicable between them by virtue of the law, custom, the memorandum or articles of association of the legal person, regulations or a decree shall have no effect in so far as, taking account of the circumstances, that would be unacceptable having regard to the criteria of reason and fairness.'

3 Article 2:92 of the Burgerlijk Wetboek provides:

'1. Save where otherwise provided in the company's memorandum or articles of association, all shares confer the same rights and obligations in proportion to their nominal value.

...

3. The memorandum or articles of association may provide that certain shares shall confer special rights described therein concerning the control of the company.'

Facts and pre-litigation procedure

4 In 1989, the Netherlands State undertaking for post, telegraph and telephone was transformed into a limited liability company called Koninklijke PTT Nederland NV ('PTT').

5 On the occasion of the partial privatisation of PTT, by the sale in 1994 of a first tranche of shares representing 30% of its capital and in 1995 of a second tranche representing a further 20%, the articles of association of the company were amended in order to introduce a special share, called a 'golden share', for the benefit of the Netherlands State.

6 In 1998, PTT was divided into two limited liability companies, namely Koninklijke KPN NV ('KPN') for telecommunications services and TNT Post Groep NV, which subsequently became TPG NV ('TPG'), for postal services.

7 On that division, the Netherlands State's special share in PTT was amended to give the State a special share in each of the two new companies ('the special shares at issue').

8 In principle, the Netherlands State could transfer its special shares to the company concerned or to another acquirer. In the latter case, the transfer would, under Article 17 of the articles of association of KPN and TPG, have to be approved by the board of directors and the supervisory board of that company.

9 The special shares at issue gives the Netherlands State special rights of prior approval of decisions of the organs of those two companies concerning the following points:

— the issuing of shares in the company (Article 12(1)(2) and (4) of the articles of association of KPN and TPG);

— the restriction or removal of any priority right of ordinary shareholders (Article 13(3) of the articles of association of KPN and TPG);

— the acquisition or disposal by the company of shares in its own capital representing more than 1% of the ordinary shares subscribed (Article 15(3) of the articles of association of KPN and TPG);

— the withdrawal of the special share (Article 16(3) of the articles of association of KPN and TPG);

— the exercise of voting rights attached to shares held in KPN Telecom BV or PTT Post Holdings BV (or in another legal person within the meaning of Article 4(1) of the Postal Law (Postwet) concerning proposals for dissolution, merger or demerger, the acquisition of shares in the company's own capital and amendment of the memorandum or articles of association concerning the powers of the general assembly of those companies in the areas mentioned above (Article 25(3)(a) of the articles of association of KPN and TPG);

— investments resulting in the company's own capital, calculated on a consolidated basis, representing less than 30% of the total resources of KPN (Article 25(3)(b) of the articles of association of KPN) or 15% of the total resources of TPG (Article 25(3)(b) of the articles of association of TPG);

— the distribution of dividends in shares of the company and/or a dividend from reserves (Article 36 of the articles of association of KPN and TPG);

— merger or demerger (Article 47(2)(a) of the articles of association of KPN and TPG);

— dissolution of the company (Article 47(2)(b) of the articles of association of KPN and TPG);

— amendment of the memorandum or articles of association of the company (Article 47(2)(c) of the articles of association of KPN and TPG) concerning in particular:

  — the company's objects, in so far as the amendment concerns the operation of concessions or authorisations;

  — the company's capital and the types of share in the company, where it is proposed to create a new type of shares, coupons or other rights over the results and/or the assets of the company or to cancel the special share or B preference shares;

— the transfer of the special share, and

— modification of the rights attached to the special share by virtue of Articles 12, 13, 15(3), 25(3), 36 and 47(2) of the articles of association of KPN and TPG, and,

— generally, any amendment prejudicial or contrary to the rights connected with the special share.

10 By the 'Afspraken op Hoofdlijnen KPN en TPG' (agreement with KPN and TPG), the Netherlands State undertook, first, to use the special share in KPN only if its interests as a major shareholder so required and, secondly, to use its special share in TPG only in the same circumstances or if protection of the general interest in the guarantee of universal postal service so required. The State also undertook not to use its rights derived from those special shares to shield the companies concerned against hostile takeover bids.

11 Between 1998 and the time-limit set in the reasoned opinion, namely 6 April 2003, the ordinary shareholding of the Netherlands State was progressively reduced to about 20% in KPN and 35% in TPG.

12 Having given the Kingdom of the Netherlands an opportunity to submit its observations, the Commission sent it two reasoned opinions on 6 February 2003, stating that the special shares held by the Netherlands State in KPN and TPG appeared to the Commission to be incompatible with Articles 56(1) EC and 43 EC. The Commission set the Netherlands a time-limit of two months within which to

adopt the measures necessary in order to comply with the reasoned opinions. Being dissatisfied with the replies of the Netherlands Government in its letters of 28 April 2003, the Commission brought these actions.

13 By order of the President of the First Chamber of 23 November 2005, Cases C-282/04 and C-283/04 were joined for the purposes of the oral procedure and judgment.

The actions

14 In support of each of its actions, the Commission makes two complaints, essentially claiming infringement of Articles 56(1) EC and 43 EC, on the ground that the Kingdom of the Netherlands holds the two special shares at issue in KPN and TPG, reserving to itself special rights of prior approval of certain management decisions of the organs of those two companies.

The complaints alleging infringement of Article 56(1) EC

Arguments of the parties

15 The Commission argues that the special shares at issue constitute obstacles to the free movement of capital for the purposes of Article 56(1) EC and that the special rights attached to those shares, even where intended to protect the general interest, are in any case disproportionate.

16 The Netherlands Government replies that those shares do not constitute obstacles to the free movement of capital. They cannot be described as 'State measures' falling within the scope of Article 56(1) EC. Moreover, they have an impact not on the acquisition of shares in the companies in question but only on certain questions concerning the management of those companies. They are not likely to deter investors from acquiring shares in those companies and have not in fact discouraged investment in any way. Even if a link were to be established between the special shares at issue and the decision to invest, such a link would be so uncertain and indirect that it could not be regarded as constituting an obstacle to the free movement of capital.

17 In the alternative, the Netherlands Government argues that the special share in TPG is in any event justified by an overriding reason in the general interest, namely the guarantee of universal postal service.

Findings of the Court

— The existence of obstacles

18 According to consistent case-law, Article 56(1) EC generally prohibits restrictions on movements of capital between Member States (see, to that effect, Case C-483/99 *Commission* v *France* [2002] ECR I-4781, paragraphs 35 and 40, and Case C-98/01 *Commission* v *United Kingdom* [2003] ECR I-4641, paragraphs 38 and 43).

19 In the absence of a definition in the EC Treaty of 'movements of capital' for the purposes of Article 56(1) EC, the Court has recognised the nomenclature annexed to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty (an article repealed by the Treaty of Amsterdam) (JO 1988 L 178, p. 5) as having indicative value. Movements of capital for the purposes of Article 56(1) EC thus include in particular direct investments in the form of participation in an undertaking through the holding of shares which confers the possibility of effectively participating in its management and control ('direct' investments) and the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking ('portfolio' investments) (see, to that effect, Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661, paragraph 21; *Commission* v *France*, paragraphs 36 and 37, and *Commission* v *United Kingdom*, paragraphs 39 and 40).

20 Concerning those two forms of investment, the Court has stated that national measures must be regarded as 'restrictions' within the meaning of Article 56(1) EC if they are likely to prevent or limit the acquisition of shares in the undertakings concerned or to deter investors of other Member States from investing in their capital (see to that effect, in particular, *Commission* v *France*, paragraph 41; Case C-174/04 *Commission* v *Italy* [2005] ECR I-4933, paragraphs 30 and 31; and Case C-265/04 *Bouanich* [2006] ECR I-923, paragraphs 34 and 35).

21 In the present case, the Court finds that the special shares at issue constitute restrictions on the free movement of capital provided for in Article 56(1) EC.

22 First of all, the introduction of the special shares at issue into the memorandum and articles of association of KPN and TPG is the result of decisions taken by the Netherlands State in the course of the privatisation of those two companies with a

view to reserving a certain number of special rights under the companies' statutes. In those circumstances, contrary to what the Netherlands Government argues, those shares must be regarded as State measures falling within the scope of Article 56(1) EC.

23 The Court further finds that the special shares at issue are likely to deter investors of other Member States from investing in KPN and TPG.

24 By virtue of those special shares, a series of very important management decisions of the organs of KPN and TPG, concerning both the activities of those two companies and their very structure (in particular questions of merger, demerger and dissolution), depend on prior approval by the Netherlands State. Thus, in the first place, as the Commission has rightly pointed out, those special shares confer on the Netherlands State an influence over the management of KPN and TPG which is not justified by the size of its investment and is significantly greater than that which its ordinary shareholding in those companies would normally allow it to obtain. Moreover, those shares limit the influence of other shareholders in relation to the size of their holding in KPN and TPG.

25 Furthermore, those special shares can be withdrawn only with the consent of the Netherlands State.

26 By making decisions of such importance subject to the prior approval of the Netherlands State and thereby limiting the possibility of other shareholders participating effectively in the management of the company concerned, the existence of those shares may have a negative influence on direct investments.

27 Similarly, the special shares at issue may have a deterrent effect on portfolio investments in KPN and TPG. A possible refusal by the Netherlands State to approve an important decision, proposed by the organs of the company concerned as being in the company's interests, would be capable of depressing the (stock market) value of the shares of that company and thus reduces the attractiveness of an investment in such shares.

28 Thus, the risk that the Netherlands State might exercise its special rights in order to pursue interests which do not coincide with the economic interests of the company concerned might discourage direct or portfolio investments in that company.

29 Finally, contrary to what the Netherlands Government argues, the Court does not find those restrictive effects to be either too uncertain or too indirect to constitute an obstacle to the free movement of capital.

30 The possibility cannot be excluded that, in certain particular circumstances, the Netherlands State might exercise its special rights in order to defend general interests, which might be contrary to the economic interests of the company concerned. The special shares at issue thus entail the real risk that decisions recommended by the organs of those companies as being in the economic interests of the latter may be blocked by that State.

31 Given the above, the special shares at issue constitute restrictions within the meaning of Article 56(1) EC.

— Possible justification for the obstacles

32 The free movement of capital may, however, be restricted by national measures justified on the grounds set out in Article 58 EC or by overriding reasons in the general interest (see, to that effect, Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 29), to the extent that there are no Community harmonising measures providing for measures necessary to ensure the protection of those interests (see, to that effect, in the context of the freedom to provide services, Case C-255/04 *Commission* v *France* [2006] ECR I-5251, paragraph 43, and case-law cited).

33 In the absence of such Community harmonisation, it is in principle for the Member States to decide on the degree of protection which they wish to afford to such legitimate interests and on the way in which that protection is to be achieved. They may do so, however, only within the limits set by the Treaty and must, in particular, observe the principle of proportionality, which requires that the measures adopted be appropriate to secure the attainment of the objective which they pursue and not go beyond what is necessary in order to attain it (see, to that effect, Case C-503/99 *Commission* v *Belgium* [2002] ECR I-4809, paragraph 45).

34 In this case, therefore, in order to assess whether the Commission's complaints are well founded, the Court needs to examine whether the special shares at issue, implying special rights of prior approval of certain management decisions of the organs of KPN and TPG, may be justified having regard to one of the reasons referred to in paragraph 32 of this judgment and whether those measures are proportionate to the objectives pursued.

35 With regard to the special share held in KPN, the Netherlands Government does not adduce any objective in the general interest capable of providing justification.

36 In those circumstances, the first complaint raised in Case C-282/04, claiming infringement of Article 56(1) EC, must be upheld.

37 Concerning the special share held in TPG, the Netherlands Government argues that it is necessary in order to guarantee universal postal service and, more particularly, in order to protect the solvency and continuity of TPG, which is the only undertaking currently capable in the Netherlands of providing that universal service at the level required by statute.

38 In that regard, the Court acknowledges that the guarantee of a service of general interest, such as universal postal service, may constitute an overriding reason in the general interest capable of justifying an obstacle to the free movement of capital (see, by analogy, Joined Cases C-388/00 and C-429/00 *Radiosistemi* [2002] ECR I-5845, paragraph 44).

39 However, the special share at issue goes beyond what is necessary in order to safeguard the solvency and continuity of the provider of the universal postal service.

40 As the Advocate General has rightly pointed out in points 38 and 39 of his Opinion, it should be noted, first, that the special rights of the Netherlands State in TPG are not limited to that company's activities as provider of a universal postal service. Moreover, the exercise of those special rights is not based on any precise criterion and does not have to be backed by any statement of reasons, which makes any effective judicial review impossible.

41 Having regard to the whole of the above, the first complaint in Case C-283/04, claiming infringement of Article 56(1) EC, must be upheld.

The complaints alleging infringement of Article 43 EC

42 The Commission also requests that the Kingdom of the Netherlands be held in breach of its obligations under Article 43 EC, on freedom of establishment, on the ground that the special shares at issue not only hinder direct and portfolio investments in KPN or TPG, but are also likely to hinder the taking of controlling holdings in those two companies, that is to say investments which confer a definite influence over the management and control of those companies (see, to that effect, Case C-208/00 *Überseering* [2002] ECR I-9919, paragraph 77 and case-law cited).

43 As the Advocate General has pointed out in point 41 of his Opinion, in so far as the special shares at issue entail restrictions on freedom of establishment, such restrictions are a direct consequence of the obstacles to the free movement of capital considered above, to which they are inextricably linked. Consequently, since an infringement of Article 56(1) EC has been established, there is no need for a separate examination of the measures at issue in the light of the Treaty rules concerning freedom of establishment (see, in particular, Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, paragraph 86).

44 Given the whole of the above, the Court finds that, by maintaining in the memorandum and articles of association of KPN and TPG certain provisions, providing that the capital of those companies is to include a special share held by the Netherlands State, which confers on the latter special rights to approve certain management decisions of the organs of those companies, which are not limited to cases where the intervention of that State is necessary for overriding reasons in the general interest recognised by the Court and, in the case of TPG in particular for ensuring the maintenance of universal postal service, the Kingdom of the Netherlands has failed to fulfil its obligations under Article 56(1) EC.

Costs

45 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has applied for costs and the Kingdom of the Netherlands has been unsuccessful in its pleas, the latter must be ordered to pay the costs.

On those grounds, the Court (First Chamber) hereby rules:

1. **By maintaining in the memorandum and articles of association of Koninklijke KPN NV and TPG NV certain provisions, providing that the capital of those companies is to include a special share held by the Netherlands State, which confers on the latter special rights to approve certain management decisions of the organs of those companies, which are not limited to cases where the intervention of that State is necessary for overriding reasons in the general interest recognised by the Court and, in the case of TPG NV in particular for ensuring the maintenance of universal postal service, the Kingdom of the Netherlands has failed to fulfil its obligations under Article 56(1) EC.**

2. **The Kingdom of the Netherlands is ordered to pay the costs.**

[Signatures]

JUDGMENT OF THE COURT (Third Chamber)

26 March 2009 *

In Case C-326/07,

ACTION under Article 226 EC for failure to fulfil obligations, brought on 13 July 2007,

Commission of the European Communities, represented by L. Pignataro-Nolin and H. Støvlbæk, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Italian Republic, represented by I.M. Braguglia, acting as Agent, assisted by P. Gentili, avvocato dello Stato, with an address for service in Luxembourg,

defendant,

* Language of the case: Italian.

THE COURT (Third Chamber),

composed of A. Rosas, President of Chamber, J.N. Cunha Rodrigues, J. Klučka, P. Lindh (Rapporteur) and A. Arabadjiev, Judges,

Advocate General: D. Ruiz-Jarabo Colomer,
Registrar: C. Strömholm, Administrator,

having regard to the written procedure and further to the hearing on 2 October 2008,

after hearing the Opinion of the Advocate General at the sitting on 6 November 2008,

gives the following

Judgment

1 By its application, the Commission of the European Communities asks the Court to declare that, by adopting the provisions contained in Article 1(2) of the Decree of the President of the Council of Ministers of 10 June 2004 defining the criteria for the exercise of the special powers referred to in Article 2 of Decree-Law No 332 of 31 May 1994, converted into law with amendments by Law No 474 of 30 July 1994 (decreto del Presidente del Consiglio dei Ministri, definizione dei criteri di esercizio dei poteri speciali, di cui all'art. 2 del decreto-legge 31 maggio 1994, n. 332, convertito, con

modificazioni, dalla legge 30 luglio 1994, n. 474), (GURI No 139, of 16 June 2004, p. 26, 'the Decree of 2004'), the Italian Republic has failed to fulfil its obligations under Articles 43 EC and 56 EC.

Legal context

Decree-Law No 332/1994

2 Decree-Law No 332 of 31 May 1994 providing for acceleration of the procedures for the disposal of the State's and public bodies' shareholdings in joint stock companies (Decreto-legge n. 332, norme per l'accelerazione delle procedure di dismissione di partecipazioni dello Stato e degli enti pubblici in società per azioni), (GURI No 126 of 1 June 1994, p. 38), was converted into law, with amendments, by Law No 474 of 30 July 1994 (GURI No 177 of 30 July 1994, p. 5). That Decree-Law was later amended by Law No 350 of 24 December 2003 relating to the provisions for drawing up the annual and pluriannual budget of the State (Finance Law for 2004) (legge n. 350, disposizioni per la formazione del bilancio annuale e pluriennale dello Stato (legge finanziaria 2004), Ordinary Supplement to GURI No 196 of 27 December 2003, 'Finance Law No 350/2003'). The Decree-Law, as converted and amended ('Decree-Law No 332/1994'), provides that the State is to hold special powers in certain companies ('special powers').

3 Article 2(1) of Decree-Law No 332/1994 provides:

'1. The President of the Council of Ministers shall determine, by decree adopted on a proposal of the Minister for Economic Affairs and Finance, in agreement with the Minister for Productivity and the competent sectoral ministers and after notification to the competent parliamentary committees, those companies controlled directly or indirectly by the State and operating in the defence, transport, telecommunications, energy resources and other public service sectors, the articles of association of which

are to stipulate that, prior to the adoption of any measure resulting in a loss of control, there shall be inserted, by resolution to that effect passed at an extraordinary general meeting of the company, a provision conferring on the Minister for Economic Affairs and Finance one or more of the following special powers, to be exercised in consultation with the Minister for Productivity …'

4 Those special powers are set out in Article 2(1)(a) to (d) as follows:

(a) power to oppose the acquisition by investors of significant shareholdings representing at least 5% of voting rights or a lower percentage fixed by decree of the Minister for Economic Affairs and Finance. For the expression of their opposition, the authorities have a period of 10 days from the date of the communication which must be made by the directors of the company concerned when the request is made for entry in the register of shareholders, while the transferee has 60 days in which to challenge the decision of the authorities before the competent court or tribunal;

(b) power to oppose the conclusion of contracts or agreements between shareholders representing at least 5% of voting rights or a lower percentage fixed by decree of the Minister for Economic Affairs and Finance. The periods of 10 and 60 days mentioned in subparagraph (a) are applicable to opposition by the authorities and to an action brought by the shareholders participating in the contracts or agreements concerned, respectively;

(c) power to veto resolutions for the dissolution of the company, transfer of the undertaking, merger, demerger, transfer abroad of the company headquarters, alteration of the company's objects, amendment of the articles of association removing or modifying the special powers. A period of 60 days is provided for challenging a veto;

(d) power to appoint a non-voting director.

5 It is clear from the application that a clause relating to the exercise of the special powers was introduced into the articles of association of, inter alia, ENI, Telecom Italia, Enel and Finmeccanica, companies governed by Italian law and operating in the petrochemical and energy, telecommunications, electricity and defence sectors, respectively.

6 Article 4(230) of Finance Law No 350/2003 provides that an ad hoc decree of the President of the Council of Ministers, on a proposal by the Minister for Economic Affairs and Finance and the Minister for Productivity, to be adopted within 90 days of the entry into force of that Law, is to determine the criteria for the exercise of the special powers, limiting their use exclusively to cases of harm to the vital interests of the State.

The Decree of 2004

7 Article 1(1) and (2) of the Decree of 2004 provides:

'1. The special powers referred to in Article 2 of Decree-Law No 332/1994 shall be exercised solely when justified by important and compelling reasons in the public interest concerning, more particularly, public policy, public security, public health and defence, and shall take the form of measures appropriate and proportionate to the protection of those interests, such as the application of appropriate time-limits, without prejudice to observance of the principles of domestic and Community law and, above all, of the principle of non-discrimination.

2. Without prejudice to the rules laid down in subparagraph 1, the special powers provided for in Article 2(1)(a), (b) and (c) of Decree-Law No 332/1994 shall be exercised in the following circumstances:

(a) real and serious risk of an interruption of the minimum national supply of energy and petroleum products or in the supply of related and subsequent services and, in general, of the supply of raw materials and goods essential to the public as a whole, and interruption of the supply of a minimum service in the telecommunications and transport sectors;

(b) real and serious risk to the continuous performance of obligations vis-à-vis the public as a whole in connection with the supply of a public service and to the performance of the duties entrusted to the company in order to serve the public interest;

(c) real and serious risk to the security of plant and networks in essential public services;

(d) real and serious risk to national defence, military security, public policy and public security;

(e) health emergencies.'

Pre-litigation procedure

8 The Commission initiated proceedings for a declaration of failure to fulfil obligations on account of infringement of Articles 43 EC and 56 EC concerning the conditions for the exercise of the special powers by sending a letter of formal notice to the Italian Republic on 6 February 2003. That Member State accordingly amended its legislation by adopting Finance Law No 350/2003 and the Decree of 2004. Taking the view, none the less, that the amendments so made were insufficient, the Commission sent it a further letter of formal notice on 22 December 2004.

9 After receiving the Italian Government's reply on 20 May 2005, the Commission, considering that it could not concur with the arguments in that reply, sent to the Italian Republic on 18 October 2005 a reasoned opinion dealing solely with the criteria fixed by Article 1(2) of the Decree of 2004, requesting that State to comply with the opinion within a period of two months from receiving it. In answer, the Italian Republic sent a note challenging, in substance, the Commission's analysis.

10 Considering that the situation remained unsatisfactory, the Commission brought the present proceedings.

The action

Arguments of the parties

11 According to the Commission, the Italian Republic's infringement of Articles 43 EC and 56 EC arises from the fact that the Decree of 2004 does not make sufficiently clear the

conditions for the exercise of the special powers. In the institution's opinion, those conditions do not enable investors to know in what situations the powers will be used.

12 The Commission thus maintains that the actual cases that may be covered by the concept of 'real and serious risk' appearing in Article 2(1)(a) to (d) are, potentially, numerous, undetermined and undeterminable. That want of precision in the determining of the specific objective circumstances which justify the State's recourse to the special powers gives those powers a discretionary nature, having regard to the latitude enjoyed by the Italian authorities. The result is to discourage investors generally, more specifically those contemplating settling in Italy with a view to exerting some influence on the management of the undertakings to which the legislation at issue applies.

13 The Commission observes that, given that Article 1(2) of the Decree of 2004 concerns the exercise of the special powers provided by Decree-Law No 332/1994, assessment of the proportionality of the Decree includes the examination of the lawfulness of those powers in particular situations.

14 The Commission accepts that freedom of establishment and free movement of capital may be restricted by national measures justified on the basis of Articles 46 EC and 58 EC or by overriding reasons in the public interest, but only in so far as there is no Community harmonising legislation providing for measures necessary to ensure the protection of the fundamental interests of the State.

15 With regard to the regulated sectors, such as those of energy, natural gas and telecommunications, the Commission considers that the object of protecting the fundamental interests of the State can be attained by adopting less restrictive measures, such as those provided for by the Community legislature. It cites in particular Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC (OJ 2003 L 176, p. 37), Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC (OJ 2003 L 176, p. 57), and Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and

services (Framework Directive) (OJ 2002 L 108, p. 33). The Commission emphasises that those directives provide for the implementation of measures designed to safeguard a minimum national supply in the spheres concerned. It argues that the Italian Republic does not explain why the protection of a minimum national supply in the sectors of the economy so regulated could not be guaranteed on the basis of those directives.

16 With regard to the non-regulated sectors, the Commission maintains that the Italian Republic has put forward no reasons for the application of the criteria at issue.

17 It notes, in addition, that there is no causal link between the need to guarantee the supply of energy and to provide public services, on the one hand, and the supervision of an undertaking's shareholding and management, on the other.

18 According to the Commission, the Decree of 2004 constitutes, therefore, an instrument which goes beyond what is necessary to defend the public interests to which it applies.

19 The Italian Republic states, first, that much of the Commission's analysis is devoted to the alleged unlawfulness of the special powers whose rules are fixed by Decree-Law No 332/1994. The breach of obligations referred to by the action and by the reasoned opinion relates to the Decree of 2004 alone, and not to Decree-Law No 332/1994. Consequently, the alleged unlawfulness of the special powers regime, laid down by that Decree-Law, is not covered by the present action.

20 According to that Member State, it follows that the essential part of the objections made by the Commission in its action cannot be upheld. The same applies to the objections

relating to the limits imposed by the Italian Republic on the acquisition of shares in the companies concerned, objections that concern the ownership of shares, that is to say, the structure of those companies. The Commission complains chiefly that the Italian Republic has introduced supervisory measures relating to that structure, and not measures making it possible to check specific management decisions. Those objections concern Decree-Law No 332/1994 and not the Decree of 2004.

21 The Italian Republic contends, therefore, that the heads of claim alleging that the measures are not proportionate to the special powers should be dismissed, given that that part of the action in fact relates to Decree-Law No 332/1994.

22 Secondly, the Italian Republic challenges the analysis made by the Commission in that the latter bases the core of its objections on an alleged infringement of Article 56 EC, relating to the free movement of capital, adding that those objections might equally be based on infringement of Article 43 EC, relating to freedom of establishment. According to the Member State, it is apparent from the Court's case-law, in particular from Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, that if a question can be examined from the point of view of freedom of establishment, it is impossible that it should fall within the scope of the free movement of capital.

23 Thirdly, the Italian Republic challenges the substance of the objection relating to the discretionary nature conferred on the special powers attributed to the national authorities by the provisions of the Decree of 2004.

24 Fourthly, that Member State disputes the Commission's arguments relating to the directives applicable to the regulated sectors. Those directives would be relevant only if

the action concerned Decree-Law No 332/1994, which lays down structural measures. The Decree of 2004, for its part, introduced no measure of that kind, but merely defined the circumstances and conditions for the adoption of the measures provided for by that Decree-Law. The Italian Republic maintains that, on any view, there is nothing to stop the Member States from adopting, in those essential sectors, measures creating powers to intervene going further even than the provisions of those directives.

25 The Italian Republic adds that the principle of subsidiarity must apply. Domestic legislation is more suitable than Community legislation for regulating situations presenting a risk to the vital interests of the State, situations that only the State can evaluate correctly and in good time.

26 In the other public-service sectors, which have not yet been subject to harmonisation, such as the national defence sector, a Member State is entitled to adopt measures for the purpose of confronting situations seriously damaging to the common good.

27 According to the Italian Republic, the only argument in the action to be taken into consideration is the alleged unforeseeability of the actual cases in which recourse may be had to the provisions of Decree-Law No 332/1994. However, that Member State argues that it is only when an investor appears that all the specific circumstances are identified and can be assessed. It concludes therefore that the conditions for the exercise of the special powers cannot be defined more precisely than they are in the Decree of 2004.

Findings of the Court

The subject-matter of the action

28 According to the Italian Republic, in a considerable part of its arguments the Commission in actual fact challenges not the criteria in the Decree of 2004 but the special powers introduced by Decree-Law No 332/1994, and seeks to have those powers held to be inconsistent with Community law. By so doing, those arguments extend the subject-matter of the dispute and are therefore inadmissible.

29 It is to be borne in mind here that the subject-matter of an action for a declaration of failure to fulfil obligations is delimited by the reasoned opinion and the application (see, to that effect, Case C-350/02 *Commission* v *Netherlands* [2004] ECR I-6213, paragraph 20 and the case-law cited). Given that in the instant case those two measures concern only the criteria fixed in Article 1(2) of the Decree of 2004, it must be held that the Commission has not extended the subject-matter of the dispute, with the result that the action is admissible.

30 The Commission has indeed developed certain arguments criticising the special powers introduced by Decree-Law No 332/1994, but it has not called the powers in question and challenges only the criteria enabling their exercise.

31 The alleged failure to fulfil obligations concerning only the criteria defined in Article 1(2) of the Decree of 2004, there is no need to rule on any point other than the compatibility of that provision with Community law.

The application of Articles 43 EC and 56 EC

32 The Commission takes the view that the infringement of which it complains must be examined in the light of Article 43 EC, relating to freedom of establishment, and of Article 56 EC, relating to free movement of capital.

33 As regards the question whether national legislation falls within the ambit of one or other of those freedoms, it is clear from well-established case-law that the purpose of the legislation concerned must be taken into consideration (see, to that effect, Case C-157/05 *Holböck* [2007] ECR I-4051, paragraph 22, and case-law cited).

34 Provisions of national law which apply to the possession by nationals of one Member State of holdings in the capital of a company established in another Member State allowing them to exert a definite influence on the company's decisions and to determine its activities fall within the ambit *ratione materiae* of the provisions of the EC Treaty on freedom of establishment (see, to that effect, in particular, Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22, and Case C-112/05 *Commission* v *Germany* [2007] ECR I-8995, paragraph 13).

35 Direct investments, that is to say, investments of any kind made by natural or legal persons which serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity fall within the ambit of Article 56 EC on the free movement of capital. That object presupposes that the shares held by the shareholder enable him to participate effectively in the management of that company or in its control (*Commission* v *Germany*, paragraph 18, and case-law cited).

36 National legislation not intended to apply only to those shareholdings which enable the holder to have a definite influence on a company's decisions and to determine its

activities but which applies irrespective of the size of the holding which the shareholder has in a company may fall within the ambit of both Article 43 EC and Article 56 EC (see, to that effect, *Holböck*, paragraphs 23 and 24). Contrary to what the Italian Republic maintains, *Cadbury Schweppes and Cadbury Schweppes Overseas* does not support the conclusion that in such a case only Article 43 EC is of relevance. That judgment, as its paragraph 32 makes clear, concerns only a situation in which a company holds shareholdings giving it control of other companies (see Case C-207/07 *Commission* v *Spain*, paragraph 36).

37 In this case, a distinction must be drawn, depending on whether the criteria are applied to the State's powers to oppose the acquisition of shareholdings and the conclusion of contracts by shareholders representing a certain proportion of voting rights or are applied to the power to veto certain company resolutions.

38 With regard, first, to the powers of opposition contained in Article 2(1)(a) and (b) of Decree-Law No 332/1994, it is clear from the documents before the Court that the proportion of at least 5% of voting rights or, as the case may be, a lesser percentage fixed by the competent minister has to enable the persons concerned to participate effectively in the management of the company in question, which is covered by Article 56 EC. It is conceivable, in respect of companies having in general large numbers of smaller shareholdings, that the holders of shareholdings corresponding to those percentages might have the power to influence in a definite manner the management of such a company and to determine its activities, which is covered by Article 43 EC, as the Italian Republic maintains. Furthermore, because Decree-Law No 332/1994 fixes a minimum percentage, that legislation is also designed to apply to holdings greater than that percentage which give an obvious power of control. It is therefore necessary to examine the criteria relating to the exercise of those powers of opposition in the light of those two Treaty provisions.

39 With regard, second, to the power of veto contained in Article 2(1)(c) of Decree-Law No 332/1994, that power clearly relates to decisions within the scope of the management of the company and therefore concerns only those shareholders capable of exerting a definite influence on the companies concerned, with the result that the criteria applying to the exercise of that power must be examined in the light of

Article 43 EC. Moreover, even if the effects of those criteria are restrictive of the free movement of capital, those effects would be the unavoidable consequence of any restriction on freedom of establishment and would not warrant independent examination in the light of Article 56 EC (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 33). Consequently, the criteria applying to the exercise of the power of veto must be examined solely from the point of view of Article 43 EC.

The criteria set out in Article 1(2) of the Decree of 2004 as they relate to the exercise of powers of opposition

— Failure to fulfil obligations under Article 56 EC

40 A preliminary point to note is that the criteria examined here determine the circumstances in which the powers of the State to oppose the acquisition of certain shareholdings or the conclusion of certain agreements of shareholders in the companies concerned may be exercised. It is apparent from the Court's case-law that the use of such powers may be contrary to the free movement of capital guaranteed by Article 56 EC (see, inter alia, Case C-98/01 *Commission* v *United Kingdom* [2003] ECR I-4641, paragraph 50, and *Commission* v *Spain*, paragraph 58). The point at issue in this case is whether those criteria fix conditions that make it possible to vindicate the exercise of such powers.

41 It is to be borne in mind, in this regard, that the free movement of capital may be restricted by national measures justified by the reasons set out in Article 58 EC or by overriding reasons in the public interest, in so far as there are no Community harmonising measures providing for measures necessary to ensure the protection of those interests (see *Commission* v *Germany*, paragraph 72, and case-law cited).

42 In the absence of such Community harmonisation, it is in principle for the Member States to decide on the degree of protection they intend to afford to such legitimate interests and on the way in which that protection is to be achieved. They may do so, however, only within the limits set by the Treaty and must, in particular, observe the principle of proportionality, which requires that the measures adopted should be appropriate to secure the attainment of the objective which they pursue and should not go beyond what is necessary in order to attain it (see *Commission* v *Germany*, paragraph 73, and case-law cited).

43 Furthermore, even in the spheres that have been harmonised, the principle of proportionality applies to those cases in which the Community legislature has left the Member States some discretion.

44 In the instant case, the Italian Republic and the Commission take points of view that differ on the issue whether the criteria applicable to the exercise of the powers of opposition to the acquisitions of shareholdings or to the conclusion of contracts by shareholders representing at least 5% of voting rights, or even a lesser percentage in certain cases, are such that that exercise is proportionate to the objectives pursued and so compatible with the freedom guaranteed by Article 56 EC.

45 It may be noted that the criteria at issue apply to common interests concerning, in particular, the minimum supply of energy resources and goods essential to the public as a whole, the continuity of public service, national defence, the protection of public policy and public security and health emergencies. The pursuit of such interests may, subject to observance of the principle of proportionality, warrant certain restrictions of the exercise of fundamental freedoms (see, inter alia, judgment of 14 February 2008 in Case C-274/06 *Commission* v *Spain*, paragraph 38).

46 However, as noted in paragraphs 42 and 43 above, the first requirement of observance of the principle of proportionality is that the measures taken should be appropriate for the purpose of attaining the objectives pursued.

47 Application of the criteria at issue as they relate to the exercise of the powers of opposition is not appropriate for the purpose of attaining the objectives pursued in the case in point, because there is no link between the criteria and the power.

48 The Court has earlier held that the mere acquisition of a holding of more than 10% of the capital of a company operating in the energy sector or any other acquisition conferring significant influence on such a company cannot, as a general rule, be regarded as a real and serious enough threat to security of supply (*Commission* v *Spain*, paragraphs 38 and 51).

49 In its written pleadings, the Italian Republic has provided no proof or even anything at all to show that the application of the criteria for the exercise of the powers of opposition makes it possible to attain the objectives pursued. At the hearing, that Member State did indeed cite several examples. Thus, it mentioned the possibility that a foreign operator with links to a terrorist organisation might seek to acquire substantial holdings in national companies in a strategic sector. It also raised the possibility that a foreign company controlling international energy transmission networks and having, in the past, used that position to create serious supply problems for bordering countries might buy shares in a national company. According to that Member State, the existence of precedents of that kind could justify opposition to the acquisition by such investors of significant holdings in the national companies concerned.

50 Such considerations do not, however, appear in the Decree of 2004, which mentions no specific objective circumstance.

51 The Court has previously held that a State's powers of intervention such as the powers of opposition in respect of which the criteria at issue determine the conditions for their exercise, which are not qualified by any condition, save for a reference to the protection of national interests, formulated in general terms and without any indication of the

specific objective circumstances in which those powers are to be exercised, constitute serious interference with the free movement of capital (see, to that effect, Case C-483/99 *Commission* v *France* [2002] ECR I-4781, paragraphs 50 and 51).

52 Those considerations are applicable to the present case. Even if the criteria at issue concern different kinds of public interests, they are formulated in a general and imprecise manner. What is more, the lack of any connection between the criteria and the special powers to which they relate increases the uncertainty surrounding the circumstances in which those powers may be exercised and gives them a discretionary nature, having regard to the latitude enjoyed by the national authorities in making use of them. Such latitude is disproportionate in relation to the objectives pursued.

53 Furthermore, the mere statement in Article 1(1) of the Decree of 2004 that the special powers must be used only in accordance with Community law cannot make the use of those criteria consistent with Community law. The general and abstract nature of those criteria is incapable of ensuring that the special powers will be exercised in accordance with the requirements of Community law (see, to that effect, Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, paragraphs 63 and 64).

54 Last, while the fact that the exercise of the special powers may be submitted to review by the national court, pursuant to Article 2(1)(a) to (c) of Decree-Law No 332/1994, is essential to the protection of persons having regard to the application of the rules on freedom of establishment, it cannot, on its own, suffice to make good the incompatibility with those rules of the criteria for the application of the special powers.

55 It is therefore to be declared that, by adopting the provisions in Article 1(2) of the Decree of 2004, the Italian Republic has failed to fulfil its obligations under

Article 56 EC, in so far as those provisions apply to the special powers provided for by Article 2(1)(a) and (b) of Decree-Law No 332/1994.

— Failure to fulfil obligations under Article 43 EC

56 In so far as the exercise of the powers of opposition also concern holdings conferring on their holders the power to influence in a definite manner the managements of the companies concerned and to determine their activities and may therefore restrict freedom of establishment, it must be considered that, for the same reasons as those set out above in the examination of the compatibility of the criteria in Article 1(2) of the Decree of 2004 with Article 56 EC, those criteria give the Italian authorities disproportionate discretion in the exercise of their powers of opposition.

57 It must consequently be declared that, by adopting the provisions in Article 1(2) of the Decree of 2004, the Italian Republic has failed to fulfil its obligations under Article 43 EC, in so far as those provisions apply to the special powers provided by Article 2(1)(a) and (b) of Decree-Law No 332/1994.

The criteria set out in Article 1(2) of the Decree of 2004 as they relate to the exercise of the power of veto

58 As mentioned in paragraph 39 above, the application of the criteria in Article 1(2) of the Decree of 2004 to the power to veto certain decisions has to be examined from the viewpoint of Article 43 EC alone.

59 The Commission takes the view that those criteria, so far as they are applicable to the power of veto, are disproportionate to the objective pursued and, accordingly, contrary to Article 43 EC. The Italian Republic challenges that analysis.

60 It must be held that, with regard to the companies concerned, resolutions for the dissolution of the company, transfer of the undertaking, merger, demerger, transfer abroad of the company headquarters, alteration of the company's objects and amendment of the articles of association removing or modifying the special powers relate to important aspects of the management of those companies.

61 It is possible that such decisions, which may affect the very existence of those companies, may impinge on the continuity of the public service or on the maintenance of a minimum national supply of goods essential to the public as a whole, which constitute public interests covered by the Decree of 2004.

62 There exists, therefore, a connection between the special power of veto and the criteria fixed in the Decree of 2004.

63 However, the circumstances in which that power may be exercised are not clear.

64 The Court has held, with regard to a right to oppose certain decisions to transfer or use as security the assets of companies operating in the oil sector, that the exercise of that right not being qualified by any condition limiting the wide discretion of the minister concerned regarding controls on the identity of the holders of those companies' assets, the system in question went beyond what was necessary in order to attain the objective pleaded, namely, the prevention of disruption of a minimum supply of petroleum products in the event of a real threat. The Court added that, failing any precise objective

criteria in the structure of the system, the legislation in question was disproportionate to the stated objective (*Commission* v *France*, paragraphs 52 and 53).

65 It falls to be ascertained whether similar considerations are applicable to the instant case.

66 The Decree of 2004 contains no details of the circumstances in which the criteria for the exercise of the power of veto provided by Article 2(1)(c) of Decree-Law No 332/1994 may be applicable. Even if that power may be exercised only in situations of real serious risk or health emergencies, in accordance with Article 1(2) of the Decree, and in observance of the conditions referred to in Article 1(1) of the Decree, that is to say, for reasons of public policy, public safety, public health and defence, investors do not know, for want of any information as to the actual circumstances permitting the exercise of the power in question, when the power of veto may be applicable. In consequence, it must be considered, as the Commission argues, that the situations allowing the exercise of the power of veto are potentially numerous, undetermined and undeterminable, and that they leave the Italian authorities broad discretion.

67 None the less, the Italian Republic argues that the principle of subsidiarity is applicable in the strategic areas concerned and that the Member States must keep a broad discretion, for they are best placed to deal with emergencies affecting the vital interests of the State. The directives issued in the regulated spheres, such as that of energy, lay down only minimum rules for the observance of public service requirements.

68 As pointed out in paragraph 43 above, even though those directives leave the Member States some leeway, especially in order to adopt measures in an emergency, the provisions they adopt must observe the limits drawn by the Treaty, in particular the principle of proportionality.

69 The Court has in particular accepted, with regard to bodies operating in the oil, telecommunications and electricity sectors, that the object of ensuring a secure supply of such services in the case of a crisis in the territory of the Member State concerned may constitute a reason of public security and, therefore, justify a restriction of a fundamental freedom (*Commission* v *Spain*, paragraph 71).

70 The Court has, nevertheless, ruled that if the Member States remain, in essential respects, free to fix, in keeping with their domestic needs, the requirements of public policy and public security, as grounds for derogating from a fundamental freedom, those requirements must be interpreted strictly, so that their scope cannot be determined unilaterally without any control by the institutions of the European Community. So, public policy and public security may not be invoked unless there is a genuine and sufficiently serious threat to a fundamental interest of society (see, inter alia, Case C-355/98 *Commission* v *Belgium* [2000] ECR I-1221, paragraph 28; Case C-54/99 *Eglise de scientologie* [2000] ECR I-1335, paragraph 17; and *Commission* v *Spain*, paragraph 47).

71 The Court has applied that analysis to an opposition system in force in Belgium in the energy sector, which covered certain decisions concerning the strategic assets of national companies, in particular energy supply networks, and specific management decisions relating to those companies, State intervention being possible only when there was a threat that the objectives of the energy policy might be compromised. The Court considered that that system was based on objective criteria amenable to judicial review and that the Commission had not shown that less restrictive measures could have been taken to attain the objective pursued (Case C-503/99 *Commission* v *Belgium* [2000] ECR I-4809, paragraphs 50 to 53).

72 In the circumstances of this case, however, as found in paragraph 66 above, the Decree of 2004 contains no details of the actual circumstances in which the power of veto may be exercised and the criteria it lays down are not, therefore, based on objective verifiable conditions.

73 As noted in paragraphs 53 and 54 above, the statement that the power of veto must be used only in accordance with Community law and the fact that its exercise may be subject to national judicial review cannot make the Decree of 2004 compatible with Community law.

74 It must therefore be declared that, by adopting the provisions in Article 1(2) of the Decree of 2004, the Italian Republic has failed to fulfil its obligations under Article 43 EC, in so far as those provisions apply to the special power provided by Article 2(1)(c) of Decree-Law No 332/1994.

Costs

75 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has applied for costs and the Italian Republic has been unsuccessful in its submissions, the latter must be ordered to pay the costs.

On those grounds, the Court (Third Chamber) hereby:

1. **Declares that, by adopting the provisions contained in Article 1(2) of the Decree of the President of the Council of Ministers of 10 June 2004 defining the criteria for the exercise of the special powers referred to in Article 2 of Decree-Law No 332 of 31 May 1994, converted into law with amendments by Law No 474 of 30 July 1994 (decreto del Presidente del Consiglio dei Ministri, definizione dei criteri di esercizio dei poteri speciali, di cui all'art. 2 del decreto-legge 31 maggio 1994, n. 332, convertito, con modificazioni, dalla**

legge 30 luglio 1994, n. 474), the Italian Republic has failed to fulfil its obligations:

— **under Articles 43 EC and 56 EC, in so far as those provisions apply to the special powers provided by Article 2(1)(a) and (b) of the Decree-Law, as amended by Law No 350 of 24 December 2003 relating to the provisions for drawing up the annual and pluriannual budget of the State (Finance Law for 2004) (legge n. 350, disposizioni per la formazione del bilancio annuale e pluriennale dello Stato (legge finanziaria 2004), and**

— **under Article 43 EC, in so far as those provisions apply to the special power provided by Article 2(1)(c) of the Decree-Law;**

2. Orders the Italian Republic to pay the costs.

[Signatures]

JUDGMENT OF THE COURT (First Chamber)

8 July 2010 *

In Case C-171/08,

ACTION under Article 226 EC for failure to fulfil obligations, brought on 21 April 2008,

European Commission, represented by E. Montaguti, M. Teles Romão and P. Guerra e Andrade, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Portuguese Republic, represented by L. Inez Fernandes, acting as Agent, and by M. Gorjão Henriques, advogado,

defendant,

* Language of the case: Portuguese.

THE COURT (First Chamber),

composed of A. Tizzano (Rapporteur), President of the Chamber, E. Levits, M. Ilešič, M. Safjan and M. Berger, Judges,

Advocate General: P. Mengozzi,
Registrar: M. Ferreira, Principal Administrator,

having regard to the written procedure and further to the hearing on 29 October 2009,

after hearing the Opinion of the Advocate General at the sitting on 2 December 2009,

gives the following

Judgment

1 By its application, the Commission of the European Communities seeks a declaration from the Court that, by maintaining special rights for the State and other public sector bodies in Portugal Telecom SGPS SA ('PT'), allocated in connection with the State's privileged ('golden') shares in PT, the Portuguese Republic has failed to fulfil its obligations under Articles 56 EC and 43 EC.

Legal context

National legislation

2 Article 15(3) of the Framework Law on Privatisations (Lei Quadro das Privatizaçoes) of 5 April 1990 (Diáro da República, Series I, No 80 of 5 April 1990) ('LQP') provides for the possibility of creating golden shares in the following terms:

'The legislative instrument referred to in Article 4(1) (approving the articles of association of the undertaking to be privatised or transformed into a public limited company) may also, in exceptional cases, where grounds of national interest so require, provide for the existence of golden shares which are intended to remain the State's property and which, irrespective of their number, confer on the State a right of veto over amendments to the company's statutes and over other decisions in a particular field, duly specified in the articles of association.'

3 Article 20(1) of Decree-Law No 44/95 of 22 February 1995 on the first phase of privatisation provides:

'If [PT]'s statutes provide for the existence of shares with special rights, other than preferred dividend shares, the majority of those shares must be held by the State or other public sector shareholders.'

PT's articles of association

4 It is apparent from the file that, pursuant to Article 4(2) of the articles of association of PT, the share capital of the company is made up of 1 025 800 000 ordinary shares and 500 class A shares.

5 Under Article 5(1) of PT's articles of association, the majority of the class A shares must be held by the State or other public sector shareholders and those shares confer certain privileges, in the form of special rights, provided for in Articles 14(2) and 19(2) of those articles.

6 The latter provisions set out those special rights as follows:

— at least one third of the total number of directors, including the chairman of the board of directors, must be elected by a majority of the votes conferred on class A shares, that is to say, by the votes of the State and the other public sector shareholders;

— among the five or seven members of the executive committee chosen from the board of directors, one or two of those members respectively must be elected by a majority of the votes conferred on class A shares;

— the nomination of at least one of the directors elected to deal specifically with certain management questions must, in order to be approved, obtain a majority of the votes conferred on class A shares;

— no decision of the general meeting on the matters set out below may be approved against a majority of the votes corresponding to the class A shares:

  — the appropriation of net income for the year,

  — alterations to the articles of association and increases in share capital,

  — any limit on or abolition of priority rights,

  — fixing the parameters of increases in share capital,

  — the issue of bonds or other securities and fixing the value of those which the board of directors is entitled to authorise and the limitation or suppression of priority rights in respect of the issue of bonds convertible into shares and the fixing of the parameters by the board of directors for the issue of those types of bonds,

— relocation of its registered office anywhere within the national territory,

— approval of the acquisition of ordinary shares exceeding 10% of the share capital by shareholders engaged in an activity which competes with those carried on by companies controlled by PT, and

— in addition, a majority of the votes corresponding to the class A shares shall be necessary as regards decisions approving the general objectives and fundamental principles of PT's policies or defining the general principles of its policy in respect of the acquisition and disposal of shareholdings in companies or groups, when the general meeting's prior authorisation is required.

Background to the dispute and the pre-litigation procedure

7 From 1992 an extensive process of restructuring took place in the Portuguese telecommunications sector which ended, in 1994, with the creation of PT, a share management holding company which came into being as a result of the merger of several wholly publicly-owned undertakings.

8 The process of privatising PT commenced in 1995. It was carried out in five successive phases, within the framework of the regime established by the LQP.

9 On 4 August 1995, at a time at which the Portuguese State held 54.2% of PT's share capital, the articles of association of that company were adopted.

10 On conclusion of the fifth phase of privatisation, all of the public shareholdings in PT were sold except for 500 class A shares, to which, pursuant to Article 5(1) of PT's articles of association, special rights are attached and, in accordance with Article 20(1) of Decree-Law No 44/95, the majority of which are allocated to the State or other public sector shareholders.

11 On 19 December 2005, the Commission sent a letter of formal notice to the Portuguese Republic accusing it of having failed to fulfil its obligations under Articles 56 EC and 43 EC on the ground that the State and other public sector shareholders held golden shares with special rights in the share capital of PT.

12 Since it was not satisfied with the Portuguese Republic's response in its letter of 21 February 2006, on 10 April 2006 the Commission sent it a reasoned opinion inviting it to comply with that opinion within two months of its receipt. The Portuguese Republic replied by letter of 24 July 2006 disputing the alleged failure to fulfil its obligations.

13 Since it considered that the Portuguese Republic had not adopted the measures necessary to comply with the reasoned opinion, the Commission decided to bring the present action.

The action

Admissibility of the action

Arguments of the parties

14 In its defence, the Portuguese Republic disputes, at the outset, the admissibility of the action on two grounds. First, it submits that, since the Commission has not placed in the file either the legislative texts or PT's articles of association containing the provisions which embody the alleged infringement, it has not complied with the rules on the burden of proof and, therefore, has based its action on mere presumptions.

15 Second, it submits that the action is in part inadmissible in so far as, in its application, the Commission made new claims which did not form part of the reasoned opinion and, in doing so, extended the subject-matter of the proceedings, as defined in the pre-litigation procedure. In that regard, the Portuguese Republic refers, in particular, to the rules in the articles of association on the basis of which the State has a greater influence over the choice of the members of the executive committee or holds special powers such as a right of veto over decisions relating to the sale of substantial assets, mergers with other companies and changes in the ownership of the company.

16 The Commission rejects all those contentions.

17 First, as regards the burden of proof, the Commission essentially submits that, in so far as it is the Portuguese Republic which is accused of the infringement and not PT, proof of the infringement needs to relate to the conduct of the Portuguese State rather than PT's articles of association. Thus, it is not necessary for the Commission to produce those articles of association to prove the alleged infringement. In any event, the Portuguese Republic itself admitted, in its response to the letter of formal notice, that the provisions of those articles existed as well as the special rights of the State laid down therein, and it contested the infringement which it is alleged to have committed specifically on the basis of those provisions.

18 Second, as regards the alleged extension of the subject-matter of the proceedings, the Commission submits that the investigation phase of the infringement procedure seeks to identify factual and legal material which is sufficient to support its suspicions of an infringement and not to deal with all of the elements constituting the infringement in an exhaustive and detailed manner. The Commission thus considers that, in the pre-litigation procedure, it was entitled to restrict itself to making a general reference to the special powers of the State in PT and then to state the content of its claims in the application.

Findings of the Court

19 In relation to the first plea of inadmissibility, it should be noted at the outset that, in accordance with established case-law, in proceedings for failure to fulfil an obligation under Article 226 EC it is for the Commission, which must prove the existence of the alleged infringement, to provide the Court with the evidence necessary for it to establish that the obligation has not been fulfilled, and, in so doing, the Commission may not rely on any presumption (see, inter alia, Case C-434/01 *Commission* v *United Kingdom* [2003] ECR I-13239, paragraph 21, and Case C-342/05 *Commission* v *Finland* [2007] ECR I-4713, paragraph 23).

20 Although it is true that the Commission did not annex to its application the full text of the relevant national legislation or PT's articles of association, the fact none the less remains that, both in the application and the reasoned opinion annexed thereto, the Commission reproduced and explained on several occasions the content of the provisions of that legislation and the articles of association on which it based its action for failure to fulfil obligations.

21 In addition, as noted by the Advocate General in point 27 of his Opinion, the Portuguese Government has never denied either the existence of those provisions or their content, as described by the Commission both during the pre-litigation phase and in the proceedings before the Court. On the contrary, the Portuguese Government confirmed that, precisely on the basis of those texts, the Portuguese State held golden shares in PT with the special rights indicated by the Commission.

22 Moreover, reading the full text of PT's articles of association, submitted by the parties in response to an express request by the Court, has made it possible to confirm the truth of the Commission's claims in relation to the content of the provisions of those articles of association and the special rights held by the State.

23 In those circumstances, it cannot be considered that the Commission based its action on mere presumptions without providing the evidence necessary to enable the Court to assess the infringement which the Portuguese Republic is alleged to have committed.

24 Accordingly, the first plea of inadmissibility must be rejected as unfounded.

25 As regards the second plea of inadmissibility, it should be noted that, in accordance with settled case-law, the subject-matter of an action under Article 226 EC for failure to fulfil obligations is determined by the Commission's reasoned opinion, so that the action must be based on the same grounds and pleas as that opinion (see Case C-33/04 *Commission* v *Luxembourg* [2005] ECR I-10629, paragraph 36 and case-law cited).

26 However, that requirement cannot be stretched so far as to mean that in every case the statement of the objections expressly set out in the reasoned opinion and the form of order sought in the application must be exactly the same, provided that the subject-matter of the proceedings as defined in the reasoned opinion has not been extended or altered (see Case C-433/03 *Commission* v *Germany* [2005] ECR I-6985, paragraph 28, and Case C-484/04 *Commission* v *United Kingdom* [2006] ECR I-7471, paragraph 25).

27 It should be pointed out in this instance that the Commission neither extended nor altered the subject-matter of the proceedings as defined in the reasoned opinion.

28 In that regard, it is sufficient to note that, both in the operative part of the reasoned opinion and in the form of order sought in the application, the Commission clearly stated that it was accusing the Portuguese Republic of having failed to fulfil its obligations under Articles 43 EC and 56 EC on the ground that the State and other public sector shareholders held golden shares with special rights in PT.

29 Therefore, the fact that, in its application, the Commission set out in detail the complaints it had already made more generally in the letter of formal notice and the reasoned opinion, by referring to other special rights held by the Portuguese State in PT, did not alter the subject of the alleged infringement, and has thus had no effect on the scope of the proceedings (see, to that effect, Case C-185/00 *Commission* v *Finland* [2003] ECR I-14189, paragraphs 84 to 87).

30 In the light of the above, the second plea of inadmissibility raised by the Portuguese Republic must also be rejected and, consequently, the Commission's action must be declared admissible.

The failure to fulfil the obligations under Articles 56 EC and 43 EC

Arguments of the parties

31 First of all, in the Commission's submission, the creation of golden shares in PT is not a result of the normal application of company law and constitutes, in any event, a State measure which falls within the scope of Article 56(1) EC.

32 In that regard, the Commission submits that, contrary to the claims of the Portuguese authorities, the golden shares at issue cannot be regarded as being purely of a private nature. Although the special rights attached to them are provided for only in PT's articles of association, not only were those articles adopted at a time when the Portuguese State held control of the company, but they should also be considered in the light of the relevant provisions of the LQP and Decree-Law No 44/95. It is apparent from that legislation that the majority of the golden shares must be allocated to the State and remain the property of the State, since they are not transferable, unlike preferred shares under private law.

33 The Commission also submits that the allocation of golden shares to the State cannot fall outside the scope of Articles 56 EC and 43 EC, in accordance with Article 295 EC, which provides that the EC Treaty is in no way to prejudice the rules in Member States governing the system of property ownership. According to settled case-law (see, in particular, Case C-367/98 *Commission* v *Portugal* [2002] ECR I-4731, paragraph 48, and Case C-302/97 *Konle* [1999] ECR I-3099, paragraph 38), the Member States cannot plead their own systems of property ownership by way of justification for obstacles to the fundamental freedoms guaranteed by the Treaty, resulting from a system of administrative authorisation relating to privatised undertakings. Since the special rights at issue confer on their holders rights of veto in respect of numerous decisions which PT is required to adopt, they establish such a system of administrative authorisation.

34 Next, the Commission essentially claims that the fact that the Portuguese State holds special rights in PT obstructs both direct and portfolio investments in that company and, consequently, constitutes a restriction on the free movement of capital and the freedom of establishment.

35 In particular, those special rights restrict the possibility for shareholders to participate effectively in the management and control of that company in proportion to the value of the shares which they hold and deprives them of the power to adopt strategic decisions, such as those concerning, inter alia, the sale of substantial assets, significant amendments to the articles of association, mergers with other companies and changes in the ownership of the undertaking. Moreover, such special rights are liable to impede the acquisition of controlling shareholdings in PT, which is also incompatible with Article 43 EC.

36 Moreover, the Commission also states that the restrictions resulting from the special rights held by the Portuguese Republic in PT cannot be justified by any of the objectives invoked by the national authorities.

37 In the first place, as regards the need invoked by the Portuguese authorities to ensure the availability of the telecommunications network in the event of crisis, war or terrorism, the Commission considers that, contrary to the requirements of the case-law and, in particular, Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, paragraphs 71 and 72, those authorities have not shown the existence of a 'genuine and sufficiently serious threat to a fundamental interest of society' capable of justifying the shares at issue on grounds of public security and public policy.

38 In the second place, the Commission disputes the arguments of the Portuguese Republic that, since PT retained the management of the cable and copper-fibre networks as well as all wholesale and retail activities, the State's holding of special rights in PT is necessary to ensure a certain degree of competition on the telecommunications market. In the Commission's submission, if such an argument were to be followed, it would lead to the paradoxical situation of having to justify one infringement of Community competition law by another infringement of that law, in this case, namely that of relying on the contested restrictions to the fundamental freedoms guaranteed by the Treaty.

39 In the third place, given that the Portuguese Republic also makes reference to the need to avoid disruptions on the capital market, the Commission cites the case-law, and in particular *Commission* v *Portugal* (paragraph 52), according to which economic grounds cannot serve as justification for obstacles prohibited by the Treaty.

40 Finally, the Commission submits that, in any event, the restrictions in question contravene the principle of proportionality. The exercise of the special rights attached to the class A shares is not subject to any condition, except that such rights must be used solely where grounds of national interest so require. Even if the objectives invoked

by that Member State were lawful, granting it such discretionary powers would go beyond what is necessary to attain them.

41 The Portuguese Republic disputes the alleged infringement by submitting, first of all, that the shares at issue are merely preferred shares under private law which cannot be assimilated to golden shares. Decree-Law No 44/95 merely envisages the possibility of providing for golden shares in PT's articles of association, without requiring that they actually be created. Consequently, the existence of those shares can be attributed only to the will of the company itself and not that of the State.

42 Next, the Portuguese authorities claim that the holding of special rights by shareholders constitutes a fundamental right, which is characteristic of private law or of the law of commercial companies, which also has a basis in Article 295 EC. The Court is entrusted with the task of safeguarding those rights, even when their holders are public sector bodies. In support of that argument, those authorities recall that, in accordance with the Court's case-law, the protection of fundamental rights is a legitimate interest which, in principle, justifies a restriction of the obligations imposed by Community law (Case C-341/05 *Laval un Partneri* [2007] ECR I-11767, paragraphs 91 to 93).

43 Moreover, the Portuguese Republic submits, in the alternative, that, even supposing that the existence of the golden shares at issue were attributable to the State, it cannot however constitute a prohibited restriction for the purposes of Articles 56 EC and 43 EC, in the light of the fact that those shares do not constitute a State measure which seeks to regulate trade or to impede the free movement of services or capital. That Member State thus invites the Court to consider the application to the present case of the logic underlying the judgment in Joined Cases C-267/91 and C-268/91 *Keck and Mithouard* [1993] ECR I-6097. Given that the present case concerns non-discriminatory rules for the management of shareholdings in the company and not rules for

acquiring those shareholdings, it is not possible for there to be an infringement of the free movement of capital or of the freedom of establishment.

44 The Portuguese authorities also point out that, even supposing that the existence of special rights in PT constitutes a restriction on the fundamental freedoms guaranteed by the Treaty and invoked by the Commission, such a restriction is justified.

45 In their submission, that justification is based, first, on the fact that PT owns the major part of the infrastructure for transmitting and distributing telecommunications, which thus renders the holding of those special rights necessary on grounds of public security and public policy so as to safeguard the provision of telecommunications services in case of crisis, war, terrorism, natural disasters and other types of threat. In this regard, that Member State submits that, contrary to the Commission's reading of the judgment in *Commission* v *Spain*, the justification related to such grounds is not dependent on the existence of a current threat to a fundamental interest of society.

46 Second, the restriction in question is also justified by the need to ensure a certain degree of competition on the telecommunications market, and the need to prevent a possible disruption of the capital market, which constitute overriding reasons in the public interest.

47 Finally, according to the Portuguese Republic, the special rights allocated to the State are proportionate in the light of the objectives which they are intended to attain. Those rights are limited to particular situations defined in advance and are no different from a regime of retrospective opposition. Consequently, a regime has been put in place which is comparable to the one at issue in Case C-503/99 *Commission* v *Belgium* [2002] ECR I-4809, which the Court declared compatible with the Treaty.

Findings of the Court

– The failure to fulfil obligations under Article 56 EC

48 It should be noted, at the outset, that, according to consistent case-law, Article 56(1) EC generally prohibits restrictions on movements of capital between Member States (see, inter alia, Joined Cases C-282/04 and C-283/04 *Commission* v *Netherlands* [2006] ECR I-9141, paragraph 18 and case-law cited).

49 In the absence of a Treaty definition of 'movement of capital' within the meaning of Article 56(1) EC, the Court has acknowledged the indicative value of the nomenclature of movements of capital set out in Annex I to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the [EC] Treaty (article repealed by the Treaty of Amsterdam) (OJ 1988 L 178, p. 5). Thus, the Court has held that movements of capital within the meaning of Article 56(1) EC include in particular 'direct' investments, namely investments in the form of participation in an undertaking through the holding of shares which confers the possibility of effectively participating in its management and control, and 'portfolio' investments, namely investments in the form of the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the

management and control of the undertaking (see *Commission* v *Netherlands*, paragraph 19 and case-law cited).

50 Concerning those two forms of investment, the Court has stated that national measures must be regarded as 'restrictions' within the meaning of Article 56(1) EC if they are likely to prevent or limit the acquisition of shares in the undertakings concerned or to deter investors of other Member States from investing in their capital (see *Commission* v *Portugal*, paragraphs 45 and 46; Case C-483/99 *Commission* v *France* [2002] ECR I-4781, paragraph 40; *Commission* v *Spain*, paragraphs 61 and 62; Case C-98/01 *Commission* v *United Kingdom* [2003] ECR I-4641, paragraphs 47 and 49; Case C-174/04 *Commission* v *Italy* [2005] ECR I-4933, paragraphs 30 and 31; and *Commission* v *Netherlands*, paragraph 20).

51 In the present case, the Portuguese Republic disputes the classification of the contested measure as a national measure within the meaning of the case-law cited in the preceding paragraph, by maintaining that the preferred shares at issue are private in nature and that their introduction into PT's articles of association resulted solely from the will of the company and not that of the State.

52 In that regard, it is admittedly established that the LQP and Decree-Law No 44/95 merely allow for the possibility of providing for golden shares in PT's statutes, and that it is precisely in accordance with the provisions of the articles of association of that company, adopted pursuant to that legislation, that those shares were introduced and allocated to the State.

53 However, the fact remains that, as was confirmed at the hearing by the Portuguese authorities themselves, those provisions were adopted on 4 April 1995, namely not only immediately after the adoption of the decree-law, but in particular at a time when the Portuguese Republic had a majority holding in PT's share capital and thus exercised control over that company.

54 In those circumstances, it must be found that it is the Portuguese Republic itself which, first, in its capacity as legislature, authorised the creation of golden shares within PT and, second, in its capacity as a public authority, decided, pursuant to Article 15(3) of the LQP and Article 20(1) of Decree-Law No 44/95, to introduce golden shares in PT, to allocate them to the State and to define the special rights which they confer.

55 In addition, as stated by the Advocate General in point 62 of his Opinion, the creation of those golden shares is not the result of a normal application of company law since, in derogation from the Portuguese Commercial Companies Code, the golden shares provided for in PT are intended to remain the property of the State and are thus not transferable.

56 Therefore, the creation of those golden shares must be regarded as being attributable to the State and, consequently, falls within the scope of Article 56(1) EC.

57 Next, as regards the restrictive nature of the system whereby golden shares in PT are held by the State, which is provided for in the national legislation in conjunction with the articles of association of that company, such a system is liable to dissuade operators from other Member States from investing in the capital of that company.

58 Under that system, the approval of a considerable number of important decisions concerning PT, listed in paragraph 6 above and concerning both the acquisition of shareholdings exceeding 10% of PT's share capital and the management of the company, depends on the agreement of the Portuguese State given that, pursuant to PT's articles of association, those decisions cannot be approved without the majority of the votes conferred on class A shares.

59 In that regard, it is also necessary to point out that such a majority is required, in particular, for any decision amending PT's articles of association, with the result that the influence of the Portuguese State on PT can be weakened only with the consent of the State itself.

60 Thus, the Portuguese State's holding of those golden shares, in so far as it confers on that State an influence on the management of PT which is not justified by the size of its shareholding in that company, is liable to discourage operators from other Member States from making direct investments in PT since they could not be involved in the management and control of that company in proportion to the value of their shareholdings (see, inter alia, Case C-112/05 *Commission* v *Germany* [2007] ECR I-8995, paragraphs 50 to 52).

61 Similarly, the structuring of the special shares at issue may have a deterrent effect on portfolio investments in PT in so far as a possible refusal by the Portuguese State to approve an important decision, proposed by the organs of the company concerned as being in the company's interests, is in fact capable of depressing the value of the shares of that company and thus reduces the attractiveness of an investment in such shares (see, to that effect, *Commission* v *Netherlands*, paragraph 27).

62 In those circumstances, it must be found that the Portuguese State's holding of the golden shares at issue constitutes a restriction on the free movement of capital for the purposes of Article 56(1) EC.

63 Such a finding cannot be undermined by the arguments raised by the Portuguese authorities that Article 295 EC and the alleged logic underlying the judgment in *Keck and Mithouard* are applicable to the present case.

64 First, as regards Article 295 EC, which states that '[the] Treaty shall in no way prejudice the rules in Member States governing the system of property ownership', it is sufficient to note that, in accordance with settled case-law, that article does not have the effect of exempting the Member States' systems of property ownership from the fundamental rules of the Treaty and cannot, therefore, be relied on by way of justification for obstacles, resulting from privileges attached to the position of Member States as shareholders in privatised undertakings, to the exercise of the freedoms laid down in the Treaty (see *Commission* v *Spain*, paragraph 67 and case-law cited).

65 Second, as regards the judgment in *Keck and Mithouard*, it should be noted that the measures at issue are not comparable to the rules concerning selling arrangements which were found in that judgment not to fall within the scope of Article 28 EC.

66 According to that judgment, the application to products from other Member States of national provisions restricting or prohibiting, within the Member State of importation, certain selling arrangements is not such as to hinder trade between Member States so long as, first, those provisions apply to all relevant traders operating within the national territory and, second, they affect in the same manner, in law and in fact, the marketing of domestic products and of those from other Member States. The

reason is that the application of such provisions is not such as to prevent access by the latter products to the market of the Member State of importation or to impede such access more than it impedes access by domestic products (Case C-384/93 *Alpine Investments* [1995] ECR I-1141, paragraph 37).

67 In the present case, although the restrictions at issue apply without distinction to both residents and non-residents, it must none the less be held that they affect the position of a person acquiring a shareholding as such and are thus liable to deter investors from other Member States from making such investments and, consequently, affect access to the market (see *Commission* v *Spain*, paragraph 61 and case-law cited).

68 That said, it therefore needs to be examined whether and, if so, under what conditions the restriction at issue may be allowed on the basis of the justifications relied on by the Portuguese Republic.

69 According to settled case-law, national measures which restrict the free movement of capital may be justified on the grounds set out in Article 58 EC or by overriding reasons in the public interest, provided that they are appropriate to secure the attainment of the objective which they pursue and do not go beyond what is necessary in order to attain it (see Case C-112/05 *Commission* v *Germany*, paragraphs 72 and 73 and case-law cited).

70 First of all, as regards the justifications based on overriding interests in the public interest, raised by the Portuguese authorities, it should be noted that the Court has already held that, an interest in ensuring the conditions of competition on a particular market cannot constitute valid justification for restrictions on the free movement of

capital (*Commission* v *Italy*, paragraphs 36 and 37, and judgment of 14 February 2008 in Case C-274/06 *Commission* v *Spain*, paragraph 44).

71 Similarly, as regards the need to prevent a possible disruption of the capital market, it is sufficient to note, as the Commission does, that this objective constitutes an economic ground which, in accordance with settled case-law, cannot justify a restriction on the free movement of capital (see, inter alia, *Commission* v *Portugal*, paragraph 52).

72 Next, as regards the derogations permitted under Article 58 EC, it cannot be denied that the objective invoked by the Portuguese authorities to ensure the security of the availability of the telecommunications network in case of crisis, war or terrorism may constitute a ground of public security (see, by analogy, in relation to energy supply, Case C-274/06 *Commission* v *Spain*, paragraph 38) and possibly justify an obstacle to the free movement of capital.

73 However, it is established that requirements of public security must, in particular as a derogation from the fundamental principle of the free movement of capital, be interpreted strictly, so that their scope cannot be determined unilaterally by each Member State without any control by the institutions of the European Union. Thus, public security may be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest of society (see, inter alia, Case C-54/99 *Église de scientologie* [2000] ECR I-1335, paragraph 17).

74 Given that the Portuguese Republic merely raised that ground without stating why it considers that the State's holding of golden shares would make it possible to prevent

such an interference with a fundamental interest of society, a justification based on public security cannot be upheld in the present case.

75 For the sake of completeness, as regards the proportionality of the restriction at issue, it should be noted that, contrary to the claims of the national authorities, the exercise of the special rights which the holding of golden shares in PT confers on the Portuguese State is not subject to any specific and objective condition or circumstances.

76 Although Article 15(3) of the LQP states that the creation of golden shares in PT which confer special powers on the State is subject to the condition, which, moreover, is formulated in a rather general and imprecise manner, that grounds of national interest must so require, the fact, none the less remains that neither that law nor PT's articles of association lay down any criteria determining when those special powers may be exercised.

77 Thus, such uncertainty constitutes serious interference with the free movement of capital in that it confers on the national authorities, as regards the use of such powers, a latitude so discretionary in nature that it cannot be regarded as proportionate to the objectives pursued (see, to that effect, Case C-326/07 *Commission* v *Italy* [2009] ECR I-2291, paragraphs 51 and 52).

78 It must consequently be declared that, by maintaining in PT special rights, such as those provided for in its articles of association for the State and other public sector bodies, allocated in connection with the State's golden shares in PT, the Portuguese Republic has failed to fulfil its obligations under Article 56 EC.

– The failure to fulfil obligations under Article 43 EC

79 The Commission also seeks a declaration that the Portuguese Republic failed to fulfil its obligations under Article 43 EC, on the ground that the State's holding of golden shares in PT is liable to impede the acquisition of controlling shareholdings in that company.

80 In that regard, it is sufficient to note that, in accordance with settled case-law, in so far as the national measures at issue entail restrictions on freedom of establishment, such restrictions are a direct consequence of the obstacles to the free movement of capital considered above, to which they are inextricably linked. Consequently, since an infringement of Article 56(1) EC has been established, there is no need for a separate examination of the measures at issue in the light of the Treaty rules concerning freedom of establishment (see, inter alia, *Commission* v *Netherlands*, paragraph 43).

Costs

81 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs, if they have been applied for in the successful party's pleadings. Since the Commission has applied for the Portuguese Republic to be ordered to pay the costs and the latter has been unsuccessful, the Portuguese Republic must be ordered to pay the costs.

On those grounds, the Court (First Chamber) hereby:

1. **Declares that, by maintaining in Portugal Telecom SGPS SA special rights, such as those provided for in that company's articles of association for the State and other public sector bodies, allocated in connection with the State's golden shares in Portugal Telecom SGPS SA, the Portuguese Republic has failed to fulfil its obligations under Article 56 EC;**

2. **Orders the Portuguese Republic to pay the costs.**

[Signatures]

5th assignment (Capital doctrine)

After completing this seminar, students should have acquired knowledge in the following main issue of the topic:

Legal Capital Doctrine & EU Influence – The legal capital doctrine protects creditors by ensuring a company has a minimum capital. It was influenced by EU directives, which harmonizes the rules on capital maintenance.

Shareholders vs Creditors' Interests – Shareholders seek profit distribution, while creditors prioritize the repayment of debt. Their interests often conflict, particularly when assets are distributed or when the company faces financial difficulties.

Covenants in Creditor Protection – Covenants serve to protect creditors by setting limits on company actions that could affect their repayment ability. Common covenants include affirmative (obligations to perform certain actions) and negative (restrictions on certain activities) covenants.

Monetary & Non-monetary Contributions – Shareholders can contribute either monetary (cash) or non-monetary (assets like property or intellectual property) to the legal capital. The value of non-monetary contributions is usually determined by an independent expert to ensure fairness.

Alternatives for Creditor Protection – The concept of legal capital may be outdated, especially in low-capital companies like Slovakia's simple joint-stock company. Alternative mechanisms could include solvency tests, secured debt or guarantees to further protect creditors in startup environments.

Compulsory reading materials:

- CARSTEN GERNER-BEUERLE, C., SCHILLIG, M.: Comparative Company Law
- PATAKYOVÁ, M., GRAMBLIČKOVÁ, B., KISELY, I. : Current Changes in the Capital Doctrine – Report from Slovak Republic.

Related Case studies:

- C-560/16 E-ON Czech holding
- C-441/93 "Pafitis"
- C -89/09 Typou v Typou
- C-719/18 Vivendi v Mediaset

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CAPITAL DOCTRINE

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1

Outline of the lecture

- Capital doctrine in the EU
- Why should law deal with capital structures and capital doctrine?
- Legal capital in numbers
- Formation of legal capital
- Acquisition and redemption of own shares, financial assistance
- Distribution of assets
- Actions in case of serious loss of capital
- Unlawful distribution of assets

2

Capital doctrine in the EU

Funded by the European Union

- Former: Capital Directive
- Current: DIRECTIVE (EU) 2017/1132 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 June 2017 relating to certain aspects of company law
- *obligation to disclose information about the capital so the external person can observe the capital composition of the particular company*
  - *creation of the minimal legal capital*
  - *maintenance of the legal capital*
  - *equal treatment of shareholders (who are in the same position)* and
  - *procedures regulating the creditor protection if the legal capital is altered*

3

Why should company law deal with capital doctrine? I.

Funded by the European Union

- Different interests between shareholders and creditors
- Shareholders
  - want to get as many profit from the company as possible
  - Shareholders tend to be profit seeking and short-term oriented

4

Why should company law deal with capital doctrine? II.

Funded by the European Union

- Creditors
  - Want to get back their principal and interest
  - Creditors are interested in solvent companies
  - Adjusting creditors can protect themselves against behaviour of shareholders through covenants

5

Why should company law deal with capit doctrine? III.

Funded by the European Union

- **What are covenants?**
  - Contractual arrangements between company and creditor so the company must "do" something (positive covenants) or must "not to do" something (negative covenants)
  - Covenants result in behaviour limitations of shareholders
  - Positive covenants – reporting covenants, covenants regulating occasions, when there is a change in the business (merger, acquisitions, change in management)
  - Negative covenants – preventing the company to sell their assets, take more loans

6

Legal Capital in numbers

Funded by the European Union

- Legal capital in numbers
  - Directive: 25.000 EUR
    → public limited liability companies

  - What is minimum legal capital in your countries for other companies?
    - Slovakia
      → private limited liability company: 5.000 EUR
      → simple joint stock company: 1 EUR

7

Capital formation I.

Funded by the European Union

- Contributions into the legal capital
  - Monetary contributions
  - In-kind contributions

- Valuation of in kind contribution
  - What is an in kind contribution?
  - Why does it need to be valued?
    → True value off assets
    → Over pricing...

- Share
  - Nominal value of shares
  - Subscription price of share
  - Share premium (creation of reserve fund)

8

Capital formation II.

Funded by the European Union

- Considerations ineligible in payment for share
  - Work and services cannot be an in-kind contribution into public limited liability companies in EU (Directive)
  - In Slovakia this rule is applicable for all of the companies (is it same in your jurisdiction?
  - EMCA Section 2.11 – the same approach as in the Capital Doctrine: *"Any contribution of assets other than cash - a "non-cash contribution" - shall have a value that can be expressed as a monetary equivalent and shall not consist of an obligation to do work or perform services."*
  - In the US based on the Model Business Corporation Act (MBCA), § 6.21 shareholders may contribute to the company by *"services performed, contracts for services to be performed, or other securities of the corporation"*
  - Work and services as in-kind contributions may be beneficial for start-up companies
  - Problem? Valuation!

9

Acquisition and redemption of own shares, financial assistance I.

Funded by the European Union

- Acquisition of own shares by the company **was banned in many legal systems in Europe, as such procedure was considered to lower the legal capital of the company**
- Over the years the strict **rules were relaxed in order to enlarge the financing opportunities** and therefore, the acquisition of own shares by the company itself is allowed, however it falls under heavy regulation
- The main rule described in the Directive enshrines an **absolute ban on the original subscription of the shares by the company itself or by a person acting on behalf of the company**
- However, the possibility to trade with company's own shares **is permitted under the Directive and it is up to the Member State whether it will introduce such concept to its law**

10

Acquisition and redemption of own shares, financial assistance II.

Funded by the European Union

- If the legal system of a particular Member State **allows acquisition of own shares** by the company based on the Directive, the following rules shall be applicable:
  - there has to be authorization by a general meeting (general meeting shall determine the conditions and terms),
  - the acquisition may not have the effect of reducing the net assets below the subscribed capital plus the restricted equity,
  - only fully paid-up shares may be included in the transaction and
  - voting rights attached to the shares are suspended.

11

Acquisition and redemption of own shares, financial assistance III.

Funded by the European Union

- **Financial assistance means that the company directly or indirectly advances funds, makes loans or provides security with a view to the acquisition of its shares by a third party**
- Under the Directive the **Member States have a discretion to decide whether they want to prohibit or allow financial assistance**, and if they decide to allow it, than the requirements of the Directive shall apply
- **As to the redeemable shares, such shares are issued with initial intention that they *(i) will be* or *(ii) may be* redeemed in the future**
- Redeemable shares are voluntary under the Capital Directive

12

Distribution of assets/Specific regulation on distribution of restricted equity

Funded by the European Union

- Specific regulation is applied **when distribution of restricted equity (especially share capital) is in question**
- Share capital is (was?) **considered to be a tool for protection of creditors** (questionable mainly in connection with companies with share capital of 1 EUR) and thus must not be returned to shareholders without specific rules protecting creditors
- The **basic rules based on the Directive are as follows**:
  - *obligation to inform creditors that share capital is being decreased,*
  - *creditors, whose claims antedate the publication of the decision on the reduction shall at least have the right to obtain security* and
  - *no payment may be made for the benefit of the shareholders, until the creditors have obtained satisfaction.*

13

Distribution of assets/ Bankruptcy test

Funded by the European Union

- **Specific test under the Slovak law**
- Distribution of a profit or other own resources is prohibited, **if such distribution may cause company's bankruptcy**
- This test consists of
  a. **insolvency test**
  b. **test of a heavily indebted party**

- **Insolvency test** - after the distribution of assets - company will not be left with at least two outstanding monetary obligations to more than one creditor 90 days after their due date
- **Test of heavily indebted party** - the company is deemed heavily indebted if the value of its obligations exceeds the value of its assets and the company has more than one creditor (plurality of creditors)

14

Who decides about the distribution?

Funded by the European Union

- Depends on **national rules** and **assets distributed** (restricted/unrestricted equity)
- Usually?

- **Distribution of unrestricted equity (profit, free funds)**
  - Proposal is made by board of directors (they will perform all the tests and usually bear liability for performing the test correctly)
  - General meeting makes the final decision

- **Distribution of restricted equity (share capital, reserve fund)**
  - Share capital – special procedure
  - Reserve fund – due to a specific purpose – to cover the losses of the company – board of directors

15

Actions in serious loss of capital

Funded by the European Union

- In case a serious loss of capital (higher than half of the subscribed capital) takes place **general meeting must be called to decide about the measures**
- A majority of the Member States have implemented the Directive as a **mere duty to call a meeting of shareholders**
- A third of the Member States, however, **goes beyond this minimum requirement and implemented other measures** – obligation to re-capitalise the company or winding down its operations and liquidating the company (so called *re-capitalise or liquidate* rule)

16

Unlawful distribution of assets



- Unlawful distribution of assets occurs when **the assets are distributed from the company in contravention of the law** – rules regulating the maintenance of the capital, as well as other rules of company law and, more generally, the legal system
- If an unlawful distribution takes place the Directive stipulates that
  - ***"Any distribution … must be returned by shareholders who have received it if the company proves that those shareholders knew of the irregularity of the distributions made to them, or could not in view of the circumstances have been unaware of them."***
- **The burden of proof is on the side of the company**, which means that if unlawful distribution takes place a shareholder is presumed to be innocent and the company needs to prove that he knew that such a distribution was unlawful
- Consequently, in the majority of cases **it is very difficult to furnish evidence of the shareholder's bad faith**

17



THANK YOU FOR YOUR ATTENTION!

Subject European Company Law was supported by project: Jean Monnet Actions - GRANT AGREEMENT - Project 101176603 — EU Tax and Corporate Law

18

Reports of Cases

JUDGMENT OF THE COURT (First Chamber)

7 March 2018*

(Reference for a preliminary ruling — Regulation (EC) No 44/2001 — Jurisdiction in civil and commercial matters — Exclusive jurisdiction — Article 22(2) — Validity of decisions of the organs of companies or legal persons having their seat in the territory of a Member State — Exclusive jurisdiction of the courts of that Member State — Decision of the general meeting of a company ordering the compulsory transfer to that company's principal shareholder of the shares held by the company's minority shareholders and determining the consideration to be paid to them by the principal shareholder — Judicial procedure for reviewing the reasonableness of that consideration)

In Case C-560/16,

REQUEST for a preliminary ruling under Article 267 TFEU from the Nejvyšší soud (Supreme Court, Czech Republic), made by decision of 20 September 2016, received at the Court on 4 November 2016, in the proceedings

E.ON Czech Holding AG

v

Michael Dědouch,

Petr Streitberg,

Pavel Suda,

intervener:

Jihočeská plynárenská, a.s.,

THE COURT (First Chamber),

composed of R. Silva de Lapuerta (Rapporteur), President of the Chamber, J.-C. Bonichot, A. Arabadjiev, S. Rodin and E. Regan, Judges,

Advocate General: M. Wathelet,

Registrar: A. Calot Escobar,

having regard to the written procedure,

* Language of the case: Czech.

after considering the observations submitted on behalf of:

– E.ON Czech Holding AG, by D. Vosol, advokát,

– Mr Dědouch, Mr Streitberg and Mr Suda, by P. Zima, advokát,

– the Czech Government, by M. Smolek and J. Vláčil, acting as Agents,

– the European Commission, by M. Heller and J. Hradil, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 16 November 2017,

gives the following

Judgment

1 The present request for a preliminary ruling concerns the interpretation of Article 5(1)(a) and (3) and Article 22(2) of Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (OJ 2001 L 12, p. 1).

2 The request has been made in proceedings between E.ON Czech Holding AG ('E.ON'), on the one hand, and Mr Michael Dědouch, Mr Petr Streitberg and Mr Pavel Suda, on the other hand, concerning the reasonableness of the consideration which, in a procedure for removing minority shareholders, E.ON was required to pay them following the compulsory transfer of the shares which they held in Jihočeská plynárenská, a.s.

Legal context

EU law

3 Recitals 2, 11 and 12 of Regulation No 44/2001 state:

'(2) Certain differences between national rules governing jurisdiction and recognition of judgments hamper the sound operation of the internal market. Provisions to unify the rules of conflict of jurisdiction in civil and commercial matters and to simplify the formalities with a view to rapid and simple recognition and enforcement of judgments from Member States bound by this Regulation are essential.

…

(11) The rules of jurisdiction must be highly predictable and founded on the principle that jurisdiction is generally based on the defendant's domicile and jurisdiction must always be available on this ground save in a few well-defined situations in which the subject matter of the litigation or the autonomy of the parties warrants a different linking factor. The domicile of a legal person must be defined autonomously so as to make the common rules more transparent and avoid conflicts of jurisdiction.

(12) In addition to the defendant's domicile, there should be alternative grounds of jurisdiction based on a close link between the court and the action or in order to facilitate the sound administration of justice.'

4 Article 1(1) of that regulation provides:

‘This Regulation shall apply in civil and commercial matters whatever the nature of the court or tribunal. It shall not extend, in particular, to revenue, customs or administrative matters.’

5 According to Article 2(1) of the regulation:

‘Subject to this Regulation, persons domiciled in a Member State shall, whatever their nationality, be sued in the courts of that Member State.’

6 Article 5 of the regulation is worded as follows:

‘A person domiciled in a Member State may, in another Member State, be sued:

(1) (a) in matters relating to a contract, in the courts for the place of performance of the obligation in question;

…

(3) in matters relating to tort, delict or quasi-delict, in the courts for the place where the harmful event occurred or may occur;

…’

7 Article 6 of Regulation No 44/2001 provides:

‘A person domiciled in a Member State may also be sued:

1. where he is one of a number of defendants, in the courts for the place where any one of them is domiciled, provided the claims are so closely connected that it is expedient to hear and determine them together to avoid the risk of irreconcilable judgments resulting from separate proceedings;

…’

8 Article 22 of that regulation provides:

‘The following courts shall have exclusive jurisdiction, regardless of domicile:

…

2. in proceedings which have as their object the validity of the constitution, the nullity or the dissolution of companies or other legal persons or associations of natural or legal persons, or of the validity of the decisions of their organs, the courts of the Member State in which the company, legal person or association has its seat. In order to determine that seat, the court shall apply its rules of private international law;

…’

Czech law

9 Paragraph 183i of Zákon č. 513/1991 Sb., obchodní zákoník (Law No 513/1991, Commercial Code) in the version applicable to the main proceedings, provides:

'(1) A person who owns participating securities in a company (a) whose aggregate nominal value makes up at least 90% of that company's share capital, or (b) which replace participating securities whose aggregate nominal value makes up at least 90% of that company's share capital, or (c) which carry at least 90% of the voting rights in the company ("the principal shareholder") is entitled to request the board of directors to call a general meeting, at which a decision shall be made on the transfer of all the company's other participating securities to that person.

…

(3) The resolution of the general meeting shall include the identification of the principal shareholder, particulars attesting that that shareholder is the principal shareholder and the amount of consideration as well as the time limit within which the consideration must be provided.'

10 Paragraph 183k of that law provides:

'(1) The owners of participating securities may, from the time when they receive the invitation to attend the general meeting or from the time when they are notified that it will take place, request a court to review the reasonableness of the consideration; …

…

(3) A court decision granting the right to a different amount of consideration shall be binding on the majority shareholder and the company as regards the basis of the right granted, as well as vis-à-vis the other owners of participating securities. …

(4) A finding that the consideration is unreasonable shall not render the resolution of the general meeting adopted under Paragraph 183i(1) invalid.

(5) An application under Paragraph 131 to have the resolution of the general meeting declared invalid may not be based on the unreasonableness of the consideration.'

The dispute in the main proceedings and the questions referred for a preliminary ruling

11 By a resolution of 8 December 2006, the general meeting of Jihočeská plynárenská decided on the compulsory transfer of all participating securities in that company to its principal shareholder, E.ON.

12 That resolution indicated the amount of the consideration that E.ON was required to pay to the minority shareholders following that transfer.

13 By an action brought on 26 January 2007, Mr Dědouch, Mr Streitberg and Mr Suda requested the Krajský soud v Českých Budějovicích (Regional Court, České Budějovice, Czech Republic) to review the reasonableness of that consideration.

14 In those proceedings E.ON raised an objection that the Czech courts lacked jurisdiction, arguing that, in view of the location of its seat, the German courts alone had international jurisdiction.

15 By an order of 26 August 2009, the Krajský soud v Českých Budějovicích (Regional Court, České Budějovice) rejected that objection on the ground that the Czech courts had jurisdiction on the basis of Article 6(1) of Regulation No 44/2001 to hear the action.

16 E.ON appealed against that order to the Vrchní soud v Praze (High Court, Prague, Czech Republic), which by order of 22 June 2010 held that the dispute before it came within the scope of Article 22(2) of Regulation No 44/2001 and that, in view of the location of the seat of Jihočeská plynárenská, international jurisdiction lay with the Czech courts.

17 On a constitutional complaint brought by E.ON, the Ústavní soud (Constitutional Court, Czech Republic), by judgment of 11 September 2012, set aside that order and referred the case back to the Vrchní soud v Praze (High Court, Prague).

18 By an order of 2 May 2014, the Vrchní soud v Praze (High Court, Prague) found that the Czech courts had jurisdiction to deal with the dispute in the main proceedings on the basis of Article 5(1)(a) of Regulation No 44/2001.

19 E.ON appealed against that order to the referring court.

20 In those circumstances, the Nejvyšší soud (Supreme Court, Czech Republic) decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

‘(1) Must Article 22(2) of [Regulation No 44/2001] be interpreted as also covering proceedings for the review of the reasonableness of the consideration which the principal shareholder is required to provide, as equivalent value for participating securities, to the previous owners of participating securities which were transferred to it as a result of a decision at a general meeting of a public limited company on the compulsory transfer of the other participating securities to that principal shareholder (otherwise known as a “squeeze-out”), where the resolution adopted at the general meeting of the public limited company determines the amount of reasonable consideration and where there is a court decision granting entitlement to a different amount of consideration which is binding on the principal shareholder and on the company as regards the basis of the right granted, as well as vis-à-vis the other owners of participating securities?

(2) If the answer to the preceding question is in the negative, must Article 5(1)(a) of [Regulation No 44/2001] be interpreted as also covering proceedings for review of the reasonableness of the consideration described in the previous question?

(3) If the answer to both the preceding questions is in the negative, must Article 5(3) of [Regulation No 44/2001] be interpreted as also covering proceedings for review of the reasonableness of the consideration described in the first question?’

Consideration of the questions referred

The first question

21 By its first question, the referring court asks, in essence, whether Article 22(2) of Regulation No 44/2001 must be interpreted as meaning that an action, such as that in the main proceedings, for review of the reasonableness of the consideration that the principal shareholder of a company is required to pay to the minority shareholders of that company in the event of the compulsory transfer of their shares to that principal shareholder comes within the exclusive jurisdiction of the courts of the Member State in which that company is established.

22 In that regard, it should be borne in mind that, in the main proceedings, although the resolution of the general meeting of Jihočeská plynárenská concerned both the transfer of its shares to the principal shareholder and the determination of the amount of consideration to be paid to the minority shareholders, Mr Dědouch, Mr Streitberg and Mr Suda, in their action, merely challenge the reasonableness of that amount.

23 Even if that action should give rise to a decision that the amount is not reasonable, Czech law explicitly precludes that decision from being able to have the effect of invalidating the resolution of the general meeting in so far as it concerned that transfer or from being relied upon for the purposes of an application to have that resolution declared invalid.

24 Consequently, according to a literal interpretation of the wording of Article 22(2) of Regulation No 44/2001, it is by no means certain that such an action comes within the scope of that provision, since the rule of jurisdiction which that provision lays down is applicable in proceedings which have as their object the 'validity of the decisions of [the] organs' of companies or legal persons.

25 According to the settled case-law of the Court, the provisions of Regulation No 44/2001 must be interpreted independently, by reference to its scheme and purpose (judgments of 13 July 2006, *Reisch Montage*, C-103/05, EU:C:2006:471, paragraph 29; of 2 October 2008, *Hassett and Doherty*, C-372/07, EU:C:2008:534, paragraph 17; and of 16 January 2014, *Kainz*, C-45/13, EU:C:2014:7, paragraph 19).

26 As regards the general scheme and context of Regulation No 44/2001, it should be recalled that the jurisdiction provided for in Article 2 of that regulation, namely that the courts of the Member State in which the defendant is domiciled are to have jurisdiction, constitutes the general rule. It is only by way of derogation from that general rule that the regulation provides for special and exclusive rules of jurisdiction for cases, which are exhaustively listed, in which the defendant may or must, depending on the case, be sued in the courts of another Member State (judgments of 13 July 2006, *Reisch Montage*, C-103/05, EU:C:2006:471, paragraph 22, and of 12 May 2011, *BVG*, C-144/10, EU:C:2011:300, paragraph 30).

27 Those rules of special and exclusive jurisdiction must accordingly be interpreted strictly. As the provisions of Article 22 of Regulation No 44/2001 introduce an exception to the general rule governing the attribution of jurisdiction, they must not be given an interpretation broader than that which is required by their objective (judgments of 2 October 2008, *Hassett and Doherty*, C-372/07, EU:C:2008:534, paragraphs 18 and 19, and of 12 May 2011, *BVG*, C-144/10, EU:C:2011:300, paragraph 30).

28 As regards the objectives and the purpose of Regulation No 44/2001, it should be recalled that, as is apparent from recitals 2 and 11 thereof, that regulation seeks to unify the rules on conflict of jurisdiction in civil and commercial matters by way of rules of jurisdiction which are highly predictable. That regulation thus pursues an objective of legal certainty which consists in strengthening the legal protection of persons established in the European Union, by enabling the applicant easily to identify the court in which he may sue and the defendant reasonably to foresee before which court he may be sued (judgments of 23 April 2009, *Falco Privatstiftung and Rabitsch*, C-533/07, EU:C:2009:257, paragraphs 21 and 22; of 17 March 2016, *Taser International*, C-175/15, EU:C:2016:176, paragraph 32; and of 14 July 2016, *Granarolo*, C-196/15, EU:C:2016:559, paragraph 16).

29 Furthermore, as is apparent from recital 12 of that regulation, the rules of jurisdiction derogating from the general rule of jurisdiction of the courts of the Member State in which the defendant is domiciled supplement the general rule where there is a close link between the court designated by those rules and the action or in order to facilitate the sound administration of justice.

30 In particular, the rules of exclusive jurisdiction laid down in Article 22 of Regulation No 44/2001 seek to ensure that jurisdiction rests with courts closely linked to the proceedings in fact and law (see, with regard to Article 16 of the Convention of 27 September 1968 on jurisdiction and the enforcement of judgments in civil and commercial matters (OJ 1972 L 299, p. 32), the provisions of which are essentially identical to those of Article 22 of Regulation No 44/2001, judgment of 13 July 2006, *GAT*, C-4/03, EU:C:2006:457, paragraph 21), in other words, to confer exclusive jurisdiction on the courts of a Member State in specific circumstances where, having regard to the matter at issue, those courts are best placed to adjudicate upon the disputes falling to them by reason of a particularly close link between those disputes and that Member State (judgment of 12 May 2011, *BVG*, C-144/10, EU:C:2011:300, paragraph 36).

31 Thus, the essential objective pursued by Article 22(2) of Regulation No 44/2001 is that of centralising jurisdiction in order to avoid conflicting judgments being given as regards the existence of a company or as regards the validity of the decisions of its organs (judgment of 2 October 2008, *Hassett and Doherty*, C-372/07, EU:C:2008:534, paragraph 20).

32 The courts of the Member State in which the company has its seat appear to be those best placed to deal with such disputes, inter alia because it is in that State that information about the company will have been notified and made public. Exclusive jurisdiction is thus attributed to those courts in the interests of the sound administration of justice (judgment of 2 October 2008, *Hassett and Doherty*, C-372/07, EU:C:2008:534, paragraph 21).

33 However, the Court has held that it cannot be inferred from this that, in order for Article 22(2) of Regulation No 44/2001 to apply, it is sufficient that a legal action involve some link with a decision adopted by an organ of a company (judgment of 2 October 2008, *Hassett and Doherty*, C-372/07, EU:C:2008:534, paragraph 22), and that the scope of that provision covers only disputes in which a party is challenging the validity of a decision of an organ of a company under the company law applicable or the provisions of its article of association governing the functioning of its organs (judgments of 2 October 2008, *Hassett and Doherty*, C-372/07, EU:C:2008:534, paragraph 26, and of 23 October 2014, *flyLAL-Lithuanian Airlines*, C-302/13, EU:C:2014:2319, paragraph 40).

34 In the present case, while it is true that, under Czech law, proceedings such as those at issue in the main proceedings may not lead formally to a decision which has the effect of invalidating a resolution of the general assembly of a company concerning the compulsory transfer of the minority shareholders' shares in that company to the majority shareholder, the fact nonetheless remains that, in accordance with the requirements of the autonomous interpretation and uniform application of the provisions of Regulation No 44/2001, the scope of Article 22(2) thereof cannot depend on the choices made in national law by Member States or vary depending on them.

35 On the one hand, the origin of those proceedings lies in a challenge to the amount of the consideration relating to such a transfer and, on the other, their purpose is to secure a review of the reasonableness of that amount.

36 It follows that, having regard to Article 22(2) of Regulation No 44/2001, legal proceedings such as those at issue in the main proceedings concern the review of the partial validity of a decision of an organ of a company and that such proceedings are, as a result, capable of coming within the scope of that provision, as envisaged by its wording.

37 Thus, in those circumstances, a court hearing such an application for review must examine the validity of a decision of an organ of a company in so far as that decision concerns the determination of the amount of the consideration, decide whether that amount is reasonable and, where necessary, annul that decision in that respect and determine a different amount of consideration.

38 Furthermore, an interpretation of Article 22(2) of Regulation No 44/2001 according to which that provision applies to proceedings such as those at issue in the main proceedings is consistent with the essential objective pursued by that provision and does not have the effect of extending its scope beyond what is required by that objective.

39 In that regard, the existence of a close link between the courts of the Member State in which Jihočeská plynárenská is established, in the present case the Czech courts, and the dispute in the main proceedings is clear.

40 In addition to the fact that Jihočeská plynárenská is a company incorporated under Czech law, it is apparent from the file submitted to the Court that the resolution of the general meeting that determined the amount of the consideration forming the subject of the main proceedings and the acts and formalities relating to it were carried out in accordance with Czech law and in the Czech language.

41 Likewise, it is not disputed that the court with jurisdiction must apply Czech substantive law to the dispute in the main proceedings.

42 Consequently, bearing in mind the close link between the dispute in the main proceedings and the Czech courts, the latter are best placed to hear that dispute relating to the review of the partial validity of that resolution and the attribution, pursuant to Article 22(2) of Regulation No 44/2001, of exclusive jurisdiction to those courts is such as to facilitate the sound administration of justice.

43 The attribution of that jurisdiction to the Czech courts is also consistent with the objectives of predictability of the rules of jurisdiction and legal certainty pursued by Regulation No 44/2001, since, as the Advocate General observed in point 35 of his Opinion, the shareholders in a company, especially the principal shareholder, must expect that the courts of the Member State in which that company is established will be the courts having jurisdiction to decide any internal dispute within that company relating to the review of the partial validity of a decision taken by an organ of a company.

44 Moreover, inasmuch as the principal shareholder of a company may change during the existence of that company, application of the general rule of jurisdiction of the courts of the Member State in which the defendant is domiciled, laid down in Article 2(1) of Regulation No 44/2001, to a situation such as that at issue in the main proceedings would not ensure that those objectives are achieved.

45 In those circumstances, the answer to the first question is that Article 22(2) of Regulation No 44/2001 must be interpreted as meaning that an action, such as that at issue in the main proceedings, for review of the reasonableness of the consideration that the principal shareholder of a company is required to pay to the minority shareholders of that company in the event of the compulsory transfer of their shares to that principal shareholder comes within the exclusive jurisdiction of the courts of the Member State in which that company is established.

The second and third questions

46 In the light of the answer to the first question, there is no need to answer the second and third questions.

Costs

47 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (First Chamber) hereby rules:

Article 22(2) of Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters must be interpreted as meaning that an action, such as that at issue in the main proceedings, for review of the reasonableness of the consideration that the principal shareholder of a company is required to pay to the minority shareholders of that company in the event of the compulsory transfer of their shares to that principal shareholder comes within the exclusive jurisdiction of the courts of the Member State in which that company is established.

[Signatures]

JUDGMENT OF THE COURT
12 March 1996 *

In Case C-441/93,

REFERENCE to the Court under Article 177 of the EEC Treaty by the Polimeles Protodikio Athinon for a preliminary ruling in the proceedings pending before that court between

Panagis Pafitis and Others,

supported by

Investment and Shipping Enterprises Est and Others

and

Trapeza Kentrikis Ellados AE and Others,

supported by

Trapeza tis Ellados AE and Others

* Language of the case: Greek.

on the interpretation of Article 25 et seq. and Article 29 of the Second Council Directive, Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (OJ 1977 L 26, p. 1),

THE COURT,

composed of: C. N. Kakouris, President of Chamber, acting for the President, D. A. O. Edward and G. Hirsch (Presidents of Chambers), G. F. Mancini, F. A. Schockweiler, J. C. Moitinho de Almeida, P. J. G. Kapteyn (Rapporteur), C. Gulmann, J. L. Murray, H. Ragnemalm and L. Sevón, Judges,

Advocate General: G. Tesauro,
Registrar: H. von Holstein, Deputy Registrar,

after considering the written observations submitted on behalf of:

— Panagis Pafitis and Others, by Sofia Koukouli-Spiliotopoulou, Ioannis Stamoulis, Feidias Doukaris and Georgios Kampitsis, of the Athens Bar,

— Investment and Shipping Enterprises Est and Others, by Nikolaos Skandamis, Georgios Kampitsis, Ioannis Stamoulis and Feidias Doukaris, of the Athens Bar,

— Trapeza Kentrikis Ellados AE and Others, by Marios Bachas, Fotis Chatzis, Alexandros Markopoulos and Konstantinos Marvrias, of the Athens Bar,

— Trapeza tis Ellados AE and Others, by Ilias Soufleros and Marios Armaos, of the Athens Bar, and Vasileios Kontolaimos, Deputy Legal Adviser in the State Legal Department, acting as Agent,

— the Greek Government, by Vasilios Kondolaimos, Deputy Legal Adviser in the State Legal Department, acting as Agent,

— the Portuguese Government, by Jorge Santos, of the Legal Department of the Bank of Portugal, and Luis Fernandes, Director of the Legal Department of the Directorate-General for the European Communities, Ministry of Foreign Affairs, acting as Agents,

— the Commission of the European Communities, by Antonio Caeiro and Dimitrios Gouloussis, Legal Advisers, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Panagis Pafitis and Others, represented by Sofia Koukouli-Spiliotopoulou, Ioannis Stamoulis and Feidias Doukaris, Investment and Shipping Enterprises Est and Others, represented by Feidias Doukaris, Trapeza Kentrikis Ellados AE and Others, represented by Marios Bachas, Konstantinos Mavrias and Krateros Ioannou, of the Athens Bar, Trapeza tis Ellados AE and Others, represented by Ilias Soufleros and Vasileios Kontolaimos, the Greek Government, represented by Panagiotis Mylonopoulos, Special Legal Assistant in the Department for Community Matters of the Ministry of Foreign Affairs, and Dimitrios Leontokianakos, Legal Assistant in the Independent Office for European Community Affairs of the Ministry of the National Economy, acting as Agents, and the Commission, represented by Dimitrios Gouloussis, at the hearing on 6 June 1995,

after hearing the Opinion of the Advocate General at the sitting on 9 November 1995,

gives the following

Judgment

1 By decision of 3 August 1993, received at the Court on 16 November 1993, the Polimeles Protodikio Athinon (Court of First Instance, Athens) referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty three questions on the interpretation of Article 25 et seq. and Article 29 of the Second Council Directive, Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (OJ 1977 L 26, p. 1, hereinafter 'the Second Directive').

2 Those questions were raised in the course of proceedings brought against Trapeza Kentrikis Ellados AE, a public limited liability company (hereinafter 'TKE Bank'), and its new shareholders, by its old shareholders, Panagis Pafitis and others, who object to the increases in the capital of TKE Bank by Decision No 826 of the Governor of the Bank of Greece of 28 July 1986 (*Official Journal of the Hellenic Republic*, ΦΕΚ Edition A 117 of 29 July 1986) and Measure No 71 of the temporary administrator of TKE Bank of 24 September 1986, subsequently ratified by Law No 1682/1987 (*Official Journal of the Hellenic Republic*, ΦΕΚ Edition A 14 of 16 February 1987). Those measures were taken pursuant to Presidential Decree No 861/1975.

3 Special Law No 1665/1951 (*Official Journal of the Hellenic Republic*, ΦΕΚ Edition A 31 of 27 January 1951), as in force at the material time, provided, in Article 6, that where the capital of a bank was eroded as a result of losses or where the Monetary Commission considered that, for any other reason, a bank's capital was not commensurate with its needs, that Commission would call on the bank to reinstate the capital lost or to increase the capital within a period of not less than 60 days set by it.

4 Pursuant to Article 8(1) of the abovementioned special law, where a bank is unable, or refuses, to increase its capital, in any way obstructs supervision or infringes any provisions of laws, or of decisions or regulations of the Monetary Commission, the latter may either withdraw the bank's licence to trade, thereby putting it into liquidation, or appoint an administrator.

5 By Measure No 397 (*Official Journal of the Hellenic Republic,* ΦΕΚ Edition A 133 of 13 September 1984), the Governor of the Bank of Greece placed TKE Bank under the supervision of a temporary administrator.

6 Article 1(3) of Presidential Decree No 861/1975 concerning the supervision of banks by temporary administrators — the text of which is repeated in its entirety in Article 1 of Law No 236/1975 (*Official Journal of the Hellenic Republic,* ΦΕΚ Edition A 275 of 5 December 1975) — provides that, upon publication of the decision appointing a temporary administrator in the *Official Journal of the Hellenic Republic*, all the powers and competencies of the organs of the bank are to lapse automatically and are to be vested, together with the management of the bank, in the temporary administrator or the temporary administrators acting jointly.

7 The plaintiffs in the main proceedings have been shareholders of TKE Bank since before 1984, at which time its capital was DR 670 000 000.

8 By the abovementioned Decision No 826 of 28 July 1986, the Governor of the Bank of Greece called on TKE Bank, pursuant to Article 6 of Special Law No 1665/1951, to increase its capital to DR 1 500 000 000 in order to stabilize the conduct of its business. Acting in the stead of the general meeting, the temporary administrator decided, by Measure No 71 of 24 September 1986, to amend Article 6 of the statutes of TKE Bank to show its capital as DR 1 700 000 000.

9 In order to give effect to that increase, the temporary administrator invited the shareholders of TKE Bank, by notice published in the political and financial press, to exercise their pre-emptive rights in relation to the increase within a period of 30 days and invited any interested third parties to participate in the increase on the expiry of that period. Since the plaintiffs had not exercised their pre-emptive rights by the end of that period, the new shares were ultimately allotted to third parties. Subsequently, the capital was increased on three further occasions in 1987, 1989 and 1990 by the general meeting of TKE Bank, with its new shareholders, the appropriate amendments being made to its statutes.

10 Article 24(2) of Greek Law No 1682/1987 ratified, with effect from the dates of their adoption, the decision to appoint a temporary administrator to manage TKE Bank and the measure by which the latter ordered that the shares representing the increase in the capital of TKE Bank should be allotted to the shareholders.

11 The plaintiffs in the main proceedings first challenged, before the national court, the amendment to the statutes of TKE Bank, whereby the capital was increased to DR 1 700 000 000 on the ground that that amendment gave effect to a decision taken by the temporary administrator without the general meeting of shareholders having been convened to decide upon any increase of capital, and that the mandate of the temporary administrator had lapsed automatically upon the expiry of a reasonable period. They also objected to the allotment of the shares and sought a declaration that the other defendants in the main proceedings, purporting to be new shareholders of the bank following the increase of capital, had acquired neither the status of shareholders nor the right to participate in the general meeting of shareholders of TKE Bank. Finally, they sought the annulment of the decisions concerning the three subsequent increases of capital and the corresponding amendments to the statutes.

12 In its decision, the national court questions whether the case-law of the Court which, in relation to ordinary public limited liability companies, upholds the principle that the general meeting of shareholders has the authority to decide upon increases of capital, extends also to banks constituted in the form of public limited

companies since, under Greek law, there is banking legislation (the abovementioned Law No 236/1975) which applies specifically to such banks. The aim of that legislation is to provide for the reorganization of banks, by reason of their particular importance in relation to credit facilities, the guarantee of deposits and the proper operation of the national economy, such matters constituting objectives relating to the public interest.

13 In those circumstances, the national court stayed the proceedings pending a preliminary ruling from the Court of Justice on the following questions:

'(1) Does the direct effect within the Hellenic Republic of the Second Council Directive of 13 December 1976 (77/91/EEC) and in particular of the provisions concerning the maintenance and alteration of the capital of public limited liability companies (Articles 25 et seq. and 29) extend so far as to mean that the Greek courts are automatically obliged to apply those provisions to banks which take the form of public limited liability companies?

(2) Are the above provisions incompatible with the contrary provisions of Presidential Decree No 861/1975, confirmed by Law No 236/1975, and of Article 24 of Law No 1682/1987, which derogate from the other provisions governing the general functioning of public limited liability companies in order more effectively to achieve reform of banks constituted in the form of public limited liability companies on the ground of the special social-economic purpose which they fulfil, which constitutes an aim of general interest, so that application of those contrary provisions is precluded?

(3) May publication of the invitation in the daily newspapers be deemed to satisfy the requirement laid down in the third sentence of Article 29(3) of the directive in question that the holders of registered shares must be informed in writing?'

The first and second questions

14 By its first and second questions, which it is appropriate to consider together, the national court raises three problems concerning the scope of the Second Directive, in particular Articles 25 and 29 thereof.

15 The first is whether banks constituted in the form of public limited liability companies fall, as such, within the scope of the Second Directive, in particular Articles 25 and 29 thereof.

16 The second concerns the applicability of the directive, having regard to the specific nature of the national rules at issue which, in pursuit of the public interest and by way of derogation from the rules of the general law on public limited liability companies, seek to secure more effective recovery of banks constituted in the form of public limited liability companies which, as a result of their burden of debt, find themselves in exceptional circumstances. The national court asks essentially whether, taking account of that special feature, Article 25 of the Second Directive precludes national legislation which provides that the capital of a bank which is constituted in the form of a public limited liability company and finds itself in the exceptional circumstances referred to above may be increased by administrative measure and without discussion by the general meeting.

17 The third problem is concerned more particularly with the conditions for the application of Article 25.

The applicability of the Second Directive to banks constituted in the form of public limited liability companies

18 It is clear from the title and Article 1 of the Second Directive that it applies to the companies referred to in the second paragraph of Article 58 of the EC Treaty constituted in the form of public limited liability companies.

19 The criterion adopted by the Community legislature to define the scope of the Second Directive is therefore that of the legal form of the company, irrespective of its business.

20 There is only one exception to that general rule, namely that provided for in Article 1(2) which authorizes the Member States not to apply the directive to investment companies with variable capital or cooperatives in the form of public limited liability companies.

21 Since banks constituted in the form of public limited liability companies do not come within that exception they are covered by the Second Directive.

22 That conclusion is also borne out by the fact that the Second Directive, in for example Articles 20(1)(c), 23(2) and 24(2), expressly takes account of the particular features of banking by providing that certain provisions do not apply, or need not be applied by the Member States, to banks and other financial institutions constituted in the form of public limited liability companies.

23 Articles 25 and 29 of the Second Directive allow for no such derogation.

24 It must therefore be held that the Second Directive, and in particular Articles 25 and 29 thereof, apply to banks constituted in the form of public limited liability companies.

The applicability of Article 25 of the Second Directive to measures for the reorganization of banks

25 The defendants in the main proceedings contend that the increase in capital at issue constitutes a measure for the reorganization of a credit institution which falls outside the scope of Article 25 of the Second Directive.

26 In support of that contention, they put forward a number of arguments to show that rules on the reorganization of credit institutions are, at both Community and national level, in the nature of a *lex specialis* as compared with ordinary company law.

27 They maintain, first, that the Second Directive is not concerned with the reorganization, liquidation and dissolution of public limited liability companies or, *a fortiori*, of credit institutions. Those are matters covered by other legislative measures adopted or envisaged by the Community.

28 They refer in particular to the amended proposal for a Council Directive concerning the reorganization and the winding-up of credit institutions and

deposit-guarantee schemes (OJ 1988 C 36, p. 1, hereinafter 'the amended proposal for a directive').

29 The defendants in the main proceedings submit that the main purpose of that amended proposal for a directive was specifically to avoid the winding-up and dissolution of credit institutions, because of the importance attached to maintaining their ability to operate on a sound basis. Even though it is intended to deal with their liquidation, it was inspired by the need for rigorous application of the supervisory rules and by the concept of the public interest.

30 They state that all the contested rules on reorganization, with the exception of certain provisions concerned simply with interpretation of the measures adopted, are included in the list of national measures appended to the amended proposal for a directive, which sets out the measures that would be reciprocally recognized by the Member States as being intended to maintain or restore the financial stability of a credit institution.

31 According to the defendants in the main proceedings, the fact that, according to the amended proposal for a directive, the application of those measures is not dependent on compliance with the provisions of the Second Directive and, in particular, with Article 25 thereof, shows that the objective of reorganization, even by means of a compulsory increase of capital, as provided for in the Greek rules, takes precedence over the more specific conditions for such increases which are necessarily accorded secondary importance and are subordinate to that primary objective.

32 They thus consider that the amended proposal for a directive shows that the matter of increasing the capital of a credit institution falls within the ambit of the wider, overriding objective of reorganizing a credit institution and is ultimately subsumed into that objective.

33 That conclusion is supported, in their view, by the existence, not only nationally but in the Community as a whole, of a set of special rules applicable to credit institutions, a fact which brings to the fore the wholly exceptional nature of credit institutions. It is very revealing in that connection that the directives concerning financial institutions are more numerous than those concerning companies in general.

34 The Portuguese Government also considers that, in the event of a financial crisis, the situation of a bank differs fundamentally from that of a public limited liability company in general in that, first, the liabilities of banks are essentially represented by their depositors' funds and, secondly, the care and management of public savings are an essential function of banks. When a bank is in financial crisis, it is necessary both to protect the interests of its depositors by taking all possible action to make certain that their assets will be returned to them and to ensure that the depositors are not seized by panic, which would spread to the public at large, precipitating widespread withdrawals of funds throughout the banking system.

35 That is why, according to the Portuguese Government, the legislation both of the Member States and of the Community recognizes the special nature of banks by adopting provisions which depart from those applicable to companies in general.

36 As far as Community legislation is concerned, the Portuguese Government refers not only to the amended proposal for a directive but, as do the plaintiffs in the main proceedings, also to the Second Directive, Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC (OJ 1977 L 386, p. 1).

37 Derogating from Article 17 of the Second Directive, Article 10(1) of Directive 89/646 lays down the rule that a credit institution's own funds may not fall below the amount of initial capital required and Article 10(5) provides that the competent

authorities may, where the circumstances so justify, allow an institution a limited period in which to rectify its situation.

38 In response to those arguments, it must be pointed out, first, that the Second Directive is intended, in accordance with Article 54(3)(g) of the EC Treaty, to coordinate the safeguards which are required by Member States of companies or firms within the meaning of the second paragraph of Article 58 of the Treaty with a view to making such safeguards equivalent and protecting the interests of members and others. The Second Directive thus seeks to ensure a minimum level of protection for shareholders in all the Member States.

39 That objective would be seriously frustrated if the Member States were entitled to derogate from the provisions of the directive by maintaining in force rules — even rules categorized as special or exceptional — under which it is possible to decide by administrative measure, separately from any decision by the general meeting of shareholders, to effect an increase in the company's capital (see the judgments in Joined Cases C-19/90 and C-20/90 *Karella and Karellas* [1991] ECR I-2691, paragraphs 25 and 26, and Case C-381/89 *Syndesmos Melon tis Eleftheras Evangelikis Ekklisias and Others* [1992] ECR I-2111, paragraphs 32 and 33).

40 For those reasons, the Court has thus already held that Article 25(1) of the Second Directive precludes the application of rules which, being designed to ensure the reorganization and continued trading of undertakings that are of particular importance to the national economy and are in an exceptional situation by reason of their debt burden, allow an increase in capital to be decided upon by administrative measure, without any resolution being passed by the general meeting (judgments in *Karella and Karellas*, paragraph 31, *Syndesmos Melon tis Eleftheras Evangelikis Ekklisias and Others*, paragraph 37, and Joined Cases C-134/91 and C-135/91 *Kerafina-Keramische und Finanz-Holding and Vioktimatiki* [1992] ECR I-5699, paragraph 18, hereinafter 'the *Karella* and *Syndesmos Melon* line of cases').

41 Although the Second Directive does not specifically refer to the reorganization of credit institutions or to public limited liability companies in general and although those matters have not yet been the subject of Community harmonization, it does not follow that it is open to the Member States to adopt reorganization measures in that field which run counter to the provisions of the Second Directive, which, as stated in paragraph 24, apply to banks.

42 As far as reorganization measures are concerned, Article 25, which, in accordance with the objective of the Second Directive, provides a minimum level of protection for shareholders in all the Member States, applies, in the absence of any express exception, to credit institutions under the same conditions as to any other undertaking which is of special importance to the national economy and, by reason of its debt burden, is in exceptional circumstances.

43 As regards the arguments based on the amended proposal for a directive, it must be pointed out that that proposal does not form part of positive Community law and, in any event, the mere fact that the legislation at issue in the main proceedings appears on the list annexed to that proposal, which, as the Commission correctly pointed out at the hearing, identifies those national measures which, according to the information provided by each of the Member States at its request, should be regarded as reorganization measures, in no way prejudges the question whether such legislation is in conformity with the Second Directive.

44 As regards the Community legislation on the banking sector, it should be observed, as has been pointed out by the Advocate General in point 19 of his Opinion, that the majority of those directives seek to uphold and extend the right of establishment and the freedom to provide services in the banking sector, by means of specific provisions applicable to banks. Moreover, the numerous provisions concerning supervision, which confer on the competent authorities, in certain circumstances, the power to require a credit institution to remedy within a specified period an insufficiency of assets, do not affect the powers of the organs of the credit institution in question to make their own arrangements to rectify matters.

45 The arguments which the defendants in the main proceedings and the Portuguese Government deduce from the amended proposal for a directive and the Community legislation in the banking sector cannot therefore be accepted.

46 The defendants in the main proceedings contend, secondly, that the *lex specialis* status of banking legislation is closely linked to the fact that supervisory rules are provisions dictated by the public interest. The rules on the supervision of credit institutions, they maintain, constitute a closed system of provisions designed, first, to protect the financial structure and preserve public confidence in it, and, secondly, to protect depositors. They consider that measures for the reorganization of credit institutions, which form an integral part of the supervisory rules, pursue the same objectives. Under the Greek legislation in force, those measures include increases in company capital by decision of a temporary administrator.

47 They maintain in that connection that the Court has already recognized that the cohesion of such a closed system is such that it must not be upset by the operation of other provisions of national law or Community law (see Case C-204/90 *Bachmann* v *Belgium* [1992] ECR I-249 and Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305). In their view, the fundamental reasons which prompted the Court so to hold should also apply to the present case, which displays considerable similarities to *Bachmann*.

48 That argument likewise cannot be upheld.

49 It is true that considerations concerning the need to protect the interests of savers and, more generally, the equilibrium of the savings system, require strict supervisory rules in order to ensure the continuing stability of the banking system.

50 However, it does not follow that national rules of that kind must necessarily provide for measures which deprive the organs of a credit institution of the powers vested in them, as organs of a public limited liability company, by Article 25 of the Second Directive.

51 The interests at issue can, as the Advocate General has rightly pointed out in point 18 of his Opinion, be given equal and appropriate protection by other means, such as for example the creation of a generalized system to guarantee deposits, which seek to achieve the same result but do not impede attainment of the objective pursued by the Second Directive of providing a minimum level of protection for shareholders in all the Member States.

52 Accordingly, the Member States could, in the event of their supervisory rules for credit institutions not meeting the requirements laid down by the Second Directive, adopt the measures needed to bring them into line with those requirements within the prescribed period and establish a system which, whilst observing the provisions of the directive, protects the interests concerned.

53 It is also apparent from the documents before the Court that the Hellenic Republic has in the meantime adopted legislative measures which introduce a system of deposit guarantees and dispense with the office of temporary administrator provided for by the legislation at issue in this case, thereby eliminating the powers attached to that office, including that of deciding, in the stead of the general meeting, to increase a bank's capital.

The conditions for the application of Article 25 of the Second Directive

54 The defendants in the main proceedings contend that, in any event, the conditions for the application of Article 25(1) of the Second Directive are not satisfied. They refer in that connection to *Karella* (paragraph 30) and *Syndesmos Melon* (paragraph 27).

55 They maintain that, unlike the national provisions at issue in the *Karella* and *Syndesmos Melon* line of cases, which merely brought to an end the powers of the management of the undertaking, whilst the general meeting continued to exist, the legislation at issue in this case provides for a temporary administrator whose appointment causes all the powers and competencies of the organs of the company, including the general meeting, to lapse and to become vested in him. Appointments of that kind constitute measures wholly analogous to execution measures, in particular rules on liquidation of the kind in point in *Karella* and *Syndesmos Melon,* and, in addition, mean that, owing to the removal of powers from the shareholders and the normal organs of the company, the company does not continue to exist within its own structures, within the meaning of those judgments.

56 That argument cannot be upheld.

57 In *Karella* (paragraph 30) and *Syndesmos Melon* (paragraph 27), the Court pointed out that the Second Directive is intended to ensure that members' and third parties' rights are safeguarded, in particular in the operations for setting up companies and increasing and reducing their capital. The directive does not, admittedly, preclude the taking of execution measures intended to put an end to the company's existence and, in particular, does not preclude liquidation measures placing the company under compulsory administration with a view to safeguarding the rights of creditors. However, the directive continues to apply where ordinary reorganization measures are taken in order to ensure the survival of the company, even if those measures mean that the shareholders and the normal organs of the company are temporarily divested of their powers.

58 In this case, the appointment of a temporary administrator does not resemble an execution measure, or, in particular, a liquidation measure, even though all the powers and competencies of the organs of the company are transferred to that administrator. As the defendants in the main proceedings themselves have stated, Article 8(1) of Special Law No 1665/1951 draws a distinction, as regards the measures to be taken by the Monetary Commission, between the withdrawal of the bank's licence to trade, entailing its liquidation, and the appointment of an administrator. Moreover, as the defendants in the main proceedings have also emphasized, the specific purpose of the appointment of the temporary administrator is to ensure the survival of the company concerned, so that it is clearly a reorganization measure.

59 It cannot therefore be considered that the company does not continue to exist, and in this case that is borne out by the fact that the organs of the company have been divested of their powers and competencies only temporarily and that all the increases in capital subsequent to that decided on by the temporary administrator were, once again, the subject of a resolution of the general meeting of shareholders.

60 Accordingly, the answer to the first and second questions must be that Article 25 of the Second Directive precludes national legislation under which the capital of a bank constituted in the form of a public limited liability company which, as a result of its debt burden, is in exceptional circumstances may be increased by an administrative measure, without a resolution of the general meeting.

The third question

61 Article 29(3) of the Second Directive concerns the procedures for an offer of subscription on a pre-emptive basis which, by virtue of Article 29(1), must be made to the shareholders of a public limited liability company whenever the capital is increased by consideration in cash.

62 It follows from that provision that the legislation of a Member State need not provide for publication of such offers of subscription in the national gazette appointed in accordance with Council Directive 68/151/EEC of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty with a view to making such safeguards equivalent throughout the Community (OJ, English Special Edition 1968 (I), p. 41), where all the shares in the company are registered shares. In such cases, pursuant to the third sentence of Article 29(3) of the Second Directive, the 'shareholders must be informed in writing'.

63 It is common ground that, at the material time, the Greek legislation did not provide, in accordance with the requirements of that provision, for the publication of information in the national gazette appointed for that purpose.

64 It is in that context that the national court asks whether publishing a notice in daily newspapers is to be regarded, for the purposes of the third sentence of Article 29(3) of the Second Directive, as informing the shareholders in writing.

65 In order to answer that question, it must be borne in mind that Article 29(3) seeks to ensure that, in the absence of publication in the national gazette appointed for that purpose, all owners of registered shares are given information addressed to them individually by name concerning the procedures for exercising their preemptive rights.

66 The answer to that question must therefore be that publication of an offer of subscription in daily newspapers does not constitute information given in writing to the holders of registered shares within the meaning of the third sentence of Article 29(3) of the Second Directive.

Abuse of rights

67 It is apparent from the decision of the national court that the defendants and the interveners in the main proceedings put forward, before that court, an argument based on Article 281 of the Greek Civil Code, pursuant to which 'the exercise of a right is prohibited where it manifestly exceeds the bounds of good faith or morality or the economic or social purpose of that right'. The national court emphasizes that that provision allows objection to be made against the exercise of rights conferred by Community law if, in a particular case, those rights are exercised abusively.

68 Although, since the national court has submitted no question on the matter, it is unnecessary to rule as to whether it is permissible, under the Community legal order, to apply a national rule in determining whether a right conferred by the provisions of Community law at issue is being exercised abusively, the fact remains that, in any event, the application of such a rule must not detract from the full effect and uniform application of Community law in the Member States.

69 It must be borne in mind in that connection that it is settled case-law that it is for the Court of Justice, in relation to rights relied on by an individual on the basis of Community provisions, to verify whether the judicial protection available under national law is appropriate.

70 In this case, the uniform application and full effect of Community law would be undermined if a shareholder relying on Article 25(1) of the Second Directive were deemed to be abusing his rights merely because he was a minority shareholder of a company subject to reorganization measures or had benefited from the reorganization of the company. Since Article 25(1) applies without distinction to all shareholders, regardless of the outcome of any reorganization procedure, to treat

an action based on Article 25(1) as abusive for such reasons would be tantamount to altering the scope of that provision.

Costs

71 The costs incurred by the Greek and Portuguese Governments and the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT,

in answer to the questions referred to it by the Polimeles Protodikio Athinon, by decision of 3 August 1993, hereby rules:

1. Article 25 of the Second Council Directive (77/91/EEC) of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent precludes national legislation under which the capital of a bank constituted in the form of a public limited liability company which, as a result of its debt burden, is in exceptional circumstances may be increased by an administrative measure, without a resolution of the general meeting.

2. **Publication of an offer of subscription in daily newspapers does not constitute information given in writing to the holders of registered shares within the meaning of the third sentence of Article 29(3) of Directive 77/91.**

Kakouris Edward Hirsch Mancini

Schockweiler Moitinho de Almeida Kapteyn

Gulmann Murray Ragnemalm Sevón

Delivered in open court in Luxembourg on 12 March 1996.

President of Chamber

R. Grass

Registrar

C. N. Kakouris

For the President

JUDGMENT OF THE COURT (Second Chamber)

21 October 2010 *

In Case C-81/09,

REFERENCE for a preliminary ruling under Article 234 EC from the Simvoulio tis Epikratias (Greece), made by decision of 17 October 2008, received at the Court on 25 February 2009, in the proceedings

Idrima Tipou AE

v

Ipourgos Tipou kai Meson Mazikis Enimerosis,

THE COURT (Second Chamber),

composed of J.N. Cunha Rodrigues, President of the Chamber, A. Arabadjiev, A. Rosas (Rapporteur), U. Lõhmus and P. Lindh, Judges,

* Language of the case: Greek.

Advocate General: V. Trstenjak,
Registrar: L. Hewlett, Principal Administrator,

having regard to the written procedure and further to the hearing on 11 March 2010,

after considering the observations submitted on behalf of:

— the Greek Government, by P. Milonopoulos, M. Apessos and N. Marioli, acting as Agents,

— the European Commission, by G. Braun and G. Zavvos, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 2 June 2010,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (OJ, English Special Edition 1968 (I), p. 41; 'the First Directive').

2 The reference has been made in proceedings between Idrima Tipou AE, a limited company whose registered office is in Athens (Greece), and the Ipourgos Tipou kai Meson Mazikis Enimerosis (Minister for the Press and the Mass Media) concerning a fine imposed on that company for infringement of the legislation and rules of good conduct governing the operation of television stations.

Legal context

European Union legislation

3 The first three recitals in the preamble to the First Directive are worded as follows:

'… the co-ordination provided for in Article 54(3)(g) [of the EEC Treaty] and in the General Programme for the abolition of restrictions on freedom of establishment is a matter of urgency, especially in regard to companies limited by shares or otherwise having limited liability, since the activities of such companies often extend beyond the frontiers of national territories;

… the co-ordination of national provisions concerning disclosure, the validity of obligations entered into by, and the nullity of, such companies is of special importance, particularly for the purpose of protecting the interests of third parties;

… in these matters Community provisions must be adopted in respect of such companies simultaneously, since the only safeguards they offer to third parties are their assets.'

4 Article 1 of the First Directive, as amended by the Act concerning the conditions of accession of the Hellenic Republic and the adjustments to the Treaties (OJ 1979 L 291, p. 17), provides:

'The co-ordination measures prescribed by this Directive shall apply to the laws, regulations and administrative provisions of the Member States relating to the following types of company:

…

— In Greece:

ανώνυμη εταιρία [broadly equivalent to a public limited company; "public limited company"], εταιρία περιωρισμένης ευθύνης [broadly equivalent to a private limited company], ετερόρρυθμη κατά μετοχές εταιρία [partnership limited by shares].'

5 The First Directive contains three sections. The first section deals with the disclosure of company documents, the second with validity of obligations which a company enters into by acts done by its organs, and the third with nullity of companies.

National legislation

6 Article 15(2) of the Greek Constitution, in the version in force prior to the constitutional revision in 2001, provided that radio and television were to be under the immediate control of the State.

7 Law No 2863/2000 'National Radio and Television Council and other authorities or bodies in the sector providing broadcasting services' (FEK (Official Gazette) A 262) created the National Radio and Television Council (Ethniko Simvoulio Radiotileorasis; 'the ESR').

8 Law No 2328/1995 'Legal regime governing private television and local radio, regulation of issues relating to the broadcasting market and other provisions' (FEK A 159), applicable here in the version following its amendment by Law No 2644/1998 'on the provision of subscription radio and television services' (FEK A 233) ('Law No 2328/1995'), defines the legal regime governing private television and local radio and the framework within which they operate.

9 Law No 2328/1995 regulates inter alia the grant of licences to found, establish and operate private television stations, and shareholdings in public limited companies which apply for such a licence. In principle, such shareholdings must be registered. Various provisions of the Law have the aim of limiting to 25 % the maximum percentage of the share capital that a natural or legal person can hold in a company which has a licence to found, establish and operate a television station. In addition, any transfer of shareholdings exceeding 2.5 % of the share capital must be notified to the ESR.

10 Article 3 of Law No 2328/1995 provides:

> '1. (b) Broadcasts of any kind (including advertisements) which are transmitted by radio and television stations must respect the character, honour, reputation, private and family life and professional, social, scientific, artistic, political or other similar activity of every person whose image appears on the screen or whose name, or information sufficient to identify him, is broadcast.'

11 Article 3(15) of Law No 2328/1995 requires the ESR to draw up codes of good conduct for the profession of journalist. Article 5 of Regulation No 1/1991 of the ESR provides that 'it is not permitted to present persons in a way which may, in the particular circumstances, foster their humiliation, their social isolation or discrimination against them.'

12 Article 4 of Law No 2328/1995 provides:

> '1. In every case of infringement (a) of the provisions of national legislation, [of legislation] of the European Union and of international law which govern, directly or indirectly, private television stations and, more generally, the operation of private television, (b) …, (c) of the rules of good conduct as determined in accordance with Article 3 of this Law, the following penalties shall be imposed …: (a) recommendations and warnings, (b) a fine of GDR 5 million to GDR 500 million …, (c) temporary suspension for up to three months or definitive cessation of the broadcasting of a particular programme of the station, (d) temporary suspension for up to three months of the broadcasting of every television programme, (e) revocation of the station's operating licence and (f) penalties of an ethical nature (such as the mandatory broadcasting of an announcement concerning the other penalties imposed). The ESR shall submit its decision promptly to the Minister for the Press and the Mass Media, who shall conduct a review as to legality and adopt the measure imposing the penalty. The type and the level of administrative penalties under this article shall be decided upon in the light of the gravity of the infringement, of the audience for the programme in which the infringement has been committed, of the share of the market for radio and

television services which the licence holder may have acquired, of the amount of the investment which has been made or planned and of the existence of any previous infringements. The decision of the ESR concerning the imposition of penalties under this paragraph shall contain a full and specific statement of reasons and shall in every case be drawn up after the interested parties have been heard during at least one meeting of that body's full membership.

…

3. The fines provided for in the preceding paragraphs shall be imposed jointly and severally on the company and personally on its legal representative or representatives, on all the members of its board of directors and on all its shareholders with a holding of over 2.5 %.

…

5. The foregoing administrative penalties shall be independent of the existence of any criminal or civil liability.'

The dispute in the main proceedings and the question referred for a preliminary ruling

13 The applicant in the main proceedings is a public limited company with a shareholding in Nea Tileorasi AE, the owner of the television station Star Channel.

14 It is challenging before the Simvoulio tis Epikratias (Council of State) (Greece) Decision No 11840/E/11.5.2001 of the Minister for the Press and the Mass Media which imposed a fine of GDR 10 000 000 (approximately EUR 29 347) jointly and severally upon it together with Nea Tileorasi AE and the other shareholders and the members of the board of directors of Nea Tileorasi AE on the ground that, during the main news programme of the Star Channel television station on 14 February 2000, it infringed the obligation to respect the character, honour, reputation, family life and presumption of innocence of various personalities. It is also challenging Decision No 122/91/20.4.2000 of the ESR, on the basis of which the contested ministerial decision was adopted.

15 The Fourth Chamber of the Simvoulio tis Epikratias, which was dealing with the case, referred it to the full court because it was of major importance.

16 The Simvoulio tis Epikratias reviewed the constitutionality of Article 4(3) of Law No 2328/1995 inasmuch as it imposes a penalty on the company's shareholders, in light of the principle of economic freedom which is laid down in Article 5 of the Greek Constitution. It held, essentially, that the national legislature is entitled to adopt rules derogating from the general law on public limited companies, and in particular from the principle that a shareholder is not liable for the debts of the legal person, which is a fundamental and binding principle of the general law on public limited companies but not a constitutional principle. The national legislature a fortiori has this power where specific companies which serve the public interest and are under the immediate control of the State are involved. The referring court observed that, in any event, Article 4(3) of Law No 2328/1995 provides not for joint and several liability of the

shareholders in respect of the legal person's 'debts', but for the imposition of administrative penalties on both the company and the persons referred to in that provision. Finally, that provision does not make it impossible or substantially difficult for business activity to be carried on.

17 The Simvoulio tis Epikratias referred, however, to minority opinions of the judges, according to which the provision at issue requires the shareholders of public limited companies in the television sector to pay an administrative fine imposed on the company as such, by reason of an infringement of the legislation in the course of its business, and the fine therefore constitutes a debt forming part of the company's liabilities. In the opinion of those judges, the provision infringes the fundamental principles of the law governing public limited companies — in particular, the principle that the risk incurred by a shareholder should be limited — and therefore economic freedom as protected by Article 5 of the Greek Constitution, which includes the right to set up commercial companies, since the free market economy cannot function without such companies. The principle that the public limited company alone is liable for company debts is the fundamental manifestation of a capital company's nature, which is possessed by public limited companies. It is of little importance that the company carries on an activity in the public interest or that it is subject to State control.

18 When examining compliance with the principle of proportionality, the Simvoulio tis Epikratias held that the legislation at issue pursues a legitimate aim and does not constitute a restriction on economic freedom that is manifestly disproportionate to the objectives that it pursues, since it clearly cannot be regarded as making it impossible or substantially difficult for business activity in the field of founding and operating private television stations to be carried on.

19 The Simvoulio tis Epikratias stated, in particular, that the national legislature, which is aware of the conditions and the actual situation obtaining on the country's television scene, considers that a shareholder with a holding above 2.5% is not an ordinary investor but, in essence, a professional person investing who, by reason of that shareholding in the company, is potentially in a position to influence the administration of the legal person and, therefore, the operation of the television station. The referring court held that this substantive assessment by the national legislature cannot be considered manifestly wrong or inappropriate if account is taken of the fact that, under Law No 2328/1995, the maximum percentage of the share capital that a shareholder (a natural or a legal person) may hold cannot exceed 25% and that, consequently, the collaboration of a number of shareholders in the administration of the company is absolutely necessary in order to influence its management.

20 The Simvoulio tis Epikratias referred, however, to minority opinions of its members that call into question this form of shareholder liability without fault, which is stated to discourage the acquisition of shares in public limited companies in the television sector. According to those members, the measure is not such as to further attainment of the objective pursued, since a shareholding slightly above 2.5% is too small to be capable of influencing the management of the company's affairs and of preventing the company from acting contrary to the rules of professional conduct. The measure is, in actual fact, equivalent to the imposition of a penalty on a shareholder of a public limited company in the television sector who holds a limited percentage of the share capital solely because he is a shareholder of a public limited company of that kind.

21 In this context, the referring court raised the question of the compatibility of Article 4(3) of Law No 2328/1995 with the various European Union directives relating to companies, which it sets out.

22 It held that the field of application of Article 4(3) of Law No 2328/1995 and that of the provisions of the directives relating to companies do not intersect. The latter do not contain any rule concerning or, a fortiori, prohibiting the attribution of liability to the shareholders of a public limited company who hold a certain percentage of shares for payment, jointly and severally with the legal person that is the company, of fines imposed for infringement of legislation by reason, generally, of the activity of that legal person but also, in particular, in the present instance, by reason of the activity of the legal person that is the public limited company holding a licence to found and operate a television station. Such a prohibition cannot be inferred from Article 1 of the First Directive, where the European Union legislature merely lists the types of company which are already in existence in the Member States and to which the provisions of the directive apply.

23 According to the referring court, even if the view were to be taken that the fields of application of the First Directive and of Article 4(3) of Law No 2328/1995 meet, the latter provision would not be contrary to Article 1 of that directive. Article 1 does not provide a definition of public limited company and merely lists the types of company to which the directive applies. Consequently, European Union law does not prevent the national legislature either from introducing new types of companies which do not fall within the field of application of the directives relating to companies or from establishing (special) public limited companies to which provisions diverging from European Union law on public limited companies will apply, in so far, of course, as those divergent provisions are not contrary to specific provisions of the directives relating to companies or of European Union law generally, as is true of Article 4(3) of Law No 2328/1995.

24 According to the Simvoulio tis Epikratias, the fact that European Union law does not guarantee that the shareholders of a public limited company will not be liable for the legal person's debts is apparent from the fact that the principle of lifting the

corporate veil, which results under certain conditions in liability being attributed to the shareholder for the obligations of a public limited company, has been established for decades in the legal systems of numerous Member States, above all through case-law, without the question of that principle conflicting with European Union law being raised, and also from the fact that no steps have been taken to harmonise the conditions for such lifting of the corporate veil.

25 Certain judges expressed a minority opinion, however, taking the view that the term 'ανώνυμη εταιρία [public limited company]' used in Article 1 of the First Directive has a mandatory minimum meaning. According to them, the fundamental characteristics of a public limited company, from which the national legislature cannot derogate, are:

(a) the strict distinction between the company's assets and those of the shareholders, and

(b) the absence of personal liability of shareholders for company debts, given that the shareholders are required only to pay their capital contribution, which corresponds to the ratio of their equity participation in the total company capital.

26 These judges also observed that in no legal system of a Member State of the European Union has legislation or case-law accepted blunting of the principle that shareholders are not liable to pay the debts of the public limited company from their own assets. All that has been accepted in case-law is that, where the assets of a public limited company and of a shareholder have been totally confused and that shareholder has, by his personal acts or omissions, administered what is now a single set of assets in a manner contrary to good faith, he can no longer rely on the principle of independence

of the two sets of assets (his personal one and that of the company) against the company's creditors.

27 The Simvoulio tis Epikratias consequently established that views diverged, first, as to whether the fields of application of Article 1 of the First Directive and Article 4(3) of Law No 2328/1995 intersect and, second, as to the compatibility of the national legislation with Article 1 of the First Directive.

28 In those circumstances, the Simvoulio tis Epikratias held that, in accordance with the third paragraph of Article 234 EC and the judgment in Case 283/81 *Cilfit and Others* [1982] ECR 3415, it was obliged to stay the proceedings and refer the following question to the Court of Justice for a preliminary ruling:

'Does Directive 68/151/EEC, which provides in Article 1 that "the coordination measures prescribed by this Directive shall apply to the laws, regulations and administrative provisions of the Member States relating to the following types of company: … – In Greece: ανώνυμη εταιρία...", contain a rule prohibiting the adoption of a national provision such as Article 4(3) of Law No 2328/1995, in so far as it specifies that the fines provided for in the preceding paragraphs of that article for infringement of legislation and rules of good conduct governing the operation of television stations are imposed jointly and severally, not only on the company which holds the licence to found and operate the television station but also on all shareholders with a holding of over 2.5 %?'

29 The Court requested the interested parties referred to in Article 23 of the Statute of the Court of Justice of the European Union which wished to participate in the hearing to express their views inter alia on the relevance of Article 49 TFEU, relating to freedom of establishment, and Article 63 TFEU, relating to the free movement of capital, to the answer to the question asked by the Simvoulio tis Epikratias.

Consideration of the question referred

30 The question asked by the referring court relates to the interpretation of the First Directive.

31 However, the fact that a national court has, formally speaking, worded the question referred for a preliminary ruling with reference to certain provisions of European Union law does not preclude the Court from providing to the national court all the guidance on points of interpretation which may be of assistance in adjudicating on the case pending before it, whether or not that court has referred to the points in its questions. It is for the Court to extract from all the information provided by the national court, in particular from the grounds of the decision referring the questions, the points of European Union law which require interpretation, having regard to the subject-matter of the dispute (see Case C-115/08 *ČEZ* [2009] ECR I-10265, paragraph 81).

32 In light of the facts of the main proceedings and the applicable Greek legislation, not only the First Directive but also Articles 49 TFEU and 63 TFEU must be interpreted.

The First Directive

33 By its question, the referring court asks whether the First Directive must be interpreted as precluding national legislation such as Article 4(3) of Law No 2328/1995, according to which the fines provided for in the preceding paragraphs of that article for infringement of the legislation and rules of good conduct governing the operation of television stations are imposed jointly and severally, not only on the company

which holds the licence to found and operate the television station but also on all shareholders with a holding of over 2.5 %.

34 The Greek Government observes that Article 4(3) of Law No 2328/1995 provides not that the company's shareholders who hold more than 2.5 % of the shares have joint and several liability generally for the legal person's debts, but that administrative fines for infringement of the legislation and operating rules governing the exploitation of television stations are imposed both on the company which holds the licence to found and operate a television station and on those shareholders, who are of particular importance for the founding and operation of the legal person.

35 It should, however, be recalled that, as is apparent from settled case-law, the procedure laid down in Article 267 TFEU is based on a clear separation of functions between national courts and tribunals and the Court of Justice, and the latter is empowered only to rule on the interpretation or the validity of the acts of European Union law referred to in that article. In that context, it is not for the Court to rule on the interpretation of national laws or regulations or to decide whether the referring court's interpretation of them is correct (see Case C-220/05 *Auroux and Others* [2007] ECR I-385, paragraph 25).

36 The Court must accordingly confine itself to the interpretation of Greek legislation as summarised in paragraph 17 of the present judgment, which constitutes the premiss for the question referred to it.

37 The First Directive was adopted on the basis of Article 54(3)(g) of the EEC Treaty, which has become Article 50(2)(g) TFEU.

38 Article 50(2)(g) TFEU provides that, in order to attain freedom of establishment, the European Union legislature is to adopt directives to coordinate to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 54 TFEU with a view to making such safeguards equivalent throughout the Community. Under the second paragraph of Article 54 TFEU, 'companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

39 As is apparent from the first two recitals in its preamble, the First Directive has the aim of co-ordinating national provisions concerning disclosure by, the validity of obligations entered into by, and the nullity of, companies limited by shares or otherwise having limited liability. The rules which should be set out in each Member State's national law are described in Articles 2 to 12 of the First Directive.

40 Although the third recital in the preamble to the First Directive implies that a principle exists that only companies are required to pay, out of their assets, company debts to third parties, that directive does not prescribe a uniform concept of companies limited by shares or otherwise having limited liability that is based on such a principle. Article 1 of the First Directive lists, on the other hand, for each Member State, the different types of company under the law of that Member State to which the rules laid down in Articles 2 to 12 will have to be applied.

41 It follows that the First Directive does not prescribe what a company limited by shares or otherwise having limited liability must be, but merely lays down rules which must be applied to certain types of companies identified by the European legislature as companies limited by shares or otherwise having limited liability.

42 Furthermore, while it is apparent from an examination of the law of the Member States, such as that conducted by the Advocate General in point 34 of her Opinion, that in the majority of cases shareholders of the companies listed in Article 1 of the First Directive are not required to be personally answerable for the debts of a company limited by shares or otherwise having limited liability, it cannot be concluded therefrom that this is a general principle of company law applicable in all circumstances and without exception.

43 Similarly, with regard to obligations entered into by a company, no general principle can be inferred from Articles 7 to 9 of the First Directive, which merely lay down a number of rules in this regard.

44 It therefore follows neither from the wording of the First Directive nor from interpreting it in the light of its aim or of the law of the Member States that it imposes a rule that a shareholder can never be liable for a fine imposed on a company, including where the fine is imposed jointly and severally on a public limited company and on the shareholder.

45 Nor would the existence of such a rule in national law undermine the First Directive's aim, given the limited nature of the latter.

46 Consequently, the answer to the question referred for a preliminary ruling is that the First Directive must be interpreted as not precluding national legislation such as Article 4(3) of Law No 2328/1995, according to which the fines provided for in the preceding paragraphs of that article for infringement of the legislation and rules of good conduct governing the operation of television stations are imposed jointly and

severally, not only on the company which holds the licence to found and operate the television station but also on all shareholders with a holding of over 2.5 %.

Freedom of establishment and free movement of capital

47 Provisions of national law which apply to the possession by nationals of one Member State of holdings in the capital of a company established in another Member State allowing them to exert a definite influence on the company's decisions and to determine its activities fall within the ambit *ratione materiae* of Article 49 TFEU on freedom of establishment (see to this effect, in particular, Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22; Case C-112/05 *Commission* v *Germany* [2007] ECR I-8995, paragraph 13; and Case C-326/07 *Commission* v *Italy* [2009] ECR I-2291, paragraph 34).

48 Article 63 TFEU on the free movement of capital covers in particular direct investments in the form of participation in an undertaking through the holding of shares which confers the possibility of participating effectively in its management and control, and also portfolio investments, that is to say, the acquisition of securities on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking (see, to this effect, Case C-182/08 *Glaxo Wellcome* [2009] ECR I-8591, paragraph 40).

49 National legislation not intended to apply only to those shareholdings which enable the holder to have a definite influence on a company's decisions and to determine its activities but which applies irrespective of the size of the holding which the shareholder has in a company may fall within the ambit of both Article 49 TFEU and Article 63 TFEU (see Case C-326/07 *Commission* v *Italy*, paragraph 36).

50 In the main proceedings, Greek legislation limits to 25 % the maximum holding that a natural or legal person can have in the share capital of a company which holds a licence to found, establish and operate a television station. Also, Article 4(3) of Law No 2328/1995 provides that a fine may be imposed on a shareholder once he holds more than 2.5 % of the shares in such a company.

51 Depending on the manner in which the remainder of a company's capital is distributed, in particular if it is spread among a large number of shareholders, a holding of 25 % may be sufficient to have control of a company or at least to exert a definite influence on the company's decisions and determine its activities for the purposes of the case-law established in *Baars* set out in paragraph 47 of the present judgment (see, to this effect, Case C-326/07 *Commission* v *Italy*, paragraph 38). The Greek legislation can therefore fall within the scope of Article 49 TFEU.

52 In addition, inasmuch as that legislation applies to shareholders whose holding exceeds 2.5 % but is not sufficient to allow them to control or exert a definite influence on the company's decisions, it can also fall within the scope of Article 63 TFEU.

53 Both those provisions must therefore be interpreted.

54 It is settled case-law that the term 'restriction' within the meaning of Article 49 TFEU covers measures which prohibit or impede the exercise of freedom of establishment or render it less attractive (Case C-518/06 *Commission* v *Italy* [2009] ECR I-3491, paragraph 62).

55 Also, national measures must be regarded as 'restrictions' within the meaning of Article 63(1) TFEU if they are liable to prevent or limit the acquisition of shares in the undertakings concerned or to deter investors of other Member States from investing in their capital (*Commission* v *Germany*, paragraph 19).

56 In the circumstances of the main proceedings, the national measure at issue has a deterrent effect on investors and thereby affects their access to the equity market.

57 The national measure allows shareholders of a public limited company in the television sector to be held liable for fines imposed on that company in order that they see to it that the company observes Greek legislation and rules of good conduct, whereas the powers accorded to those shareholders by the rules applicable to the operation of public limited companies' organs do not actually give them a possibility of so doing.

58 Furthermore, although the measure is applicable without distinction to Greek investors and investors from other Member States, its deterrent effect is greater for investors from other Member States than for Greek investors.

59 Inasmuch as the objective of the Law is to induce shareholders to ally themselves with other shareholders in order to be able to influence the decisions of the company's management, even though this option is applicable to all shareholders it is indisputably much more difficult for use to be made of it in the case of investors from other Member States who know less about the realities of media life in Greece and are not

necessarily acquainted with the various groups or alliances represented amongst the shareholders of a company holding a licence to found, establish and operate a television station.

60 It follows that a national measure such as that at issue in the main proceedings restricts both freedom of establishment and the free movement of capital.

61 That would be so even if such a measure were interpreted in the manner indicated by the Greek Government, set out in paragraph 34 of the present judgment.

62 A restriction on freedom of establishment and the free movement of capital can be accepted where it serves overriding requirements in the public interest, is suitable for securing the attainment of the objective which it pursues and does not go beyond what is necessary in order to attain it (for freedom of establishment, see, to this effect, Case C-518/06 *Commission* v *Italy*, paragraph 72, and for the free movement of capital, see, to this effect, *Commission* v *Germany*, paragraphs 72 and 73).

63 As the referring court has set out, the measure at issue in the main proceedings has the objective of securing compliance by television companies with legislation and journalists' rules of professional conduct in order, inter alia, to prevent the honour or the private life of persons whose image appears on the screen or whose name is referred to from being adversely affected. This is unquestionably a legitimate objective.

64 At the hearing, the Commission submitted that none of the material in the file explained why a shareholder possessing a holding of more than 2.5 % in a television company should be regarded as being in a position to influence the company's administration. When asked about this, the Greek Government stated that, at the time when Law No 2328/1995 was adopted, numerous journalists were such shareholders

and that the objective of that Law was, first, to fragment the capital of television companies in order to prevent a single shareholder having too much power and, second, to encourage the shareholders to come together to adopt decisions relating to programmes.

65 Even if, at the time when Law No 2328/1995 was adopted, a statistical correlation existed between being a shareholder with a holding of 2.5 % in a television company and the profession of journalist, such a link does not appear sufficient to hold that the measure at issue is suitable for securing the attainment of the objective which it pursues or, above all, that it does not go beyond what is necessary in order to attain it.

66 Whilst the profession of journalist may be considered an appropriate criterion for identifying the persons liable to influence the management of a television company, that is not true of merely being a shareholder possessing a holding of slightly more than 2.5 % or even enough shares to exert a definite influence, for the purposes of the judgment in *Baars*, in the organs of the television company.

67 If the objective of the measure is that journalists comply with legislation and their rules of professional conduct, it could be appropriate for them to be punished personally for the infringements that they commit, rather than imposing penalties on shareholders who are not necessarily journalists.

68 In this context, it is to be noted that the Greek legislation contains other possible penalties more appropriate to the objective that it pursues, in that they are imposed in respect of television operations and not the mere holding of share capital, such

as the suspension or cessation of the broadcasting of a particular programme, the temporary suspension for up to three months of the broadcasting of every television programme, the revocation of the station's operating licence or penalties of an ethical nature.

69 Furthermore, to assume that all the shareholders of a public limited company are engaged professionally in the sector within which the company objects fall is the very negation of the free movement of capital, which applies inter alia to portfolio investments, that is to say, the acquisition of securities on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking (Joined Cases C-282/04 and C-283/04 *Commission* v *Netherlands* [2006] ECR I-9141, paragraph 19). It is precisely this type of investment that investors from other Member States who are seeking to diversify their investments would be liable to make.

70 It follows from all the foregoing that Articles 49 TFEU and 63 TFEU must be interpreted as precluding national legislation such as Article 4(3) of Law No 2328/1995, according to which the fines provided for in the preceding paragraphs of that article for infringement of the legislation and rules of good conduct governing the operation of television stations are imposed jointly and severally, not only on the company which holds the licence to found and operate the television station but also on all shareholders with a holding of over 2.5 %.

Costs

71 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the referring court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Second Chamber) hereby rules:

1. **First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, must be interpreted as not precluding national legislation such as Article 4(3) of Law No 2328/1995 'Legal regime governing private television and local radio, regulation of issues relating to the broadcasting market and other provisions', as amended by Law No 2644/1998 'on the provision of subscription radio and television services', according to which the fines provided for in the preceding paragraphs of that article for infringement of the legislation and rules of good conduct governing the operation of television stations are imposed jointly and severally, not only on the company which holds the licence to found and operate the television station but also on all shareholders with a holding of over 2.5 %.**

2. **Articles 49 TFEU and 63 TFEU must be interpreted as precluding such national legislation.**

[Signatures]

Reports of Cases

JUDGMENT OF THE COURT (Fifth Chamber)

3 September 2020*

(Reference for a preliminary ruling – Electronic communications – Article 11(2) of the Charter of Fundamental Rights of the European Union – Freedom and pluralism of the media – Freedom of establishment – Article 49 TFEU – Directive 2002/21/EC – Articles 15 and 16 – National legislation prohibiting an undertaking which has significant market power in a sector from establishing a 'significant economic dimension' in another sector – Calculation of revenues received in the electronic communications sector and the media sector – Definition of the electronic communications sector – Restriction to markets which have been subject to *ex ante* regulation – Account taken of the income of affiliated companies – Fixing of different income thresholds for undertakings active in the electronic communications sector)

In Case C-719/18,

REQUEST for a preliminary ruling under Article 267 TFEU from the Tribunale amministrativo regionale per il Lazio (Regional Administrative Court, Lazio, Italy), made by decision of 26 September 2018, received at the Court on 15 November 2018, in the proceedings

Vivendi SA

v

Autorità per le Garanzie nelle Comunicazioni,

intervening party:

Mediaset SpA,

THE COURT (Fifth Chamber),

composed of E. Regan, President of the Chamber, I. Jarukaitis (Rapporteur), E. Juhász, M. Ilešič and C. Lycourgos, Judges,

Advocate General: M. Campos Sánchez-Bordona,

Registrar: R. Șereș, Administrator,

having regard to the written procedure and further to the hearing on 9 October 2019,

after considering the observations submitted on behalf of:

– Vivendi SA, by G. Scassellati Sforzolini, G. Faella, C.F. Emanuele and M. D'Ostuni, avvocati,

* Language of the case: Italian.

– Mediaset SpA, by A. Catricalà, D. Lipani, C.E. Cazzato, G.M. Roberti, G. Bellitti and M. Serpone, avvocati,

– the Italian Government, by G. Palmieri, acting as Agent, and S. Fiorentino, avvocato dello Stato,

– the European Commission, by L. Armati, L. Nicolae and L. Malferrari, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 18 December 2019,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Articles 49, 56 and 63 TFEU and Articles 15 and 16 of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive) (OJ 2002 L 108, p. 33), as amended by Directive 2009/140/EC of the European Parliament and of the Council of 25 November 2009 (OJ 2009 L 337, p. 37), ('the Framework Directive').

2 The request has been made in proceedings between Vivendi SA, on the one hand, and the Autorità per le Garanzie nelle Comunicazioni (Communications Regulatory Authority, Italy) ('AGCOM') and Mediaset SpA, on the other, concerning a provision of Italian law which prohibits an undertaking from receiving revenue in excess of 10% of the total revenues generated in the integrated communications system ('the SIC'), in the case where that undertaking has a share of more than 40% of the total revenues generated in the electronic communications sector.

Legal context

EU law

The Framework Directive

3 Recitals 5, 25 and 27 of the Framework Directive state:

'(5) The convergence of the telecommunications, media and information technology sectors means all transmission networks and services should be covered by a single regulatory framework. … It is necessary to separate the regulation of transmission from the regulation of content. This framework does not therefore cover the content of services delivered over electronic communications networks using electronic communications services, such as broadcasting content, financial services and certain information society services, and is therefore without prejudice to measures taken at [EU] or national level in respect of such services, in compliance with [EU] law, in order to promote cultural and linguistic diversity and to ensure the defence of media pluralism. … The separation between the regulation of transmission and the regulation of content does not prejudice the taking into account of the links existing between them, in particular in order to guarantee media pluralism, cultural diversity and consumer protection.

…

(25) There is a need for *ex ante* obligations in certain circumstances in order to ensure the development of a competitive market. The definition of significant market power in Directive 97/33/EC of the European Parliament and of the Council of 30 June 1997 on interconnection in telecommunications with regard to ensuring universal service and interoperability through application of the principles of open network provision (ONP) [(OJ 1997 L 199, p. 32)] has proved effective in the initial stages of market opening as the threshold for *ex ante* obligations, but now needs to be adapted to suit more complex and dynamic markets. For this reason, the definition used in this Directive is equivalent to the concept of dominance as defined in the case-law of the Court of Justice and the [General] Court …

…

(27) It is essential that *ex ante* regulatory obligations should only be imposed where there is not effective competition, i.e. in markets where there are one or more undertakings with significant market power, and where national and [EU] competition law remedies are not sufficient to address the problem. It is necessary therefore for the [European] Commission to draw up guidelines at [EU] level in accordance with the principles of competition law for national regulatory authorities to follow in assessing whether competition is effective in a given market and in assessing significant market power. …'

4 Article 1 of that directive, headed 'Scope and aim', provides:

'1. This Directive establishes a harmonised framework for the regulation of electronic communications services, electronic communications networks, associated facilities and associated services, and certain aspects of terminal equipment to facilitate access for disabled users. It lays down tasks of national regulatory authorities and establishes a set of procedures to ensure the harmonised application of the regulatory framework throughout the [European Union].

2. This Directive as well as the Specific Directives are without prejudice to obligations imposed by national law in accordance with [EU] law or by [EU] law in respect of services provided using electronic communications networks and services.

3. This Directive as well as the Specific Directives are without prejudice to measures taken at [EU] or national level, in compliance with [EU] law, to pursue general interest objectives, in particular relating to content regulation and audio-visual policy.

…'

5 Article 2 of that directive, headed 'Definitions', states:

'…

(c) "electronic communications service" means a service normally provided for remuneration which consists wholly or mainly in the conveyance of signals on electronic communications networks, including telecommunications services and transmission services in networks used for broadcasting, but exclude services providing, or exercising editorial control over, content transmitted using electronic communications networks and services …;

…'

6 Article 15 of the Framework Directive, headed ‘Procedure for the identification and definition of markets’, provides:

‘1. After public consultation including with national regulatory authorities and taking the utmost account of the opinion of [the Body of European Regulators for Electronic Communications (BEREC)], the Commission shall, in accordance with the advisory procedure referred to in Article 22(2), adopt a Recommendation on Relevant Product and Service Markets (the Recommendation). The Recommendation shall identify those product and service markets within the electronic communications sector the characteristics of which may be such as to justify the imposition of regulatory obligations set out in the Specific Directives, without prejudice to markets that may be defined in specific cases under competition law. The Commission shall define markets in accordance with the principles of competition law.

The Commission shall regularly review the Recommendation.

2. The Commission shall publish, at the latest on the date of entry into force of this Directive, guidelines for market analysis and the assessment of significant market power (hereinafter “the Guidelines”) which shall be in accordance with the principles of competition law.

3. National regulatory authorities shall, taking the utmost account of the Recommendation and the Guidelines, define relevant markets appropriate to national circumstances, in particular relevant geographic markets within their territory, in accordance with the principles of competition law. National regulatory authorities shall follow the procedures referred to in Articles 6 and 7 before defining the markets that differ from those identified in the Recommendation.

4. After consultation including with national regulatory authorities the Commission may, taking the utmost account of the opinion of BEREC, adopt a Decision identifying transnational markets …’

7 Article 16 of the Framework Directive, headed ‘Market analysis procedure’, states:

‘1. National regulatory authorities shall carry out an analysis of the relevant markets taking into account the markets identified in the Recommendation, and taking the utmost account of the Guidelines. Member States shall ensure that this analysis is carried out, where appropriate, in collaboration with the national competition authorities.

2. Where a national regulatory authority is required under paragraphs 3 or 4 of this Article, Article 17 of Directive 2002/22/EC [of the European Parliament and of the Council of 7 March 2002 on universal service and users’ rights relating to electronic communications networks and services] (Universal Service Directive) [(OJ 2002 L 108, p. 51)], or Article 8 of Directive 2002/19/EC [of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities] (Access Directive) [(OJ 2002 L 108, p. 7)] to determine whether to impose, maintain, amend or withdraw obligations on undertakings, it shall determine on the basis of its market analysis referred to in paragraph 1 of this Article whether a relevant market is effectively competitive.

3. Where a national regulatory authority concludes that the market is effectively competitive, it shall not impose or maintain any of the specific regulatory obligations referred to in paragraph 2 of this Article. In cases where sector specific regulatory obligations already exist, it shall withdraw such obligations placed on undertakings in that relevant market. An appropriate period of notice shall be given to parties affected by such a withdrawal of obligations.

4. Where a national regulatory authority determines that a relevant market is not effectively competitive, it shall identify undertakings which individually or jointly have a significant market power on that market in accordance with Article 14, and the national regulatory authority shall on such undertakings impose appropriate specific regulatory obligations referred to in paragraph 2 of this Article or maintain or amend such obligations where they already exist.

…'

The Audiovisual Media Services Directive

8 Recitals 5 and 8 of Directive 2010/13/EU of the European Parliament and of the Council of 10 March 2010 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services (Audiovisual Media Services Directive) (OJ 2010 L 95, p. 1) ('the Audiovisual Media Services Directive') state:

'(5) Audiovisual media services are as much cultural services as they are economic services. Their growing importance for societies, democracy – in particular by ensuring freedom of information, diversity of opinion and media pluralism – education and culture justifies the application of specific rules to these services.

…

(8) It is essential for the Member States to ensure the prevention of any acts which may prove detrimental to freedom of movement and trade in television programmes or which may promote the creation of dominant positions which would lead to restrictions on pluralism and freedom of televised information and of the information sector as a whole.'

Italian law

TUSMAR

9 Decreto legislativo n. 177 – Testo Unico dei Servizi di Media Audiovisivi e Radiofonici (Legislative Decree No 177 consolidating the provisions on broadcasting and audiovisual media services) of 31 July 2005 (Ordinary Supplement to *GURI* No 208 of 7 September 2005), in the version applicable to the dispute in the main proceedings ('TUSMAR'), provides in Article 2(1)(s):

'The "[SIC]" covers the following activities: daily newspapers and periodicals; publication of directories and electronic publications, including via the internet; radio and audiovisual media services; cinema; external advertising; communication initiatives for goods and services; sponsorship.'

10 Article 43 of TUSMAR, headed 'Dominant positions in the [SIC]', provides:

'1. Entities active in the [SIC] shall be required to notify [AGCOM] of agreements and concentrations, in order that the latter may verify compliance with the principles set out in paragraphs 7, 8, 9, 10, 11 and …, in accordance with the procedures laid down in the ad hoc regulation adopted by [AGCOM].

…

5. Adapting to changes in market characteristics, … [AGCOM] shall take the measures necessary to eliminate or prevent the formation of the positions referred to in paragraphs 7, 8, 9, 10, 11 … or any other position detrimental to pluralism. …

7. When fully implementing the national plan for the allocation of digital radio and television frequencies, a single content provider may not – including through companies which may be regarded as being controlled by it or affiliated with it within the meaning of paragraphs 13, 14 and 15 of this article – be the holder of authorisations permitting it to broadcast more than 20% of all television programmes or more than 20% of the radio programmes broadcast via terrestrial radio link at national level on the networks provided for at that level.

8. Until the national plan for the allocation of digital television frequencies is implemented in full, the limit set for the total number of programmes per entity shall be 20%, calculated in relation to the total number of television programmes that, including for the purposes of Article 23(1) of legge n. 112 – Norme di principio in materia di assetto del sistema radiotelevisivo e della RAI-Radiotelevisione italiana SpA, nonche' delega al Governo per l'emanazione del testo unico della radiotelevisione (Law No 112 on regulations and principles governing the set-up of the broadcasting system and RAI-Radiotelevisione italiana SpA, authorising the government to issue a consolidated broadcasting statute) of 3 May 2004 [(Ordinary Supplement to *GURI* No 104 of 5 May 2004)], are licensed or broadcast at the national level on both analogue and digital terrestrial frequencies. Digitally broadcast television programmes may combine to form the basis for calculation where they cover 50% of the population. In determining whether there is compliance with the 20% limit, no account shall be taken of the programmes which make up the simultaneous retransmission of those broadcast in analogue mode. This calculation criterion shall apply only to entities which digitally broadcast programmes covering 50% of the national population.

9. Without prejudice to the prohibition on creating dominant positions within the individual markets that make up the [SIC], entities which are required to be entered in the Register of Communications Operators established under Article 1(6)(a)(5) of legge n. 249 – Istituzione dell'Autorità per le garanzie nelle comunicazioni e norme sui sistemi delle telecomunicazioni e radiotelevisivo (Law No 249 establishing the Communications Regulatory Authority and laying down rules relating to the telecommunications and radiotelevision systems) of 31 July 1997 [(Ordinary Supplement to *GURI* No 177 of 31 July 1997)] may neither directly, nor through controlled or affiliated companies within the meaning of paragraphs 14 and 15, earn revenue exceeding 20% of the total revenues in the [SIC].

10. The revenues referred to in paragraph 9 are those received from public service broadcasting funding, after deduction of the duties payable to the Treasury, from national and local advertising, including in direct form, from teleshopping, from sponsorship, from product dissemination activities at points of sale, with the exception of discounts on prices, from continuous agreements concluded with public entities and from public aid granted directly to the entities carrying on the activities referred to in Article 2(1)(s), from pay-television offers, from subscriptions and sales of newspapers and periodicals, including in direct form, from television products, including printed and audio products marketed in annex, from press agencies operating on a national scale, from electronic publication and publication of directories, including on the internet, from advertising online and on various platforms, whether or not direct, including resources obtained by search engines and social and sharing platforms, and from the use of cinematographic works in various forms accessible to the public.

11. Undertakings the revenue of which in the electronic communications sector as defined in Article 18 of decreto legislativo n. 259 – Codice delle comunicazioni elettroniche (Legislative Decree No 259 establishing the Electronic Communications Code) of 1 August 2003 [(Ordinary Supplement to *GURI* No 214 of 15 September 2003)], including that of subsidiaries or affiliates, exceeds 40% of the total revenues in that sector, may not earn, within the [SIC], revenue exceeding 10% of the total revenues generated in that system.

…

13. For the purposes of determining dominant positions prohibited under this consolidated text in the [SIC], account shall also be taken of shares acquired or, in any event, held by subsidiaries, even indirectly, by fiduciary companies, or through intermediaries. Shareholdings are considered to be acquired when their ownership passes from one entity to another as a result of or in connection with a merger, division, assignment, company transfer or similar transaction concerning those entities. Where there are agreements, of any kind, between the various shareholders concerning the concerted exercise of voting rights or, in any event, the management of the company concerned, distinct from mere mutual consultation between the shareholders, each shareholder shall be deemed to hold all the stocks or shares owned or controlled by the parties involved.

14. For the purposes of the present Consolidated Law, there is control, in particular with regard to entities other than companies, in the cases provided for in the first and second paragraphs of Article 2359 of the Codice civile (Civil Code).

15. Control is considered to exist in the form of the exercise of a dominant influence, in the absence of evidence to the contrary, in any of the following situations:

(a) where there is an entity which, alone or in conjunction with other shareholders, is able to exercise a majority of the votes in ordinary shareholders' meetings or to appoint or revoke the majority of directors;

(b) where there are, in particular between the members, financial, organisational or economic links capable of producing any of the following effects:
   (1) profit and loss transfer;
   (2) coordination of the management of an undertaking with that of other undertakings, with a view to pursuing a common objective;
   (3) conferral of powers exceeding those inherent in the stocks or shares held;
   (4) conferral of powers, as regards the selection of directors and managers of undertakings, on entities other than those so entitled on the basis of the ownership structure;

(c) where there is a relationship of subordination to common management, which may, inter alia, result from the compositional characteristics of the administrative bodies or from other significant qualitative factors.

…'

The Civil Code

11 Article 2359 of the Civil Code, headed 'Controlled companies and affiliated companies', provides:

'The following shall be regarded as controlled companies:

1. companies in which another company holds the majority of the voting rights that may be exercised in ordinary shareholders' meetings;

2. companies in which another company holds sufficient voting rights to exercise a dominant influence in ordinary shareholders' meetings;

3. companies which are under the dominant influence of another company by virtue of specific contractual links.

For the purposes of applying points 1 and 2 of the first paragraph, account shall also be taken of votes available to controlled companies, trust companies and intermediaries; no account shall be taken of votes exercised on behalf of third parties.

Companies over which another company exercises significant influence shall be regarded as affiliates. Such influence shall be presumed where, in ordinary shareholders' meetings, that other company is able to exercise at least one fifth of the voting rights, or one tenth if the company shares are quoted on regulated markets.'

The Electronic Communications Code

12 Article 18 of Legislative Decree No 259 establishing the Electronic Communications Code, in the version applicable to the dispute in the main proceedings ('the Electronic Communications Code'), is headed 'Procedure for listing and defining markets'. It provides as follows:

'1. While taking utmost account of the recommendations in relation to the relevant product and service markets in the electronic communications sector (hereinafter referred to as "the recommendations") and the Guidelines, [AGCOM] shall define the relevant markets in accordance with the principles of competition law and on the basis of the characteristics and structure of the national electronic communications market. [AGCOM] shall follow the procedure provided for in Articles 11 and 12 before defining the markets that differ from those identified in the recommendations.'

Law No 249 of 31 July 1997

13 Law No 249 of 31 July 1997 indicates in its Article 1(6)(a)(5) that the powers of AGCOM include the following:

'[AGCOM] shall ensure the maintenance of the Register of Communications Operators in which the following are required to be entered in accordance with the present law: operators granted licences or authorisations by [AGCOM] or other competent authorities under the legislation in force, advertising undertakings which are concessionaires for advertising broadcast by means of radio or television equipment or in daily or periodical newspapers, on the internet and other fixed or mobile digital platforms, undertakings engaged in the production and distribution of radio and television programmes, undertakings publishing daily newspapers, periodicals or reviews, press agencies and undertakings providing telematic and telecommunications services, including electronic and digital publishing. The broadcasting infrastructures operating in the national territory shall also be recorded in the register. [AGCOM] shall adopt a specific regulation governing the organisation and maintenance of the register and establishment of the criteria for determining which entities are required to register, independently of those already entered on the register on the date on which the present Law enters into force.'

The dispute in the main proceedings and the questions referred for a preliminary ruling

14 Vivendi, a company governed by French law and entered in the Paris (France) register of companies, is the parent company of a group that is active in the media sector and in the creation and distribution of audiovisual content.

15 Vivendi holds a 23.9% stake in the capital of Telecom Italia SpA, a company which it controls since, in essence, it secured a majority of the voting rights in the general meeting of that company at the vote which took place at the shareholders' meeting on 4 May 2017.

16 On 8 April 2016, Vivendi, Mediaset and Reti Televisive Italiane SpA entered into a strategic partnership agreement under which Vivendi acquired 3.5% of Mediaset's share capital and 100% of Mediaset Premium SpA's share capital, in exchange for transferring 3.5% of its own share capital to Mediaset.

17 In December 2016, as a result of disagreements relating to that agreement, Vivendi launched a hostile acquisition campaign for shares in Mediaset. By 22 December 2016, Vivendi had thus succeeded in securing 28.8% of Mediaset's share capital and 29.94% of the voting rights at Mediaset's shareholders' meetings. That qualified minority shareholding did not, however, enable it to exercise control over Mediaset, which remained under the control of the Fininvest group.

18 Against that background, on 20 December 2016, Mediaset lodged a complaint with AGCOM, alleging that Vivendi had infringed Article 43(11) of TUSMAR ('the provision at issue in the main proceedings'), on the ground that Vivendi's shareholdings in Telecom Italia and in Mediaset meant that Vivendi's revenue in the electronic communications sector, on the one hand, and in the SIC, on the other hand, exceeded, according to Mediaset, the thresholds laid down in that provision, under which undertakings the revenue of which in the electronic communications sector, including that secured through controlled or affiliated undertakings, is greater than 40% of the total revenues generated in that sector, may not earn, within the SIC, revenue exceeding 10% of the total revenues generated in that system.

19 By decision of 18 April 2017 ('the decision of AGCOM'), AGCOM held that Vivendi had infringed the provision at issue in the main proceedings. In that regard, AGCOM noted that (i) Vivendi was a company affiliated with Telecom Italia and Mediaset since it held more than one fifth of the voting rights in the shareholders' meetings of each of those companies, (ii) Vivendi had secured 59% of the revenues generated in the electronic communications sector, which consists of fixed network retail services, fixed and mobile network wholesale services and television broadcasting services for the transmission of content to end users, and (iii) Mediaset had received 13.3% of the revenues generated in the SIC. By that decision, AGCOM also ordered Vivendi to terminate its acquisition of shareholdings in Mediaset or in Telecom Italia within 12 months.

20 In that decision, AGCOM took the view, inter alia, that only markets which had been regulated in accordance with Articles 15 and 16 of the Framework Directive were relevant for the purposes of applying the provision at issue in the main proceedings. It also stated that that provision was intended to protect media pluralism and that its objective in particular was to avoid, in the light of the growing phenomenon of convergence between telecommunications and the media, distorting effects on media pluralism, which may occur where an undertaking with significant market power in the electronic communications sector acquires a 'significant economic dimension' in the SIC. In that context, AGCOM added that the limits laid down by the provision at issue in the main proceedings were automatic, since they apply independently of any analysis of those distorting effects and irrespective of any consideration relating to competition law.

21 On 6 April 2018, Vivendi complied with the injunction issued to it by AGCOM by transferring to a third company 19.19% of the share capital in Mediaset, representing 19.95% of the voting rights in Mediaset's shareholders' meetings. Vivendi thus retained a direct holding in Mediaset's capital of less than 10% of the voting power in Mediaset's shareholders' meetings.

22 Vivendi nevertheless brought an action against AGCOM's decision before the Tribunale amministrativo regionale per il Lazio (Regional Administrative Court, Lazio, Italy), the referring court.

23 In that action Vivendi claims, in the first place, that AGCOM incorrectly defined the electronic communications sector in so far as, in calculating the total revenues generated in that sector, AGCOM ought to have taken into consideration all of the markets actually comprising the electronic communications sector and not only some of those markets, namely those which have been the

subject of a market analysis decision designed to detect the presence of an operator in a dominant position, to the exclusion of significant markets such as the market for mobile telephone retail services.

24 In the second place, Vivendi submits that AGCOM incorrectly interpreted the concept of 'affiliated company', within the meaning of the third paragraph of Article 2359 of the Civil Code, by taking into account the revenues of the companies belonging to the Mediaset group, whereas these are neither controlled by nor affiliated with Vivendi and Vivendi exercises no 'significant influence' over them within the meaning of that provision.

25 In the third place, Vivendi alleges infringement of Articles 49, 56 and 63 TFEU, in so far as, in its view, AGCOM's decision adversely affected the ability of a company registered in France to acquire a minority shareholding in a company registered in Italy.

26 In the fourth place, Vivendi alleges that the provision at issue in the main proceedings is discriminatory, given that, for certain other operators in the electronic communications sector, it sets the threshold for revenue obtained in the SIC at 20% instead of 10%.

27 AGCOM submits that the legal basis of the prohibition of establishing a 'significant economic dimension' in the SIC, laid down by the provision at issue in the main proceedings, is the principle of media pluralism, enshrined in particular in Article 11 of the Charter of Fundamental Rights of the European Union, and in recital 8 of the Audiovisual Media Services Directive. AGCOM also notes that, according to the Court's case-law, the fundamental freedoms may be restricted in order to ensure media pluralism in the Member States.

28 In that context, the referring court observes that it is necessary to assess the appropriateness and proportionality of the restrictions imposed by the provision at issue in the main proceedings not only in relation to the freedom of establishment, the freedom to provide services and the free movement of capital, but also in relation to principles such as the freedom and pluralism of the media.

29 In those circumstances, the Tribunale amministrativo regionale per il Lazio (Regional Administrative Court, Lazio) decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) While Member States have the ability to investigate when undertakings have a dominant position (and to impose specific obligations on those undertakings as a result), is [the provision at issue in the main proceedings] incompatible with EU law and, in particular, with the principle of free movement of capital laid down in Article 63 TFEU? This question is asked in so far as that provision, by reference to Article 18 of the Electronic Communications Code, restricts the sector in question to the markets susceptible to *ex ante* regulation, despite it being common knowledge that information (the pluralism of which the rule is designed to protect) is increasingly conveyed by the use of the internet, personal computers and mobile telephony, which is sufficient to make it unreasonable to exclude from that sector, in particular, mobile telephone retail services, simply because they operate entirely competitively. This question is also asked in the light of the fact that, for the purposes of applying [the provision at issue in the main proceedings], AGCOM, [in the course of the main proceedings], defined the electronic communications sector by taking into account only the markets where at least one analysis has been carried out since the entry into force of the [Electronic Communications Code], that is to say, from 2003 to date, and with revenues resulting from the last useful assessment, carried out in 2015.

(2) Do the principles of freedom of establishment and freedom to provide services laid down in Articles 49 and 56 TFEU [and] Articles 15 and 16 of [the Framework Directive], which are intended to safeguard pluralism and freedom of expression, together with the EU-law principle of proportionality, preclude the application of national legislation concerning public broadcasting and

audiovisual media services, such as that of Italy, contained in [the provision at issue in the main proceedings] and Article 43(14) [of TUSMAR], according to which the revenues relevant for determining the second threshold of 10% include those of undertakings that are neither subsidiaries nor under a dominant influence, but are merely 'affiliates' within the meaning of Article 2359 of the Codice Civile (Civil Code) (referred to in Article 43(14) [of TUSMAR]), even if it is not possible to exert any influence on the information being broadcast by those undertakings?

(3) Do the principles of freedom of establishment and freedom to provide services laid down in Articles 49 and 56 TFEU [and] Articles 15 and 16 of [the Framework Directive], together with the principles on safeguarding pluralism of information sources and competition in the broadcasting sector laid down by [the Audiovisual Media Services Directive] and by [the Framework Directive], preclude national legislation such as [TUSMAR] which, in Article 43(9) thereof and in [the provision at issue in the main proceedings], sets very different thresholds (20% and 10% respectively) for "entities required to be entered in the Register of Communications Operators established under Article 1(6)(a)(5) of Law No 249 of 31 July 1997" (that is, entities that have received a concession or authorisation under the legislation in force, from AGCOM or from other competent administrative authorities, and concessionaires of advertising, however transmitted, publishers, and so on, referred to in Article 43(9)), on the one hand, and for undertakings operating in the electronic communications sector, as defined above (covered by [the provision at issue in the main proceedings]), on the other?'

Consideration of the questions referred

Admissibility

30 The Italian Government takes the view that the first question is hypothetical, on the ground that, even if the electronic communications sector had been defined more broadly, Vivendi's share for the reference year would, as a result of its control over Telecom Italia, have been equal to 45.9% of the revenues generated in that sector. The threshold of 40% laid down by the provision at issue in the main proceedings would therefore, it submits, have been exceeded in any event.

31 Mediaset claims that the request for a preliminary ruling is inadmissible in its entirety, on the ground that the referring court does not define the national legislative framework in a clear and coherent manner or explain how certain provisions of EU law to which it refers in that request are relevant to the outcome of the dispute in the main proceedings.

32 In that regard, it should be recalled that it is solely for the national court before which the dispute has been brought, and which must assume responsibility for the subsequent judicial decision, to determine, in the light of the particular circumstances of the case, both the need for a preliminary ruling in order to enable it to deliver judgment and the relevance of the questions which it submits to the Court. Consequently, where the questions submitted concern the interpretation of a rule of EU law, the Court is in principle bound to give a ruling (judgment of 10 December 2018, *Wightman and Others*, C-621/18, EU:C:2018:999, paragraph 26 and the case-law cited).

33 It follows that questions relating to EU law enjoy a presumption of relevance. The Court may refuse to rule on a question referred for a preliminary ruling by a national court only where it is quite obvious that the interpretation of EU law that is sought bears no relation to the actual facts of the main action or its purpose, where the problem is hypothetical, or where the Court does not have before it the factual or legal material necessary to give a useful answer to the questions submitted to it (judgment of 10 December 2018, *Wightman and Others*, C-621/18, EU:C:2018:999, paragraph 27 and the case-law cited).

34 In the present case, with regard to the Italian Government's arguments, it should be noted that the first question referred specifically concerns the compatibility with EU law of the threshold of 40% of the total revenues generated in the electronic communications sector, which is set in order to restrict the access of undertakings active in that sector to the SIC. The fact that, as that Government claims, Vivendi would in any event exceed that threshold has no bearing on the question as to whether the very existence of such a threshold may be regarded as compatible with EU law, which is, in essence, what the referring court seeks to determine. Thus, the first question is not hypothetical within the meaning of the case-law cited in paragraph 33 above.

35 As regards the arguments put forward by Mediaset, it should be noted that, even though, in the request for a preliminary ruling, the referring court mentions certain provisions of EU law without explaining their relevance to the outcome of the dispute in the main proceedings, that request contains sufficient information to make it possible to understand the points of law raised as regards the possible incompatibility of the provision at issue in the main proceedings with the rules of EU law.

36 It follows that the questions referred for a preliminary ruling are admissible.

Substance

Preliminary observations

37 In the first place, it should be noted that the first question referred for a preliminary ruling refers to Article 63 TFEU, relating to the free movement of capital, while the second and third questions refer to Article 49 TFEU, relating to freedom of establishment, and to Article 56 TFEU, relating to the freedom to provide services. Thus, it is appropriate to begin by determining the freedom which is relevant in the present case.

38 In that regard, it should be noted, first of all, that the order for reference does not contain any specific information to suggest that the case in the main proceedings concerns the cross-border supply of services. Accordingly, the Court will not examine Article 56 TFEU in the context of this reference for a preliminary ruling.

39 Next, concerning the freedom of establishment and the free movement of capital, it must be borne in mind that, as regards the question whether national legislation comes within the scope of either of those freedoms, it is clear from well-established case-law that the purpose of the legislation concerned must be taken into consideration (see, to that effect, judgment of 13 November 2012, *Test Claimants in the FII Group Litigation*, C-35/11, EU:C:2012:707, paragraph 90 and the case-law cited).

40 Thus, national legislation intended to apply only to those acquisitions of shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities comes within the scope of Article 49 TFEU on freedom of establishment (judgment of 13 November 2012, *Test Claimants in the FII Group Litigation*, C-35/11, EU:C:2012:707, paragraph 91 and the case-law cited).

41 By contrast, national provisions which apply to shareholdings acquired with the sole intention of making a financial investment without any intention to influence the management and control of the undertaking concerned must be examined exclusively in the light of the free movement of capital (judgment of 13 November 2012, *Test Claimants in the FII Group Litigation*, C-35/11, EU:C:2012:707, paragraph 92 and the case-law cited).

42 In the present case, the objective of Article 43 of TUSMAR is to monitor concentrations in the SIC in order to avoid the creation of 'dominant positions', within the meaning of Italian law, in each of the markets which make up the SIC. In other words, the purpose of that article, which includes the provision at issue in the main proceedings, is, overall, to set limits on the control which may be exercised over companies active in the SIC.

43 In that regard, the provision at issue in the main proceedings, which prevents a company the revenue of which in the electronic communications sector exceeds 40% of the total revenues generated in that sector from earning revenue in the SIC that corresponds to more than 10% of the total revenues generated in that system, allows limits to be placed on such control.

44 Furthermore, first, the acquisition of 23.94% of Telecom Italia's capital enabled Vivendi to obtain a majority of the voting rights in Telecom Italia's shareholders' meetings and, subsequently, to acquire control of that undertaking, a situation which comes within the scope of freedom of establishment. Second, it is apparent from the file before the Court that the objective pursued by Vivendi when it acquired Mediaset's shares was not to make a mere financial investment, but to intervene in the management of Mediaset and to acquire a significant share of the Italian media sector.

45 Thus, in the light of the general objective of Article 43 of TUSMAR and the purpose of the acquisition of the shareholdings at issue in the main proceedings, which is to exert a definite influence on Mediaset's decisions and the determination of its activities, within the meaning of the case-law referred to in paragraph 40 above, the present case must be examined in the light of the provisions of the FEU Treaty on freedom of establishment.

46 In the second place, it must be noted that the second and third questions referred for a preliminary ruling refer to Articles 15 and 16 of the Framework Directive, the principle of proportionality and the principle of competition in the television broadcasting sector referred to in the Audiovisual Media Services Directive and in the Framework Directive.

47 In that regard, it should be observed, first, that both the Framework Directive and the Audiovisual Media Services Directive effect a non-exhaustive harmonisation of national rules in their respective fields, leaving the Member States with a margin of discretion to adopt decisions at national level. In particular, in accordance with Article 1(3) of the Framework Directive, the Member States remain competent to pursue general interest objectives, in particular relating to content regulation and audiovisual policy, having due regard for EU law.

48 Second, it is not apparent from the order for reference to what extent the provision at issue in the main proceedings might conflict with Articles 15 and 16 of the Framework Directive, the principle of proportionality and the principle of competition in the television broadcasting sector referred to in the Audiovisual Media Services Directive and in the Framework Directive. Those articles and principles are mentioned in the order for reference without any explanation as to what connection they have with the questions referred.

49 Thus, even though certain provisions of those two directives may, where appropriate, be taken into account in the examination of the questions referred for a preliminary ruling, those questions do not in fact relate to the obligations which may arise from those articles and principles. By contrast, they raise the question of the extent to which the provision at issue in the main proceedings exceeds the discretion granted to the Member States by the Framework Directive and the Audiovisual Media Services Directive, which makes necessary an examination in the light of the primary law, in this case Article 49 TFEU.

Consideration of the questions referred

50 By its three questions, which it is appropriate to examine together, the referring court asks, in essence, whether Article 49 TFEU must be interpreted as precluding legislation of a Member State which has the effect of preventing a company registered in another Member State, the revenue of which in the electronic communications sector, as defined for the purposes of that national legislation, including through controlled or affiliated companies, is in excess of 40% of the total revenues in that sector, from earning, within the SIC, revenue exceeding 10% of the total revenues generated in that system.

51 In that regard, it must be borne in mind that Article 49 TFEU precludes any national measure which, even if applicable without discrimination on grounds of nationality, is liable to hinder or render less attractive the exercise by EU nationals of the freedom of establishment guaranteed by the FEU Treaty, and that such restrictive effects may arise, inter alia, where, on account of national legislation, a company may be deterred from setting up subsidiary bodies, such as permanent establishments, in other Member States and from carrying on its activities through such bodies (judgment of 10 May 2012, *Duomo Gpa and Others*, C-357/10 to C-359/10, EU:C:2012:283, paragraph 35 and the case-law cited).

52 That is that case of the provision at issue in the main proceedings, since it prohibits any undertaking, whether or not established in the national territory, the revenue of which in the electronic communications sector as defined for the purposes of that provision represents 40% of the total revenues generated in that sector, from exceeding the threshold of 10% of the revenues generated in the SIC and, therefore, from taking control, as the case may be, of another undertaking established in that territory which carries on activities there.

53 Thus, in the present case, as is apparent from paragraphs 17 to 20 above, when Vivendi acquired 28.8% of Mediaset's share capital and 29.94% of the voting rights in Mediaset's shareholders' meetings, AGCOM prohibited Vivendi, on the basis of that provision, from retaining the shareholdings that it had acquired in Mediaset or that it held in Telecom Italia and ordered Vivendi to cease to hold those shares in one or other of those undertakings in so far as they exceeded the thresholds laid down in that provision.

54 The provision at issue in the main proceedings thus restricted Vivendi's freedom to establish itself in Italy, by preventing it from exerting a greater influence on Mediaset's management by acquiring more shares than it had envisaged. It therefore constitutes a restriction on the freedom of establishment, within the meaning of Article 49 TFEU.

55 According to the Court's settled case-law, such a restriction on freedom of establishment is permissible only if it is justified by overriding reasons in the public interest. It is further necessary that it should be appropriate for ensuring the attainment of the objective in question and not go beyond what is necessary to attain that objective (judgment of 25 October 2017, *Polbud – Wykonawstwo*, C-106/16, EU:C:2017:804, paragraph 52 and the case-law cited).

56 In that regard, in relation to, in the first place, the existence of overriding reasons in the public interest, it is apparent from the information provided by the referring court and from the observations submitted to the Court that the provision at issue in the main proceedings was adopted in order to ensure pluralism of information and of the media. Article 43(5) of TUSMAR also provides that AGCOM must adopt the measures necessary to eliminate or prevent the formation of the positions contemplated by, inter alia, the provision at issue in the main proceedings, or of any other position detrimental to pluralism.

57 The Court has held that the safeguarding of the freedoms protected under Article 11 of the Charter of Fundamental Rights, which in paragraph 2 thereof refers to the freedom and pluralism of the media, unquestionably constitutes a legitimate aim in the general interest, the importance of which in a

democratic and pluralistic society must be stressed in particular, capable of justifying a restriction on freedom of establishment (see, to that effect, judgment of 22 January 2013, *Sky Österreich*, C-283/11, EU:C:2013:28, paragraph 52 and the case-law cited).

58 Protocol No 29 on the system of public broadcasting in the Member States, annexed to the EU and FEU Treaties, also refers to media pluralism, stating that 'the system of public broadcasting in the Member States is directly related to the democratic, social and cultural needs of each society and to the need to preserve media pluralism'.

59 In the present case, the restriction on freedom of establishment resulting from the provision at issue in the main proceedings could therefore, in principle, be justified by an overriding reason in the public interest, namely the protection of pluralism of information and the media.

60 As regards, in the second place, the proportionate nature of that restriction in relation to the objective pursued, it must be observed that Article 43(9) of TUSMAR provides that entities which are required to be entered in the Register of Communications Operators are prohibited from generating more than 20% of the total revenues generated in the SIC, thereby establishing a general rule intended to apply only to entities that are active in the electronic communications sector.

61 In addition, the provision at issue in the main proceedings introduces an even more specific rule than that laid down in Article 43(9) of TUSMAR, concerning only entities in the electronic communications sector, as defined for the purposes of that provision, earning more than 40% of the total revenues generated in that sector and prohibits such entities from earning more than 10% of the total revenues generated in the SIC.

62 That provision thus, in essence, precludes a single undertaking from acquiring, by itself or through its subsidiaries, a large part of the media sector in Italy when it already has significant market power in the electronic communications sector in that Member State.

63 Since a prohibition such as that which arises from the provision at issue in the main proceedings amounts to a derogation from the principle of the freedom of establishment, it is for the national authorities to demonstrate that that provision is consistent with the principle of proportionality, that is to say, that it is appropriate and necessary in order to achieve the declared objective, and that that objective could not be achieved by prohibitions or restrictions that are less extensive, or that have less of an effect on the exercise of that freedom (see, by analogy, judgment of 23 December 2015, *Scotch Whisky Association and Others*, C-333/14, EU:C:2015:845, paragraph 53 and the case-law cited).

64 In the present case, it should be noted that it is apparent from recital 5 of the Framework Directive that, indeed, there are links between the two sectors referred to in the provision at issue in the main proceedings, given the convergence of the telecommunications, media and information technology sectors.

65 As the Advocate General observed, in essence, in point 74 of his Opinion, given the proximity between the electronic communications services sector and the media sector, it may, in principle, be accepted that certain limits may be imposed on the possibility for undertakings which already occupy a 'dominant position' in the first sector to take advantage of that position in order to strengthen their position in the second.

66 However, the Court has held that the various directives comprising the new regulatory framework applicable to electronic communications services, which include the Framework Directive, make a clear distinction between the production of content, which involves editorial responsibility, and the transmission of content, which does not entail any editorial responsibility, content and transmission being covered by different measures which pursue their own specific objectives (see, to that effect, judgment of 13 June 2019, *Google*, C-193/18, EU:C:2019:498, paragraph 31 and the case-law cited).

67 By reason of that clear distinction between the production of content and the transmission of content, undertakings active in the electronic communications sector which control the transmission of content do not necessarily have control over its production, which involves editorial responsibility.

68 In the present case, the provision at issue in the main proceedings does not refer to those links between the production of content and the transmission of content, and it is also not worded in such a way as to apply specifically in relation to those links.

69 That provision prohibits, in absolute terms, entities the revenue of which in the electronic communications sector, as defined for the purposes of that provision, is greater than 40% of the total revenues generated in that sector, from earning within the SIC revenue exceeding 10% of the total revenues generated in that system.

70 Thus, in order to determine whether a provision such as the provision at issue in the main proceedings is appropriate for attaining that specific objective, which seeks to prevent the negative aspects of convergence between the electronic communications sector and the SIC, it is necessary to assess the link between, on the one hand, the thresholds referred to in that provision and, on the other hand, the risk to media pluralism.

71 As regards, first of all, the definition of the electronic communications sector, it is apparent from the request for a preliminary ruling that AGCOM defines that sector restrictively as encompassing the markets susceptible to *ex ante* regulation.

72 As is apparent from Articles 15 and 16 of the Framework Directive, read in the light of recitals 25 and 27 thereof, those markets are those of the electronic communications sector in general, including the new markets, on which there is no effective competition, which have been identified by the Commission as relevant product or service markets with a view, where appropriate, to the introduction by the competent national authorities of *ex ante* regulatory obligations designed to supplement the rules of competition law in order to resolve the difficulties which exist on those markets (judgment of 3 December 2009, *Commission* v *Germany*, C-424/07, EU:C:2009:749, paragraphs 56 and 64).

73 It is therefore apparent that the mechanism of *ex ante* regulatory obligations is intended to resolve specific problems arising on specific markets in the electronic communications sector and not to ensure pluralism in the media sector by making it possible to identify, from among the undertakings which already have significant market power in the electronic communications sector, those which might achieve a 'significant economic dimension' in the SIC.

74 As the Advocate General observed, in essence, in points 51, 52, 79 and 80 of his Opinion, by limiting the definition of the electronic communications sector to the markets susceptible to *ex ante* regulation, the provision at issue in the main proceedings, as interpreted by AGCOM, excludes from the electronic communications sector markets which are of increasing importance for the transmission of information, namely mobile telephone retail services or other electronic communications services linked to the internet and satellite broadcasting services. These, however, have become the main avenue of access to media, with the result that there is no justification for excluding them from that definition.

75 As regards, next, the threshold of 10% of total revenues generated within the SIC, mentioned in the provision at issue in the main proceedings, it should be observed that the issue of whether or not an undertaking earns revenue equivalent to 10% of the total revenues generated in the SIC is not, in itself, an indication of the risk of influencing media pluralism. It is apparent from Article 2(1)(s) of TUSMAR that the SIC includes a wide range of different markets. Thus, if the total revenue earned by an undertaking in the SIC were to be concentrated in just one of the markets making up that system, with the result that the rate achieved for that market was significantly higher than 10%, but

remained below 10% when all the markets making up the SIC were taken into consideration, the fact that the 10% threshold of total revenue generated in the SIC was not achieved would not be such as to exclude all risk to pluralism of the media. Similarly, in the event that the threshold of 10% of total revenue generated in the SIC were reached, but that 10% of revenue were shared between each of the markets comprising the SIC, the fact that the 10% threshold had been reached or exceeded would not necessarily point to a risk to media pluralism.

76 Finally, as regards the fact that, for the purpose of identifying the revenue earned by an undertaking in the electronic communications sector or in the SIC, AGCOM takes into consideration not only revenue obtained through 'controlled' companies, but also that obtained through 'affiliated' companies, over which the undertaking concerned exercises a 'significant influence', within the meaning of the third paragraph of Article 2359 of the Civil Code, it must be observed that it is apparent from the request for a preliminary ruling that such a practice is likely to lead to revenue being taken into consideration twice and thus to a distortion of the calculation of revenue generated in the SIC. The same revenue of a company active in the SIC might therefore be taken into account both for the calculation of the income of an undertaking which is its minority shareholder and in calculating the revenue of an undertaking which is its majority shareholder and actually controls it.

77 In addition, it must be observed that 'control' exercised over an 'affiliated company' is based on a broad presumption that one company exercises 'significant influence' over another company where the first can exercise one fifth of the voting rights in the shareholders' meetings of the second company, or one tenth if the company shares are quoted on regulated markets. Such circumstances do not, however, appear to make it possible to establish that the first company can actually exert an influence on the second in such a way as to undermine the pluralism of information and of the media.

78 Thus, in a situation such as that in the main proceedings, treating a 'controlled company' in the same way as an 'affiliated company' when calculating the revenue of an undertaking in the electronic communications sector or the SIC does not appear reconcilable with the objective pursued by the provision at issue in the main proceedings.

79 Consequently, that provision cannot be considered to be appropriate for attaining the objective which it pursues, in so far as it sets thresholds which bear no relation to the risk to media pluralism, since those thresholds do not make it possible to determine whether and to what extent an undertaking is actually in a position to influence the content of the media.

80 In the light of all of the foregoing considerations, the answer to the questions referred is that Article 49 TFEU must be interpreted as precluding legislation of a Member State which has the effect of preventing a company registered in another Member State, the revenue of which in the electronic communications sector, as defined for the purposes of that legislation, is in excess of 40% of the total revenues generated in that sector, from earning, within the SIC, revenue which exceeds 10% of the total revenues generated in that system.

Costs

81 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Fifth Chamber) hereby rules:

Article 49 TFEU must be interpreted as precluding legislation of a Member State which has the effect of preventing a company registered in another Member State, the revenue of which in the electronic communications sector, as defined for the purposes of that legislation, is in excess of

40% of the total revenues generated in that sector, from earning, within the integrated communications system, revenue which exceeds 10% of the total revenues generated in that system.

[Signatures]

6th assignment (Accountinf/Financial Statements/Distribution of Assets)

After completing this seminar, students should have acquired knowledge in the following main issue of the topic:

Assessment of Dividend Distribution – Evaluating the conditions required for a dividend distribution, the amount available for distribution and the legal tests (such as solvency tests) that must be met before declaring a dividend.

Disguised Distribution – A disguised distribution occurs when a transaction, such as overestimating the value of goods between companies, is used to effectively transfer funds in a way that bypasses the formal dividend distribution process, potentially violating legal requirements.

Liability of Parent for Subsidiary's Financial Obligations – Generally, a parent company is not liable for the financial obligations of its subsidiary. However, under specific conditions (such as abuse of corporate structure or cross-company guarantees), the parent company could be held responsible for the subsidiary's debts.

Your assignment is a CASE STUDY, please find attached the case study in Moodle. Please address the issues raised at the end of the case study, plus address these following issues as well:

1. Assessment of the dividend distribution in the case (specifically the conditions imposed on making of the distribution, distributable amounts, test applicable on distribution etc.)
2. Disguised distribution (matter of fact that in the contract between Builpod and MultiSteel the value of goods had been overestimated)
3. Liability of the parent company for the financial obligations of the subsidiary company

Look at the case not only from the general concepts, but look at it from the perspective of your national jurisdiction or you can look at the issue from the perspective of EMCA.

Facultative readings materials:

- KPMG_Balance sheet (from page 75 it is in English)

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ACCOUNTING OF COMPANIES

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1

Basic terminology

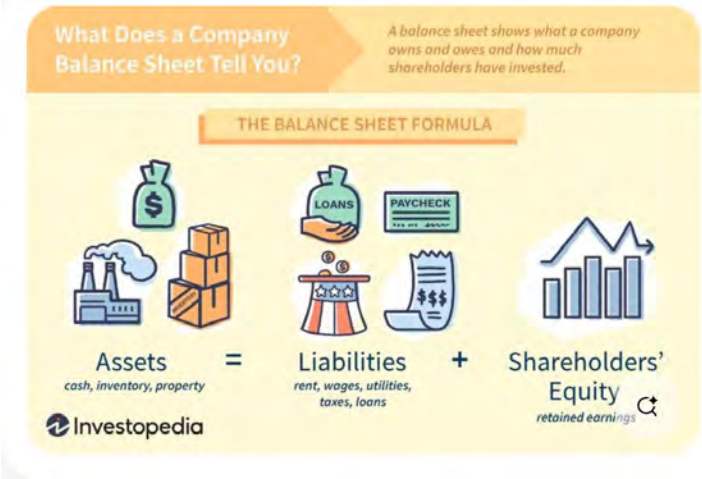
Funded by the European Union

- Financial Statements for accounting entities consists of three parts
  - Balance Sheet
  - Income Statement / Profit and loss account
  - Notes to the Financial Statements
- Financial statements shall be submitted to a local financial authority within specific deadlines
- Financial statements are prepared by directors (hiring accountants) and shall be approved by a relevant body of a company (general meeting)

2

Balance sheet

Funded by the European Union



3

Simple balance sheet example

Funded by the European Union

Balance sheet example

TEDDY FAB INC.
BALANCE SHEET
December 31, 2100

ASSETS		LIABILITIES AND SHAREHOLDERS' EQUITY	
Current assets		**Current liabilities**	
Cash and cash equivalents	$ 100,000	Accounts payable	$ 30,000
Accounts receivable	20,000	Notes payable	10,000
Inventory	15,000	Accrued expenses	5,000
Prepaid expense	4,000	Deferred revenue	2,000
Investments	10,000	Total current liabilities	47,000
Total current assets	149,000		
		Long-term debt	200,000
Property and equipment		**Total liabilities**	247,000
Land	24,300		
Buildings and improvements	250,000	**Shareholders' Equity**	
Equipment	50,000	Common stock	10,000
Less accumulated depreciation	(5,000)	Additional paid-in capital	20,000
		Retained earnings	197,100
Other assets		Treasury stock	(2,000)
Intangible assets	4,000		
Less accumulated amortization	(200)	**Total liabilities and shareholders' equity**	$ 472,100
Total assets	$ 472,100		

4

Balance sheet I.

Funded by the European Union

- A balance sheet lists company's
  - assets,
  - liabilities, and
  - shareholders' equity

  at a point in time, typically at the end of a period (accounting year, usually calendar year)

- A balance sheet shows what a company:
  - owns in the form of assets,
  - what it owes in the form of liabilities, and
  - amount of money invested by shareholders and retained by the company from historical profits

- The balance sheet shows a company's assets, but also shows how those assets were financed, whether it was through debt or through issuing equity (undistributed profit)

5

Balance sheet I.

Funded by the European Union

- **1.** The balance sheet is broken down into three parts: assets, liabilities, and owners' equity, is represented by the following equation:

  Assets = Liabilities + Owners' Equity

- The balance sheet shows a snapshot of the assets and liabilities for the period, but it **does not show the company's activity during the period, such as revenue, expenses, gains, losses** – which are recorded in **income statement**

6

Income statement

Funded by the European Union



7

Simple Income Statement

Funded by the European Union

Excel Sports Income Statement
For the quarter ended 30 September 2018

Revenue	Merchandise Sale	25,800
	Revenue from Training	5,000
	Total Revenue	30,800
Expenses	Procurement Costs	8,000
	Wages	700
	Rent	1,000
	Interest Paid	500
	Transportation	300
	Utilities	150
	Total Expenses	10,650
Gains	Income from sale of van	2,000
Losses	Settlement cost of consumer lawsuit	800
Net Income	(Revenue + Gains) - (Expenses + Losses)	21,350

Investopedia

8

Income Statement

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- Also known as the **profit and loss statement** or the **statement of revenue and expe** the income statement primarily focuses on the company's revenues and expenses during a particular period (accounting year, usually calendar year)

- The income statement focuses on four key items
  - revenue,
  - expenses (cost of goods sold / operating expenses),
  - gains and
  - losses

9

EBITDA v. Net profit

Funded by the European Union

- EBITDA is essentially net income or earnings before interest, taxes, depreciatic amortization
- EBITDA is used in practice to **analyse and compare profitability among companies and industries**, as it eliminates the effects of financing and capital expenditures

- Net profit (net profit after taxes) generated by the company (in a given year) equals to:
  - Net profit = EBITDA – (interest, taxes, depreciation, and amortization)
  - Recorded in the balance sheet as of period end within Owners' Equity (current profit)

10

Notes to the Financial Statements

Funded by the European Union

- The notes to the financial statements include the **cash flow statement** and the **stateme changes in equity** (in other countries and under IFRS, these are not separate statements with the same prominence as the balance sheet and income statement)
- The notes to the financial statements should also contain the following information:
  - summary of movements in non-current assets;
  - contingent liabilities;
  - other financial commitments;
  - related party transactions; and
  - events subsequent to the balance sheet date.

11

Distribution of assets

Funded by the European Union

1. **Net surplus test**
2. **Balance sheet test**

+ Bankruptcy test (specific for Slovak jurisdiction)

+ Test of the company in crisis (specific for Slovak jurisdiction)

12

Net surplus test



Until the company is wound up, shareholders are only entitled to the distribution among/between them of **net profit that has been**

a. **reduced** by contributions to the reserve fund, or any other funds if applicable, created by the company under the law, and by the accumulated loss of previous years,
b. **increased** by the retained profit of previous years and other of the company's own resources whose utilisation is not stipulated by law.

13

Balance sheet test



The company **may not distribute net profit or other resources** it has among/between shareholders if the equity ascertained from the approved annual financial statements is, or would be in consequence of the distribution of the profit or other resources it has, **lower than the value of the registered capital increased by the reserve fund** (Section 217), or any other funds if applicable, created by the company which must not be, under the law or articles of association, used for payments to shareholders, reduced by the value of unpaid registered capital, provided this value has not yet been included in the assets reported in the balance sheet under a special Act.

14

Distribution of assets – example I.

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- Company limited by shares
  - Legal capital (30.000 eur), reserve fund (3.000 eur)
  - Loss from 2013 (5.000 eur)
  - Profit form 2024 (10.000 eur)

- Net surplus test:

Current profit (10.000 eur) – contribution to the reserve fund (10% from the current profit – 1.000 eur) - loss (5.000 eur) = 4.000 eur

15

Distribution of assets – example II.

Funded by the European Union

- Balance sheet test
  - The amount of legal capital (30.000 eur) + reserve fund (4.000) must be higher than the amount of equity

Balance sheet				
Assets		**Liabilities**		
Assets	38.000	Equity	Legal capital	30.000
			Reserve fund	4.000 (3.000 + 1.000)
			Net profit (after tax)	9.000
			Retained earnings from previous years	-5.000
Total assets	38.000	Total liabilities and owners' equity		38.000

16



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17

7th assignment (Mergers and Acquisition I)

After completing this seminar, students should have acquired knowledge in the following main issue of the topic:

Assessment of Dividend Distribution – Evaluating the conditions required for a dividend distribution, the amount available for distribution and the legal tests (such as solvency tests) that must be met before declaring a dividend.

Merger and Types of Mergers – A merger involves the combination of two or more companies into one. Types include merger by the formation of a new company and merger by acquisition.

Reasons for Mergers – Mergers occur for various reasons, such as expanding market share, gaining efficiencies, entering new markets, or achieving synergies.

Divisions – A division is a corporate restructuring operation in which a company – known as the divided company – transfers all or part of its assets and liabilities to one or more other companies.

Share Deal vs. Asset Deal – A share deal involves buying shares in a company, transferring ownership of the entire company, while an asset deal involves buying specific assets of a company. The main difference lies in what is transferred – assets versus equity.

Transformation of Company's Legal Form – Transformation refers to changing a company's legal structure, such as from a limited liability company to a joint-stock company.

Compulsory reading materials:

- VICARI, A: EU Company Law. 10. Chapter

Voluntary reading materials:

- SCHMIDT, J.: Cross-Border Mergers, Divisions and Conversions: Accomplishments and Deficits of the Company Law Package.
- MUCHA, A.: Letterbox companies and the corporate mobility regime in the EU after Directive 2019/2121.

Related case studies (facultative):

- C-79/85 Segers
- C-55/95 Gebhard
- C-411/03 Sevic

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MERGERS AND ACQUISITIONS I.

JUDr. Barbora Grambličková, PhD., LL.M.
Dr. iur. Angelika Mašurová, MLE
Department of Commercial Law and Economic Law
Comenius University in Bratislava

1

TRANSACTIONS

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1. Mergers
   - Domestic mergers
   - Cross-border mergers
2. Divisions
   - Domestic divisions
   - Cross-border divisions
3. Change of the legal form
4. Cross-border change of the seat/transfer of the seat (separate class)
5. Acquisitions
   - Share deal
   - Asset dea

2

Merger I.

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- Major transformation in the company
- Why are companies merging?
  - Strengthen their position on market
  - Cross-border transfer of company´s seat without liquidation of companies, to relocate the company in more favorable legislation
  - To save a company in a bad financial situation

- Merger
  a. Merger by acquisition
  b. Merger by formation of a new company

3

Merger II.

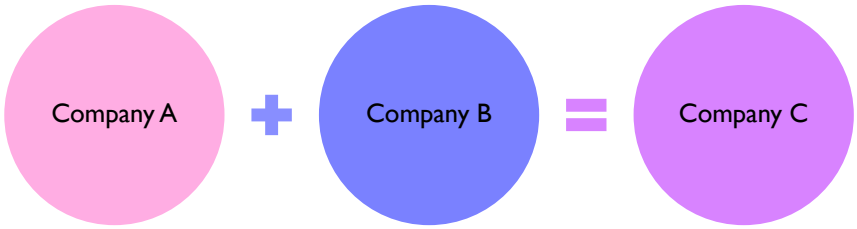
Funded by the European Union

- A merger is a deal to unite (merge) two or more existing companies into one company (existing / new)
- There are two basic merger structures:
  - **merger by the formation of a new company** is a merger carried out through the integration of companies into a **new company**
  - **merger by acquisition** is a merger carried out in a way that one or more companies (acquired companies) are **integrated into another company that already exists**

4

Merger by the formation of a new company

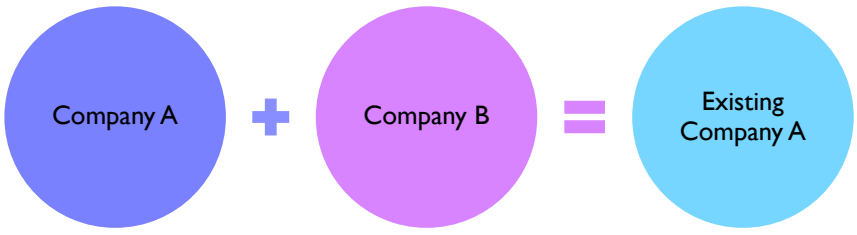
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5

Merger by Acquisition

Funded by the European Union



6

Merger regulation under EU Law

Funded by the European Union

- Third Company Law Directive – Mergers
  - Adopted in 1978
  - Harmonizing merger rules of the national laws concerning domestic companies
  - Not covering cross-border mergers as they need separate attention due to the administrative and legislative burden
  - Now: Art. 87-117 of DIRECTIVE (EU) 2017/1132 relating to certain aspects of company law

- It was common that many of the Member States would not allow these cross-border transformation
- Case SEVIC Systems: Court of Justice held that different treatment in national and cross-border mergers created a restriction on freedom of establishment

7

Cross-border merger regulation under EU Law

Funded by the European Union

- Tenth Company Law Directive on gross-border mergers
  - Adopted in 2005
  - Long negotiation process was caused by the dispute over the ***employee participation***
  - Process of adoption was reopened after the adoption of the ***Regulation on the European Company*** and Directive 2001/86/EC supplementing the Statute for a European company with regard to the involvement of employees which provided consensus between member states about the issues of employee participation
  - **Scope:** limited liability companies which have their ***registered office, central administration, principal place of business*** within the EU

- Now: Art. 118-134 of DIRECTIVE (EU) 2017/1132 relating to certain aspects of company law

8

Merger – process I.

Funded by the European Union

- **Drafting the common merger terms (common draft terms)**
  - The management/administrative organ of each merging company must draw up a "common draft terms of the merger".
  - The draft must include specific minimum content: e.g., form, name & registered office of the companies; share-exchange ratio; date from which rights attach; likely impact on employment; etc.

- **Publication / Disclosure of the draft terms**
  - The draft terms must be published (or made available via website) in the manner prescribed by Member States. For cross-border mergers: the draft must be made public at least one month before the general meeting that will decide on it.
  - This step ensures shareholders, creditors and third parties are appropriately informed.

9

Merger – process II.

Funded by the European Union

- **Approval by the General Meetings of each merging company**
  - Each merging company's general meeting must decide on the approval of the common draft terms.
  - Member States may set special majorities (quorums).

- **Pre-merger certificate / legal scrutiny (for cross-border mergers)**
  - For cross-border mergers, after approval each merging company must supply a certificate from the competent authority (court, notary etc) attesting to the completion of the acts and formalities.
  - The national authorities scrutinise the legality of the merger, ensuring that the formalities and protections (for employees, creditors etc) are respected.

10

Merger – process III.

Funded by the European Union

- **Set the date on which the merger takes effect**
  - The law of the Member State of the company resulting from the merger determines the date on which the merger takes effect.
  - From that date, all assets and liabilities of the merging companies transfer, the merging companies cease to exist (if by formation of a new company) etc.

- **Registration and effect**
  - The merger must be entered in the public register(s) of each of the Member States concerned.
  - Legal consequences flow: e.g., the acquiring/new company inherits all assets & liabilities; the dissolving company or companies cease to exist (unless national law allows otherwise).

11

Merger – process IV.

Funded by the European Union

- **Protection of stakeholders (shareholders, creditors, employees)**
  - The directive emphasises safeguards for minority shareholders, creditors and employees: e.g., right to withdraw, rights of information, guarantees for creditors.
  - These protections are interwoven into the above procedural steps (drafting, disclosure, approval, scrutiny).

12

Divisions I.

Funded by the European Union

- Business of the company is usually divided internally **into various divisions**, during the lifetime of the company, these divisions can grew so big that the company will **carve-out them into separate companies**
- This transformation is called **division / spin-off / carve-out of a company**
- Types of (total) divisions
  a. **Division by acquisition** - company is dissolved, and the assets (+liabilities) of the company being dissolved shall pass to **other existing companies** that thereby become its legal successors
  b. **Divisions by the formation of a new company** - a company is dissolved, and the assets (+ liabilities) of the company being dissolved shall pass **to new companies which**, upon their incorporation, become the legal successors of the dissolved companies

13

Divisions II.

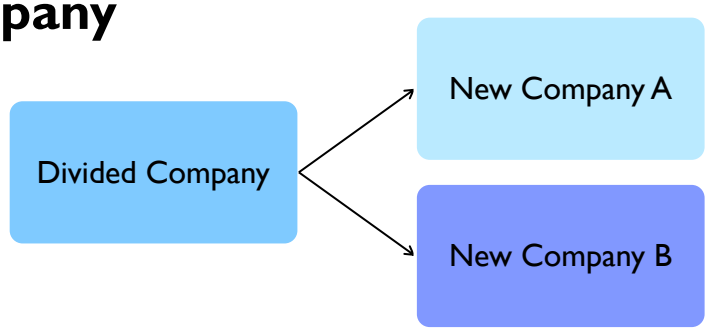
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- Whereas the Second Directive (Directive 82/891/EEC) required the Member States to introduce only "total division" (which takes place when the divided company assigns all of its assets to two or more pre-existing or newly-formed companies and at the same time is wound up), the more recent Directive also regulates the "partial" division, which occurs when the divided company transfers only a portion of its assets, and therefore survives.
- Types of partial divisions
  a. **Division by acquisition** - company is divided, and the selected assets (+liabilities) of the company being divided shall pass to **other existing companies** (divided company survives)
  b. **Divisions by the formation of a new company** - a company is divided, and the assets (+ liabilities) of the company being divided shall pass **to new companies which**, upon their incorporation (divided company survives)

14

Division by Formation of a New Company

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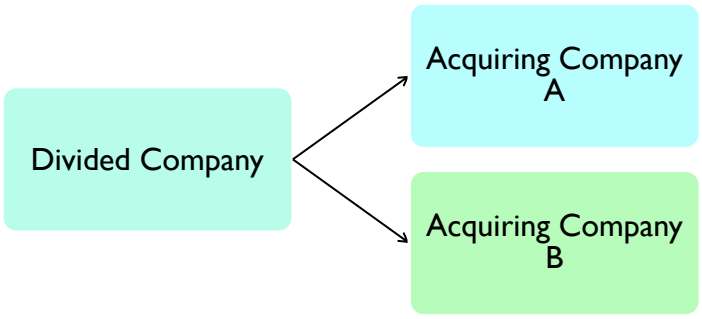


- Assets and liabilities transferred to new companies (A, B)
  a. Total division – divided company is dissolved
  b. Partial division – divided company survives

15

Division by Acquisition

Funded by the European Union



- Assets and liabilities transferred to existing companies (A, B)
  a. Total division – divided company is dissolved
  b. Partial division – divided company survives

16

Divisions III.

Funded by the European Union

- Usually each **of the successor/acquiring companies shall be liable for the obligations (liabilities) that passed upon division from the divided company to other companies** to the entire extent of their property; they are bound to fulfil such obligations jointly and severally (a creditor may demand complete fulfilment of an obligation from any of them, and upon fulfilment of such obligation by one of the successor companies, the obligation of the other companies shall cease to exist)
- The new entity becomes an **independent company** with assets, employees, intellectual property, technology, or existing products that are taken from the parent company

17

Change of the legal form

Funded by the European Union

- During a lifetime of a company there can occur a situation that the company may change its legal form to another legal form of company, **as other company form may be more suitable**
- A change in a company's legal form **does not result in the dissolution of the company as a legal entity**
- A decision on a change of legal form requires (in most of the jurisdictions) **approval by all shareholders** as it is a major change for shareholders as residual owners of the company

18

Cross-border change of the seat (separate class)

Funded by the European Union

- In the European Union **14th Company Law Directive** (which shall regulate cross-border movement of companies – change of the registered seat) **was not adopted**
- Failure to adopt the directive was supplemented by the decisions of the Court of Justice of the European Union (Daily Mail, Cartesio, VALE, Polbud)
- Cross-border change of the company's seat shall be possible, **however, the company needs to transform its legal form into a company legal form of the host state** (based on the concept of similarity of legal forms)
- Currently regulated by a directive (2121/2019 which amended directive 2017/1132

19

Acquisitions - Asset deal

Funded by the European Union

- An asset deal occurs when a buyer is interested in **purchasing the operating assets of a business**
- The transaction consists of **acquiring certain assets and inheriting the liabilities that either comprise the business tied to the asset, or are tied to the asset itself**
- An asset purchase can include either tangible (equipment, inventory, and fixtures) or intangible (IP rights, know-how, client lists) assets
- This transaction allows the buyer to **acquire certain assets** and not others, this also gives the buyer the ability to avoid assumption of any liabilities it doesn't need (cherry picking)
- An asset sale might require a **longer preparation and negotiation** of all the deal aspects (including asset allocated, employment termination and rehiring, lease assignment, contract transferability, creditor payouts, etc)
- Contract: **Assets Purchase Agreement**

20

Acquisitions - Share deal



- Through a share deal the **buyer acquires shares** in the target company and becomes its **shareholder**
- The target company remains the owner of the real property, but in their position as shareholders the buyers gain indirect control and authority to dispose of the real property
- The buyers indirectly acquire all assets and liabilities of the target company, including the real property (transferring individual assets or agreements of the target company is not required)
- Contract: **Share Purchase Agreement**

21



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22

JUDGMENT OF THE COURT (Second Chamber)
10 July 1986 *

In Case 79/85

REFERENCE to the Court under Article 177 of the EEC Treaty by the Centrale Raad van Beroep [Court of last instance in social security matters] for a preliminary ruling in the proceedings pending before that court between

D. H. M. Segers, of Linden (Netherlands)

and

Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen

on the interpretation of Articles 52, 58, 60 and 66 of the EEC Treaty with regard to the obligation to provide sickness insurance under Netherlands social security legislation,

THE COURT (Second Chamber)

composed of: K. Bahlmann, President of Chamber, O. Due and T. F. O'Higgins, Judges,

Advocate General: M. Darmon
Registrar: P. Heim

after considering the observations submitted on behalf of

Mr Segers, by I. G. F. Cath, of the Amsterdam Bar,

the Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen, by W. M. Levelt-Overmars, Head of the Legal Affairs — Social Security Division of the Gemeenschappelijk Administratiekantoor Asso-

* Language of the Case: Dutch.

ciation, Amsterdam, in the written procedure, and by W. W. Wijnbeek, acting as Agent, in the oral procedure,

the Commission of the European Communities, by A. Haagsma, a member of its Legal Department,

after hearing the Opinion of the Advocate General delivered at the sitting on 10 June 1986,

gives the following

JUDGMENT

(The account of the facts and issues which is contained in the complete text of the judgment is not reproduced)

Decision

1 By an order of 29 January 1985 which was received at the Court on 1 April 1985, the Centrale Raad van Beroep referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty two questions, the first concerning the interpretation of Articles 52, 58, 60 and 66 of the EEC Treaty, and the second that of Article 3 of Regulation (EEC) No 1408/71 of the Council, with a view to determining whether it is compatible with those provisions to apply the Ziektewet [Netherlands law establishing a general sickness insurance scheme] in a way which results in a difference of treatment, as far as admission to the scheme is concerned, for a director of a company according to whether or not the company is incorporated under Netherlands law.

2 The questions were raised in connection with an action brought by Mr Segers, a Netherlands national and the director of a company incorporated under English law, against the refusal of the Netherlands authorities, specifically the Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen [Banking, Insurance, Wholesale Trade and Professions' Association, hereinafter referred to as 'the Association'] to accord him sickness insurance benefits under the Ziektewet.

3 In April 1981 the private limited liability company Slenderose Limited, whose registered office is in London, was formed in accordance with English law. In June 1981 Mr Segers and his wife took over that company, each holding an equal number of shares. In July 1981 Mr Segers incorporated into Slenderose Limited as a subsidiary of that company his one-man business, Free Promotion International, whose registered office is in the Netherlands. At the same time, he became a director of Slenderose. In practice all of Slenderose's business is conducted by its subsidiary and solely in the Netherlands.

4 In July 1981, in order to obtain sickness insurance benefits, Mr Segers registered as sick with the Association. That body refused to grant him such benefits on the grounds that he had no employment contract with Slenderose and that consequently he was not subordinate to an employer. The Ziektewet provides, *inter alia*, that any person who is in a subordinate position in relation to another person, an employer, is insured.

5 Following the rejection by the court of first instance of his action against that decision, Mr Segers appealed to the Centrale Raad van Beroep. That court referred to its own decisions according to which the director of a company who himself holds 50% or more of the shares of that company must be deemed to work for that company in a position subordinate to it. The Association, however, contended before the national court that that case-law should apply only to directors of companies whose registered office was in the Netherlands and not to a company incorporated under foreign law.

6 The Centrale Raad van Beroep took the view that the Association's argument had some force and that an interpretation of Community law was required. It therefore stayed the proceedings and referred the following questions to the Court of Justice for a preliminary ruling:

'(1) Do the principles of freedom of establishment within the EEC and freedom to provide services within the EEC — in particular the last sentence of Article 52 read with Article 58 of the EEC Treaty and the last sentence of Article 60

read with Article 66 of that Treaty — mean that, when deciding whether there is an insurance obligation under Netherlands social security legislation, Netherlands courts may not make any distinction between the director/major shareholder of a private company incorporated under Netherlands law and a director/major shareholder of a private company incorporated under the laws of another Member State, even if the foreign company clearly does not carry out any actual business in the other Member State concerned but carries on business only in the Netherlands?

(2) If that question must be answered in the negative, does Community social security law (in particular, Article 3 (1) of Regulation No 1408/71) or any other provision of Community law prohibit such a distinction?'

The first question

7 The first question seeks essentially to establish whether Articles 52 and 58 of the EEC Treaty and Articles 60 and 66 must be interpreted as meaning that the competent authorities of a Member State may not exclude the director of a foreign company from a national sickness insurance benefit scheme solely on the ground that the company in question was formed in accordance with the law of another Member State, where it also has its registered office, even though it does not conduct any business there.

8 Mr Segers considers that in view of the direct effect of the provisions of the EEC Treaty concerning freedom of establishment and in the light of the General Programmes of the Council for the abolition of restrictions on freedom of establishment and the freedom to provide services the competent national authorities must abolish national provisions restricting the right of directors of companies incorporated under foreign law to be admitted to sickness insurance schemes. He notes in addition that in this case the provisions of the Treaty concerning the freedom to provide services do not apply.

9 The Association considers that the provisions of the EEC Treaty concerning freedom of establishment and the freedom to provide services do not apply in this instance. In its view, those provisions do not require that companies formed in

accordance with the laws of other Member States be treated in the same way as those formed in accordance with Netherlands law. As far as admission to sickness insurance benefits is concerned, a difference of treatment as between the directors of a company incorporated under Netherlands law and those of a company incorporated under the law of another Member State cannot be regarded as unlawful discrimination since the two types of companies are not comparable. Any person who forms a company under Netherlands law is subject to the same conditions regarding insurance, irrespective of his nationality or his place of establishment. Similarly, persons who form a company under foreign law do so under identical conditions. Any person may form a company under Netherlands law or under foreign law, irrespective of his nationality or place of establishment. It is always open to the persons concerned to consider the advantages and disadvantages from the point of view of social security and tax, or any other advantages or disadvantages, of those two forms of company.

10 It also maintains that the difference in treatment in question is justified by the need to combat abuse and to ensure that the Netherlands social security legislation is properly implemented. It is necessary to ensure that directors do not elect to form a company under foreign law solely in order to circumvent the restrictions provided for in the Netherlands legislation concerning the formation of private limited companies. In addition, the Association draws attention to the difficulty of collecting social security contributions in other Member States.

11 The Commission takes the view that, by virtue of Article 52 of the EEC Treaty, a company formed in accordance with the law of another Member State is entitled to conduct its business in the Netherlands under the same conditions as those applying to companies formed under Netherlands law. Those conditions include *inter alia* the right to be affiliated to a specific social security scheme. The legal conditions for affiliation to such a scheme must be the same for employees of a foreign company as for employees of companies formed under the law of the Member State concerned. To refuse to apply to the director of a company formed in accordance with the law of another Member State social security legislation applying to the directors of companies formed in accordance with the law of the Member State concerned must therefore be regarded as contrary to the principle of freedom of establishment.

12 In order to reply to the question submitted it is necessary to consider in the first place Article 52 *et seq.* of the Treaty. In that respect it should be noted that Article 52 of the EEC Treaty is one of the fundamental provisions of the Community and has been directly applicable in the Member States since the expiry of the transitional period. By virtue of that provision, freedom of establishment for nationals of a Member State in the territory of another Member State includes *inter alia* the right to set up and manage undertakings, in particular companies within the meaning of the second paragraph of Article 58, under the same conditions as those laid down for its own nationals by the law of the country where such establishment is effected.

13 The question submitted to the Court concerns a case in which the refusal to grant benefits is based not on the nationality of the director but on the location of the registered office of the company which he directs. However, as far as companies are concerned, it should be recalled that according to the judgment of the Court of 28 January 1986 (Case 270/83 *Commission* v *France* [1986] ECR 273) the right of establishment includes, pursuant to Article 58 of the EEC Treaty, the right of companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community to pursue their activities in another Member State through an agency, branch or subsidiary. With regard to companies, it should be noted that it is their registered office in the abovementioned sense that serves as the connecting factor with the legal system of a particular State, as does nationality in the case of natural persons.

14 In that respect the Court would observe that a company which has been formed in accordance with the law of another Member State and which conducts its business through an agency, branch or subsidiary in the Member State in which it seeks to establish itself cannot be deprived of the benefit of the rule set out above. As the Court has already stated, in its judgment of 28 January 1986, cited above, acceptance of the proposition that the Member State in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its registered office is situated in another Member State would deprive Article 58 of all meaning.

15 It is established that entitlement to reimbursement of sickness costs pertains to a person and not to a company. However, the requirement that a company formed in accordance with the law of another Member State must be accorded the same

treatment as national companies means that the employees of that company must have the right to be affiliated to a specific social security scheme. Discrimination against employees in connection with social security protection indirectly restricts the freedom of companies of another Member State to establish themselves through an agency, branch or subsidiary in the Member State concerned. That proposition is supported by the fact that according to the Council's General Programme for the abolition of restrictions on freedom of establishment of 18 December 1961 (Official Journal, English Special Edition, Second Series IX, p. 7), which provides useful guidance for the implementation of the relevant provisions of the Treaty (see judgments of 28 April 1977, Case 71/76 *Thieffry* [1977] ECR 765 and of 18 June 1985 in Case 197/84 *Steinhauser* [1985] ECR 1819), all provisions and administrative practices which 'deny or restrict the right to participate in social security schemes, in particular sickness . . . insurance schemes' are to be regarded as restrictions on the freedom of establishment.

16 As regards the doubt expressed by the national court concerning the significance of the fact that the English company clearly does not conduct business in the United Kingdom, it should be noted that for the application of the provisions on the right of establishment, Article 58 requires only that the companies be formed in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the Community. Provided that those requirements are satisfied, the fact that the company conducts its business through an agency, branch or subsidiary solely in another Member State is immaterial.

17 As regards the grounds put forward by the Association to justify its refusal, namely the need to combat possible abuse and to ensure the proper implementation of the national social security legislation, it should be noted that Article 56 of the EEC Treaty allows within certain limits special treatment for companies formed in accordance with the law of another Member State provided that that treatment is justified on grounds of public policy, public security or public health. Although the need to combat fraud may therefore justify a difference of treatment in certain circumstances, the refusal to accord a sickness benefit to a director of a company formed in accordance with the law of another Member State cannot constitute an appropriate measure in that respect.

18 The reply given to the first question is based on the provisions of the Treaty concerning the freedom of establishment. It is therefore not necessary to consider the provisions concerning the freedom to provide services.

19 In the light of all the foregoing considerations, the reply to the first question referred to the Court by the Centrale Raad van Beroep should be that the provisions of Articles 52 and 58 of the EEC Treaty must be interpreted as prohibiting the competent authorities of a Member State from excluding the director of a company from a national sickness insurance scheme solely on the ground that the company in question was formed in accordance with the law of another Member State, where it also has its registered office, even though it does not conduct any business there.

The second question

20 Since a reply to the second question was required only in the event of a negative reply to the first question, the second question has become devoid of purpose.

Costs

21 The costs incurred by the Commission of the European Communities, which has submitted observations to the Court, are not recoverable. Since these proceedings are, in so far as the parties in the main proceedings are concerned, in the nature of a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Second Chamber),

in reply to the questions referred to it by the Centrale Raad van Beroep by order of 29 January 1985, hereby rules:

The provisions of Articles 52 and 58 of the EEC Treaty must be interpreted as prohibiting the competent authorities of a Member State from excluding a director of a company from a national sickness insurance benefit scheme solely on the ground that the company in question was formed in accordance with the law of another Member State, where it also has its registered office, even though it does not conduct any business there.

Bahlmann Due O'Higgins

Delivered in open court in Luxembourg on 10 July 1986.

P. Heim
Registrar

K. Bahlmann
President of the Second Chamber

JUDGMENT OF THE COURT
30 November 1995 *

In Case C-55/94,

REFERENCE to the Court under Article 177 of the EC Treaty by the Consiglio Nazionale Forense (Italy) for a preliminary ruling in the proceedings pending before that court between

Reinhard Gebhard

and

Consiglio dell'Ordine degli Avvocati e Procuratori di Milano,

on the interpretation of Council Directive 77/249/EEC of 22 March 1977 to facilitate the effective exercise by lawyers of freedom to provide services (OJ 1977 L 78, p. 17),

THE COURT,

composed of: G. C. Rodríguez Iglesias, President, C. N. Kakouris, D. A. O. Edward (Rapporteur) and G. Hirsch (Presidents of Chambers), G. F. Mancini, F. A. Schockweiler, J. C. Moitinho de Almeida, P. J. G. Kapteyn, C. Gulmann, J. L. Murray, P. Jann, H. Ragnemalm and L. Sevón, Judges,

* Language of the case: Italian.

Advocate General: P. Léger,
Registrar: H. A. Rühl, Principal Administrator,

after considering the written observations submitted on behalf of:

— the applicant in the main proceedings, by Reinhard Gebhard, Rechtsanwalt, Massimo Burghignoli, of the Milan Bar, Jim Penning, of the Luxembourg Bar, and Fabrizio Massoni, of the Brussels Bar,

— Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, by Professor Bruno Nascimbene, Avvocato,

— the Greek Government, by Evi Skandalou, of the Special Community Legal Affairs Department of the Ministry of Foreign Affairs, and Stamatina Vodina, Jurist, researcher in that department, acting as Agents,

— the Spanish Government, by Alberto José Navarro González, Director-General for Community Legal and Institutional Coordination, and Miguel Bravo-Ferrer Delgado, Abogado del Estado in the Community Legal Affairs Department, acting as Agents,

— the French Government, by Philippe Martinet, Foreign Affairs Secretary in the Legal Affairs Directorate of the Ministry of Foreign Affairs, and Catherine de Salins, Deputy Director in that directorate, acting as Agents,

— the United Kingdom, by Stephen Braviner, of the Treasury Solicitor's Department, acting as Agent, and Daniel Bethlehem, Barrister,

— the Commission of the European Communities, by Marie-José Jonczy, Legal Adviser, and Enrico Traversa, of its Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Reinhard Gebhard, represented by Massimo Burghignoli; Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, represented by Bruno Nascimbene; the Greek Government, represented by Evi Skandalou and Stamatina Vodina; the Spanish Government, represented by Miguel Bravo-Ferrer Delgado; the French Government, represented by Marc Perrin de Brichambaut, Legal Affairs Director in the Ministry of Foreign Affairs, acting as Agent, and Philippe Martinet; the Italian Government, represented by Pier Giorgio Ferri, Avvocato dello Stato; the United Kingdom, represented by Stephen Braviner and Daniel Bethlehem, and the Commission of the European Communities, represented by Marie-José Jonczy and Enrico Traversa, at the hearing on 10 May 1995,

after hearing the Opinion of the Advocate General at the sitting on 20 June 1995,

gives the following

Judgment

1 By order of 16 December 1993, received at the Court on 8 February 1994, the Consiglio Nazionale Forense (National Council of the Bar) referred to the Court for a preliminary ruling under Article 177 of the EC Treaty two questions on the interpretation of Council Directive 77/249/EEC of 22 March 1977 to facilitate the effective exercise by lawyers of freedom to provide services (OJ 1977 L 78, p. 17).

2 The questions have been raised in the course of disciplinary proceedings opened by the Consiglio dell'Ordine degli Avvocati e Procuratori di Milano (Council of the Order of Advocates and Procurators of Milan, hereinafter 'the Milan Bar Council') against Mr Gebhard, who is accused of contravening his obligations under Law No 31 of 9 February 1982 on freedom for lawyers who are nationals of a Member State of the European Community to provide services (GURI No 42 of 12 February 1982) on the ground that he pursued a professional activity in Italy on a permanent basis in chambers set up by himself whilst using the title *avvocato*.

3 According to the case-file and information provided in answer to the written questions put by the Court, Mr Gebhard, a German national, has been authorized to practise as a *Rechtsanwalt* in Germany since 3 August 1977. He is a member of the Bar of Stuttgart, where he is an 'independent collaborator' in a set of chambers (*Bürogemeinschaft*) although he does not have chambers of his own in Germany.

4 Mr Gebhard has resided since March 1978 in Italy, where he lives with his wife, an Italian national, and his three children. His income is taxed entirely in Italy, his country of residence.

5 Mr Gebhard has pursued a professional activity in Italy since 1 March 1978, initially as a collaborator (*con un rapporto di libera collaborazione*) in a set of chambers of lawyers practising in association in Milan, and subsequently, from 1 January 1980 until the beginning of 1989, as an associate member (*associato*) of those chambers. No criticism has been made of him in relation to his activities in those chambers.

6 On 30 July 1989, Mr Gebhard opened his own chambers in Milan in which Italian *avvocati* and *procuratori* work in collaboration with him. In response to a written

question from the Court, Mr Gebhard stated that he instructed them from time to time to act in judicial proceedings involving Italian clients in Italy.

7 Mr Gebhard avers that his activity in Italy is essentially non-contentious, assisting and representing German-speakers (65% of his turnover) and representing Italian-speakers in Germany and Austria (30% of his turnover). The remaining 5% is accounted for by assistance to Italian practitioners whose clients are faced with problems of German law.

8 A number of Italian practitioners, including the Italian *avvocati* with whom Mr Gebhard was associated until 1989, lodged a complaint with the Milan Bar Council. They complained of his use of the title *avvocato* on the letterhead of notepaper which he used for professional purposes, of his having appeared using the title *avvocato* directly before the Pretura and the Tribunale di Milano and of his having practised professionally from 'Studio Legale Gebhard'.

9 The Milan Bar Council prohibited Mr Gebhard from using the title *avvocato*. Thereafter, on 19 September 1991, it decided to open disciplinary proceedings against him on the ground that he had contravened his obligations under Law No 31/82 by pursuing a professional activity in Italy on a permanent basis in chambers set up by himself whilst using the title *avvocato*.

10 On 14 October 1991 Mr Gebhard applied to the Milan Bar Council to be entered on the roll of members of the Bar. His application was based on Council Directive 89/48/EEC of 21 December 1988 on a general system for the recognition of higher-education diplomas awarded on completion of professional education and

training of at least three years' duration (OJ 1989 L 19, p. 16) and on his having completed a ten-year training period in Italy. It does not appear that the Bar Council has taken any formal decision on that application.

11 The disciplinary proceedings opened on 19 September 1991 were completed by a decision of 30 December 1992 by which the Milan Bar Council imposed on Mr Gebhard the sanction of suspension from pursuing his professional activity (*sospensione dell'esercizio dell'attività professionale*) for six months.

12 Mr Gebhard appealed against that decision to the Consiglio Nazionale Forense, making it clear, however, that he was also appealing against the implied rejection of his application to be entered on the roll. In particular, he argued in his appeal that Directive 77/249 entitled him to pursue his professional activities from his own chambers in Milan.

13 Directive 77/249 applies to the activities of lawyers pursued by way of provision of services. It states that a lawyer providing services is to adopt the professional title used in the Member State from which he comes, expressed in the language or one of the languages of that State, with an indication of the professional organization by which he is authorized to practise or the court of law before which he is entitled to practise pursuant to the laws of that State (Article 3).

14 The directive draws a distinction between (a) activities relating to the representation of a client in legal proceedings or before public authorities and (b) all other activities.

15 In pursuing activities relating to representation, the lawyer must observe the rules of professional conduct of the host Member State, without prejudice to his obligations in the Member State from which he comes (Article 4(2)). As far as the pur-

suit of all other activities is concerned, the lawyer remains subject to the conditions and rules of professional conduct of the Member State from which he comes, without prejudice to respect for the rules, whatever their source, which govern the profession in the host Member State, especially those concerning the incompatibility of the exercise of the activities of a lawyer with the exercise of other activities in that State, professional secrecy, relations with other lawyers, the prohibition on the same lawyer acting for parties with mutually conflicting interests, and secrecy (Article 4(4)).

16 Article 4(1) of Directive 77/249 provides that 'Activities relating to the representation of a client in legal proceedings or before public authorities shall be pursued in each host Member State under the conditions laid down for lawyers established in that State, with the exception of any conditions requiring residence, or registration with a professional organization, in that State.'

17 Directive 77/249 was implemented in Italy by Law No 31/82, Article 2 of which provides as follows:

' [Nationals of Member States authorized to practise as lawyers in the Member State from which they come] shall be permitted to pursue lawyers' professional activities on a temporary basis (*con carattere di temporaneità*) in contentious and non-contentious matters in accordance with the detailed rules laid down in this title.

For the purpose of the pursuit of the professional activities referred to in the preceding paragraph, the establishment on the territory of the Republic either of chambers or of a principal or branch office is not permitted.'

18 In those circumstances, the Consiglio Nazionale Forense stayed the proceedings and referred questions to the Court for a preliminary ruling:

'(a) as to whether Article 2 of Law No 31 of 9 February 1982 on freedom for lawyers who are nationals of the Member States of the European Community to provide services (enacted in implementation of Council Directive 77/249/EEC of 22 March 1977) which prohibits "the establishment on the territory of the Republic either of chambers or of a principal or branch office", is compatible with the rules laid down by that directive, given that in the directive there is no reference to the fact that the possibility of opening an office could be interpreted as reflecting a practitioner's intention to carry on his activities, not on a temporary or occasional basis, but on a regular basis;

(b) as to the criteria to be applied in assessing whether activities are of a temporary nature, with respect to the continuous and repetitive nature of the services provided by lawyers practising under the system referred to in the abovementioned directive of 22 March 1977.'

19 In view of the wording of the preliminary questions, it should be remembered that the Court has consistently held that it does not have jurisdiction to rule on the compatibility of a national measure with Community law. However, the Court is competent to provide the national court with all criteria for the interpretation of Community law which may enable it to determine the issue of compatibility for the purposes of the decision in the case before it (see in particular Case C-63/94 *Groupement National des Négociants en Pommes de Terre de Belgique (Belgapom)* [1995] ECR I-2467, paragraph 7).

20 The situation of a Community national who moves to another Member State of the Community in order there to pursue an economic activity is governed by the

chapter of the Treaty on the free movement of workers, or the chapter on the right of establishment or the chapter on services, these being mutually exclusive.

21 Since the questions referred are concerned essentially with the concepts of 'establishment' and 'provision of services', the chapter on workers can be disregarded as having no bearing on those questions.

22 The provisions of the chapter on services are subordinate to those of the chapter on the right of establishment in so far, first, as the wording of the first paragraph of Article 59 assumes that the provider and the recipient of the service concerned are 'established' in two different Member States and, second, as the first paragraph of Article 60 specifies that the provisions relating to services apply only if those relating to the right of establishment do not apply. It is therefore necessary to consider the scope of the concept of 'establishment'.

23 The right of establishment, provided for in Articles 52 to 58 of the Treaty, is granted both to legal persons within the meaning of Article 58 and to natural persons who are nationals of a Member State of the Community. Subject to the exceptions and conditions laid down, it allows all types of self-employed activity to be taken up and pursued on the territory of any other Member State, undertakings to be formed and operated, and agencies, branches or subsidiaries to be set up.

24 It follows that a person may be established, within the meaning of the Treaty, in more than one Member State — in particular, in the case of companies, through

the setting-up of agencies, branches or subsidiaries (Article 52) and, as the Court has held, in the case of members of the professions, by establishing a second professional base (see Case 107/83 *Ordre des Avocats au Barreau de Paris* v *Klopp* [1984] ECR 2971, paragraph 19).

25 The concept of establishment within the meaning of the Treaty is therefore a very broad one, allowing a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin and to profit therefrom, so contributing to economic and social interpenetration within the Community in the sphere of activities as self-employed persons (see, to this effect, Case 2/74 *Reyners* v *Belgium* [1974] ECR 631, paragraph 21).

26 In contrast, where the provider of services moves to another Member State, the provisions of the chapter on services, in particular the third paragraph of Article 60, envisage that he is to pursue his activity there on a temporary basis.

27 As the Advocate General has pointed out, the temporary nature of the activities in question has to be determined in the light, not only of the duration of the provision of the service, but also of its regularity, periodicity or continuity. The fact that the provision of services is temporary does not mean that the provider of services within the meaning of the Treaty may not equip himself with some form of infrastructure in the host Member State (including an office, chambers or consulting rooms) in so far as such infrastructure is necessary for the purposes of performing the services in question.

28 However, that situation is to be distinguished from that of Mr Gebhard who, as a national of a Member State, pursues a professional activity on a stable and contin-

uous basis in another Member State where he holds himself out from an established professional base to, amongst others, nationals of that State. Such a national comes under the provisions of the chapter relating to the right of establishment and not those of the chapter relating to services.

29 The Milan Bar Council has argued that a person such as Mr Gebhard cannot be regarded for the purposes of the Treaty as being 'established' in a Member State — in his case, Italy — unless he belongs to the professional body of that State or, at least, pursues his activity in collaboration or in association with persons belonging to that body.

30 That argument cannot be accepted.

31 The provisions relating to the right of establishment cover the taking-up and pursuit of activities (see, in particular, the judgment in *Reyners*, paragraphs 46 and 47). Membership of a professional body may be a condition of taking up and pursuit of particular activities. It cannot itself be constitutive of establishment.

32 It follows that the question whether it is possible for a national of a Member State to exercise his right of establishment and the conditions for exercise of that right must be determined in the light of the activities which he intends to pursue on the territory of the host Member State.

33 Under the terms of the second paragraph of Article 52, freedom of establishment is to be exercised under the conditions laid down for its own nationals by the law of the country where establishment is effected.

34 In the event that the specific activities in question are not subject to any rules in the host State, so that a national of that Member State does not have to have any specific qualification in order to pursue them, a national of any other Member State is entitled to establish himself on the territory of the first State and pursue those activities there.

35 However, the taking-up and pursuit of certain self-employed activities may be conditional on complying with certain provisions laid down by law, regulation or administrative action justified by the general good, such as rules relating to organization, qualifications, professional ethics, supervision and liability (see Case C-71/76 *Thieffry* v *Conseil de l'Ordre des Avocats à la Cour de Paris* [1977] ECR 765, paragraph 12). Such provisions may stipulate in particular that pursuit of a particular activity is restricted to holders of a diploma, certificate or other evidence of formal qualifications, to persons belonging to a professional body or to persons subject to particular rules or supervision, as the case may be. They may also lay down the conditions for the use of professional titles, such as *avvocato*.

36 Where the taking-up or pursuit of a specific activity is subject to such conditions in the host Member State, a national of another Member State intending to pursue that activity must in principle comply with them. It is for this reason that Article 57 provides that the Council is to issue directives, such as Directive 89/48, for the mutual recognition of diplomas, certificates and other evidence of formal qualifications or, as the case may be, for the coordination of national provisions concerning the taking-up and pursuit of activities as self-employed persons.

37 It follows, however, from the Court's case-law that national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the

general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it (see Case C-19/92 *Kraus* v *Land Baden-Württemberg* [1993] ECR I-1663, paragraph 32).

38 Likewise, in applying their national provisions, Member States may not ignore the knowledge and qualifications already acquired by the person concerned in another Member State (see Case C-340/89 *Vlassopoulou* v *Ministerium für Justiz, Bundes- und Europaangelegenheiten Baden-Württemberg* [1991] ECR I-2357, paragraph 15). Consequently, they must take account of the equivalence of diplomas (see the judgment in *Thieffry*, paragraphs 19 and 27) and, if necessary, proceed to a comparison of the knowledge and qualifications required by their national rules and those of the person concerned (see the judgment in *Vlassopoulou*, paragraph 16).

39 Accordingly, it should be stated in reply to the questions from the Consiglio Nazionale Forense that:

— the temporary nature of the provision of services, envisaged in the third paragraph of Article 60 of the EC Treaty, is to be determined in the light of its duration, regularity, periodicity and continuity;

— the provider of services, within the meaning of the Treaty, may equip himself in the host Member State with the infrastructure necessary for the purposes of performing the services in question;

— a national of a Member State who pursues a professional activity on a stable and continuous basis in another Member State where he holds himself out from an established professional base to, amongst others, nationals of that State comes under the provisions of the chapter relating to the right of establishment and not those of the chapter relating to services;

— the possibility for a national of a Member State to exercise his right of establishment, and the conditions for his exercise of that right, must be determined in the light of the activities which he intends to pursue on the territory of the host Member State;

— where the taking-up of a specific activity is not subject to any rules in the host State, a national of any other Member State will be entitled to establish himself on the territory of the first State and pursue that activity there. On the other hand, where the taking-up or the pursuit of a specific activity is subject to certain conditions in the host Member State, a national of another Member State intending to pursue that activity must in principle comply with them;

— however, national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it;

— likewise, Member States must take account of the equivalence of diplomas and, if necessary, proceed to a comparison of the knowledge and qualifications required by their national rules and those of the person concerned.

Costs

40 The costs incurred by the Italian, Greek, Spanish and French Governments, the United Kingdom and the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT

in answer to the questions referred to it by the Consiglio Nazionale Forense, by order of 16 December 1993, hereby rules:

1. **The temporary nature of the provision of services, envisaged in the third paragraph of Article 60 of the EC Treaty, is to be determined in the light of its duration, regularity, periodicity and continuity.**

2. **The provider of services, within the meaning of the Treaty, may equip himself in the host Member State with the infrastructure necessary for the purposes of performing the services in question.**

3. **A national of a Member State who pursues a professional activity on a stable and continuous basis in another Member State where he holds himself out from an established professional base to, amongst others, nationals of that State comes under the provisions of the chapter relating to the right of establishment and not those of the chapter relating to services.**

4. **The possibility for a national of a Member State to exercise his right of establishment, and the conditions for the exercise of that right, must be determined in the light of the activities which he intends to pursue on the territory of the host Member State.**

5. **Where the taking-up of a specific activity is not subject to any rules in the host State, a national of any other Member State will be entitled to establish**

himself on the territory of the first State and pursue that activity there. On the other hand, where the taking-up or the pursuit of a specific activity is subject to certain conditions in the host Member State, a national of another Member State intending to pursue that activity must in principle comply with them.

6. National measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it.

7. Member States must take account of the equivalence of diplomas and, if necessary, proceed to a comparison of the knowledge and qualifications required by their national rules and those of the person concerned.

Rodríguez Iglesias Kakouris Edward Hirsch

Mancini Schockweiler Moitinho de Almeida

Kapteyn Gulmann Murray

Jann Ragnemalm Sevón

Delivered in open court in Luxembourg on 30 November 1995.

R. Grass G. C. Rodríguez Iglesias

Registrar President

JUDGMENT OF THE COURT (Grand Chamber)

13 December 2005 *

In Case C-411/03,

REFERENCE for a preliminary ruling under Article 234 EC from the Landgericht Koblenz (Germany), made by decision of 16 September 2003, received by the Court on 2 October 2003, in the proceedings:

SEVIC Systems AG,

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans, A. Rosas and K. Schiemann, Presidents of Chambers, C. Gulmann (Rapporteur), J.N. Cunha Rodrigues, R. Silva de Lapuerta, K. Lenaerts, P. Kūris, E. Juhász, G. Arestis and A. Borg Barthet, Judges,

Advocate General: A. Tizzano,
Registrar: L. Hewlett, Principal Administrator,

having regard to the written procedure and further to the hearing on 10 May 2005,

* Language of the case: German.

after considering the observations submitted on behalf of:

— SEVIC Systems AG, by C. Beul, Rechtsanwalt,

— the German Government, by M. Lumma and A. Dittrich, acting as Agents,

— the Netherlands Government, by H.G. Sevenster and N.A.J. Bel, acting as Agents,

— the Commission of the European Communities, by C. Schmidt and G. Braun, acting as Agents,

after hearing the Opinion of the Advocate General at the hearing on 7 July 2005,

gives the following

Judgment

1 The reference for a preliminary ruling concerns the interpretation of Articles 43 EC and 48 EC.

2 The reference is made in the context of an action brought by SEVIC Systems AG ('SEVIC'), a company established in Neuwied (Germany), against a decision of the Amtsgericht Neuwied rejecting its application for registration in the national commercial register of the merger between itself and Security Vision Concept SA ('Security Vision'), a company established in Luxembourg, on the ground that the German law on company transformations provides only for mergers between companies established in Germany.

Legal context

3 Paragraph 1 of the German Law on transforming companies (Umwandlungsgesetz), of 28 October 1994 (BGBl. 1994 I, p. 3210), as amended in 1995 and subsequently ('the UmwG'), headed 'Types of transformation, statutory restrictions', provides:

'(1) Legal entities established in Germany may be transformed

1. by merger;

2. by demerger ... ;

3. by transfer of assets;

4. by change of legal form.

(2) Apart from the cases governed by this law, transformation within the meaning of subparagraph (1) is possible only if express provision is made for it by another federal law, or by a law of a Land.

(3) Derogations from the provisions of this law are possible only if expressly authorised. Supplementary provisions appearing in contracts, memoranda and articles of association or statements of intention are permitted, save where this law makes exhaustive provision.'

4 Paragraph 2 of the UmwG, headed 'Types of merger', provides:

'Legal entities may merge by dissolution without liquidation

1. by way of absorption through the transfer of all the assets of one or more legal entities (the absorbed entities) to another existing legal entity (the absorbing entity) or

2. ...

by the allocation of shares ... in the absorbing entity or the new entity to the shareholders ... of the absorbed entity.'

5 The other provisions of the UmwG specifically concerning merger by absorption make the merger contract subject to certain conditions (Paragraphs 4 to 6), and require the drawing up of a merger report (Paragraph 8), verification of the merger by experts (Paragraph 9 et seq.), and notification of the merger (Paragraph 16 et seq.) prior to its registration in the commercial register of the place of establishment of the absorbing entity (Paragraph 19). Paragraph 20 et seq. of the UmwG enumerates the effects of registration in that register. Protective provisions in favour of third parties concerned by the merger, particularly creditors, complete the general provisions concerning merger by absorption.

The dispute in the main proceedings and the question referred for a preliminary ruling

6 The merger contract concluded in 2002 between SEVIC and Security Vision provided for the dissolution without liquidation of the latter company and the transfer of the whole of its assets to SEVIC, without any change in the latter's company name.

7 The Amtsgericht Neuwied rejected the application for registration of the merger in the commercial register, arguing that Paragraph 1(1)(1) of the UmwG provides only for mergers between legal entities established in Germany.

8 SEVIC brought an action against that rejection decision before the Landgericht Koblenz.

9 For the Landgericht Koblenz, the question whether registration of the merger between the abovementioned companies in the commercial register can be refused on the basis of Paragraph 1(1)(1) of the UmwG depends on the interpretation of Articles 43 EC and 48 EC in the context of mergers between companies established in Germany and companies established in other Member States ('cross-border mergers').

10 In those circumstances, taking the view that resolution of the dispute before it depended on the interpretation of those EC Treaty provisions, the Landgericht Koblenz decided to stay the proceedings and refer the following question to the Court of Justice for a preliminary ruling:

'Are Articles 43 and 48 EC to be interpreted as meaning that it is contrary to freedom of establishment for companies if a foreign European company is refused registration of its proposed merger with a German company in the German register of companies under Paragraphs 16 et seq. of the Umwandlungsgesetz (Law on transformations), on the ground that Paragraph 1(1)(1) of that law provides only for transformation of legal entities established in Germany?'

The question referred for a preliminary ruling

Preliminary observations

11 SEVIC has applied for registration in the commercial register, in accordance with the UmwG, of the merger with Security Vision, the relevant contract providing for the absorption of the latter company and its dissolution without liquidation.

12 That application was rejected by the Amtsgericht Neuwied on the ground that, in Paragraph 1(1)(1), the UmwG provides that only legal entities established in national territory may be the subject of transformation by merger ('internal mergers') and that, therefore, that law does not apply to transformations resulting from cross-border mergers.

13 In Germany, there are no general rules, analogous to those laid down by that law, which apply to cross-border mergers.

14 There is therefore a difference in treatment in Germany between internal and cross-border mergers.

15 In those circumstances, the question referred by the national court should be understood as asking essentially whether Articles 43 EC and 48 EC preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State, whereas such registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State.

Applicability of Articles 43 EC and 48 EC

16 Contrary to the arguments of the German and Netherlands Governments, Articles 43 EC and 48 EC apply to a merger situation such as that at issue in the main proceedings.

17 In accordance with the second paragraph of Article 43 EC, read in conjunction with Article 48 EC, the freedom of establishment for companies referred to in that latter article includes in particular the formation and management of those companies under the conditions defined by the legislation of the State of establishment for its own companies.

18 As the Advocate General points out in point 30 of his Opinion, the right of establishment covers all measures which permit or even merely facilitate access to another Member State and the pursuit of an economic activity in that State by allowing the persons concerned to participate in the economic life of the country effectively and under the same conditions as national operators.

19 Cross-border merger operations, like other company transformation operations, respond to the needs for cooperation and consolidation between companies established in different Member States. They constitute particular methods of exercise of the freedom of establishment, important for the proper functioning of the internal market, and are therefore amongst those economic activities in respect of which Member States are required to comply with the freedom of establishment laid down by Article 43 EC.

The existence of a restriction on the freedom of establishment

20 In this regard, it is sufficient to note that in German law, unlike what exists for internal mergers, there is no provision for registration in the commercial register of cross-border mergers, and that, therefore, applications for the registration of such mergers are generally refused.

21 As the Advocate General has pointed out in point 47 of his Opinion, a merger such as that at issue in the main proceedings constitutes an effective means of transforming companies in that it makes it possible, within the framework of a single operation, to pursue a particular activity in new forms and without intrerruption, thereby reducing the complications, times and costs associated with other forms of company consolidation such as those which entail, for example, the dissolution of a company with liquidation of assets and the subsequent formation of a new company with the transfer of assets to the latter.

22 In so far as, under national rules, recourse to such a means of company transformation is not possible where one of the companies is established in a Member State other than the Federal Republic of Germany, German law establishes a difference in treatment between companies according to the internal or cross-border nature of the merger, which is likely to deter the exercise of the freedom of establishment laid down by the Treaty.

23 Such a difference in treatment constitutes a restriction within the meaning of Articles 43 EC and 48 EC, which is contrary to the right of establishment and can be permitted only if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. It is further necessary, in such a case, that its application must be appropriate to ensuring the attainment of the objective thus pursued and must not go beyond what is necessary to attain it (see Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 49; Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 49).

Possible justification for the restriction

24 The German and Netherlands Governments argue that internal mergers are subject to conditions more particularly designed to protect the interests of creditors, minority shareholders and employees, and to preserve the effectiveness of fiscal

supervision and the fairness of commercial transactions. They submit in that respect that specific problems arise in relation to cross-border mergers and that the solution to those problems presupposes the existence of specific rules designed to protect those interests in the context of a cross-border merger that involves the application of several national legal systems in a single legal operation. Such rules, they submit, presuppose a harmonisation of the legislation at the Community level.

25 In that context, the Netherlands Government points out that the Commission of the European Communities submitted to the Community legislature on 18 November 2003 the Proposal for a Directive of the European Parliament and of the Council on cross-border mergers of companies with share capital (COM(2003) 703 final), the first and second recitals of which state:

'(1) The need for cooperation and consolidation between companies from different Member States and the difficulties encountered, at the legislative and administrative levels, by cross-border mergers of companies in the Community make it necessary, with a view to the completion and functioning of the single market, to lay down Community provisions to facilitate the carrying-out of cross-border mergers ...

(2) ... The abovementioned objectives cannot be sufficiently attained by the Member States in so far they involve laying down rules with common features applicable at transnational level; owing to the scale and impact of the proposed action, they can therefore best be achieved at Community level ...'

26 It should be noted in that respect that, whilst Community harmonisation rules are useful for facilitating cross-border mergers, the existence of such harmonisation

rules cannot be made a precondition for the implementation of the freedom of establishment laid down by Articles 43 EC and 48 EC (see, to that effect, Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 11).

27 It should nevertheless also be noted that whilst, by reason of the adoption of the Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies (OJ 1978 L 295, p. 36), harmonised rules exist in the Member States concerning internal mergers, cross-border mergers pose specific problems.

28 In that respect, it is not possible to exclude the possibility that imperative reasons in the public interest such as protection of the interests of creditors, minority shareholders and employees (see Case C-208/00 *Überseering* [2002] ECR I-9919, paragraph 92), and the preservation of the effectiveness of fiscal supervision and the fairness of commercial transactions (see Case C-167/01 *Inspire Art* [2003] ECR I-10155, paragraph 132), may, in certain circumstances and under certain conditions, justify a measure restricting the freedom of establishment.

29 But such a restrictive measure would also have to be appropriate for ensuring the attainment of the objectives pursued and not go beyond what is necessary to attain them.

30 To refuse generally, in a Member State, to register in the commercial register a merger between a company established in that State and one established in another Member State has the result of preventing the realisation of cross-border mergers even if the interests mentioned in paragraph 28 of this judgment are not threatened. In any event, such a rule goes beyond what is necessary to protect those interests.

31 In those circumstances, the answer to the question referred must be that Articles 43 EC and 48 EC preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State, whereas such registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State.

Costs

32 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

Articles 43 EC and 48 EC preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State, whereas such registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State.

[Signatures]

8th assignment (Mergers and Acquisition II)

After completing this seminar, students should have acquired knowledge in the following main issue of the topic:

Exclusivity Agreement and Letter of Intent – An exclusivity agreement ensures one party has the exclusive right to negotiate or enter into a deal, preventing others from interfering during a specified period. A letter of intent is a preliminary document outlining the intentions of parties to negotiate a deal, clarifying the basic terms before a formal agreement.

Culpa in Contrahendo – "Culpa in contrahendo" refers to the liability for damages arising from bad faith or negligent conduct during contract negotiations. It is recognized in many jurisdictions, including Slovak law, where it protects parties from harm caused by unfair conduct before an agreement is finalized.

Due Diligence vs. Audit – Due diligence is a comprehensive investigation into a company's financial, legal, and operational aspects before a transaction. An audit typically refers to a formal examination of financial records, often done annually, to ensure accuracy and compliance with accounting standards.

Representations and Warranties – Representations are statements of fact made by a party in a contract, while warranties are assurances or guarantees that those facts are true. Their purpose is to protect the parties by providing remedies if the facts turn out to be untrue.

Disclosure Letter and MAC Clauses – A disclosure letter accompanies contracts, revealing any exceptions or clarifications regarding representations and warranties. A material adverse change (MAC) clause allows a buyer to withdraw from a deal if significant negative changes occur in the target company's condition.

Compulsory readings materials:

- PETER, H.: M&A: Process and possible dispute
- Sample of Seller's Representations & Warranties (R&W Sample)
- Sample Due Diligence Report Issues (DD Report)

Related case studies (facultative):

- C-446/03 Mark & Spencer
- C-343/13 Modelo Continente Hipermercados
- C-394/18 IGI

JUDGMENT OF THE COURT (Grand Chamber)

13 December 2005 *

In Case C-446/03,

REFERENCE for a preliminary ruling under Article 234 EC from the High Court of Justice of England and Wales, Chancery Division (United Kingdom), made by decision of 16 July 2003, received at the Court on 22 October 2003, in the proceedings

Marks & Spencer plc

v

David Halsey (Her Majesty's Inspector of Taxes),

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans and A. Rosas, Presidents of Chambers, C. Gulmann (Rapporteur), A. La Pergola, J.-P. Puissochet, R. Schintgen, N. Colneric, J. Klučka, U. Lõhmus, E. Levits and A. Ó Caoimh, Judges,

* Language of the case: English.

Advocate General: M. Poiares Maduro,
Registrar: K. Sztranc, Administrator,

having regard to the written procedure and further to the hearing on 1 February 2005,

after considering the observations submitted on behalf of:

— Marks & Spencer plc, by G. Aaronson QC and P. Farmer, Barrister,

— the United Kingdom Government, by M. Bethell, acting as Agent, with R. Plender QC and D. Ewart, Barrister,

— the German Government, by W.-D. Plessing and A. Tiemann, acting as Agents,

— the Greek Government, by K. Boskovits and V. Kyriazopoulos, and also by I. Pouli and S. Trekli, acting as Agents,

— the French Government, by G. de Bergues and C. Jurgensen-Mercier, acting as Agents,

— Ireland, by D.J. O'Hagan, acting as Agent, with E. Fitzsimons SC and G. Clohessy, BL,

— the Netherlands Government, by H.G. Sevenster, S. Terstal and J. van Bakel, acting as Agents,

— the Finnish Government, by A. Guimaraes-Purokoski, acting as Agent,

— the Swedish Government, by A. Kruse, acting as Agent,

— the Commission of the European Communities, by R. Lyal, acting as Agent,

after hearing the Opinion of the Advocate General at the sitting on 7 April 2005,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 43 EC and 48 EC.

2 The request was submitted in proceedings between Marks & Spencer plc ('Marks & Spencer') and the United Kingdom tax authority concerning the latter's rejection of a claim for tax relief by Marks & Spencer, which sought to deduct from its taxable profits in the United Kingdom losses incurred by its subsidiaries established in Belgium, Germany and France.

National legal context

3 The provisions of national law applicable in the main proceedings are to be found in the Income and Corporation Taxes Act 1988 ('the ICTA'). They are set out below on the basis of the information provided in the decision for reference.

Liability to corporation tax

4 Under sections 6(1) and 11(1) of the ICTA, corporation tax is charged on the profits of companies which are resident in the United Kingdom or which conduct trading activities in the United Kingdom through a branch or agency.

5 Under section 8(1) of the ICTA, resident companies are charged to corporation tax in respect of their worldwide profits. Under section 11(1), non-resident companies are charged to corporation tax only in respect of the profits attributable to their United Kingdom branches or agencies.

6 Under taxation conventions between the United Kingdom and, in particular, Belgium, Germany and France, the foreign subsidiaries of resident companies, as non-resident companies, fall within the scope of United Kingdom corporation tax in respect of their trading activities only if those activities are conducted in the United Kingdom through a permanent establishment within the meaning of those Conventions.

7 A tax credit system of relieving double taxation is provided for in the United Kingdom.

8 That system has, in particular, the following two aspects.

9 First, a company established in the United Kingdom which conducts trading activities in another Member State through a branch in that State is taxed in the United Kingdom on the profits of that subsidiary and deducts from the tax payable the tax paid in the other Member State, or is allowed to deduct that tax when calculating branch profits or losses in the United Kingdom. The branch trading profits are calculated on United Kingdom tax principles. If a trading loss arose that loss could be set against the profits of the company established in the United Kingdom. Any unrelieved loss may be carried forward to subsequent periods. The fact that the loss may also be relieved in the other Member State against the branch's future profits does not affect the relief against United Kingdom profits.

10 Second, a company established in the United Kingdom which conducts trading activities in another Member State through a subsidiary established in that State is taxed in the United Kingdom on the dividends paid by that subsidiary and credit is

given for the tax paid in the other Member State on the profits out of which the dividend is paid and for any withholding tax. Where controlled foreign company legislation is not applicable, the parent company is not taxed on its non-resident subsidiary's profits and it cannot set the subsidiary's losses against its own profits.

11 Under section 208 of the ICTA, dividends received by a parent company established in the United Kingdom from a subsidiary also established in that Member State are not taxed, unlike those paid by a subsidiary established in another Member State.

Group relief for losses

12 In the United Kingdom, group relief allows the resident companies in a group to offset their profits and losses among themselves.

13 Section 402 of the ICTA provides:

'(1) Subject to and in accordance with this Chapter and section 492(8), relief for trading losses and other amounts eligible for relief from corporation tax may, in the cases set out in subsections (2) and (3) below, be surrendered by a surrendering company ("the surrendering company") and, on the making of a claim by another company ("the claimant company") may be allowed to the claimant company by way of relief from corporation tax called group relief.

(2) Group relief shall be available in a case where the surrendering company and the claimant company are both members of the same group ..."

14 Section 403 of the ICTA provides that:

'(1) If in an accounting period ("the surrender period") the surrendering company has —

(a) trading losses ... the amount may, subject to the provisions of this Chapter, be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period.'

15 As regards the accounting periods ending before 1 April 2000, section 413(5) of the ICTA states:

'References in this Chapter to a company apply only to bodies corporate resident in the United Kingdom ...'

16 Following a change in the law consequent upon the judgment of the Court of 16 July 1998 in Case C-264/96 *ICI* [1998] ECR I-4695, group relief has since 2000 been applicable to profits and losses within the scope of United Kingdom tax law.

17 As a consequence of that change in the law:

— losses made by a United Kingdom branch of a non-resident company may be surrendered to another group company for offset against its United Kingdom taxable profits;

— losses made by a group company established in the United Kingdom may be surrendered to the branch for offset against its profits in the United Kingdom.

Main proceedings and questions referred for a preliminary ruling

18 Marks & Spencer is a company incorporated and registered in England and Wales. It is the parent company of a number of companies established in the United Kingdom and in other States. It is one of the leading United Kingdom retailers of clothing, food, homeware and financial services.

19 From 1975 Marks & Spencer began to move into other States, with the opening of a store in France. By the end of the 1990s it had sales outlets in more than 36 countries, with a network of subsidiaries and a system of franchises.

20 A trend towards increasing losses became evident in the mid-1990s.

21 In March 2001 Marks & Spencer announced its intention to divest itself of its Continental European activity. By 31 December 2001 the French subsidiary had been sold to third parties, while the other subsidiaries, including those established in Belgium and Germany, had ceased trading.

22 In the United Kingdom, Marks & Spencer claimed group tax relief pursuant to paragraph 6 of Schedule 17A to the ICTA in respect of losses incurred by its subsidiaries in Belgium, Germany and France for the four accounting periods ended 31 March 1998, 31 March 1999, 31 March 2000 and 31 March 2001. It is clear from the file before the Court that both parties to the main proceedings agree that the losses must be computed on a United Kingdom tax basis. At the tax authority's request, Marks & Spencer therefore recomputed the losses on that basis.

23 Each of the subsidiaries had operated in the Member State in which it had its registered office. The subsidiaries had no permanent establishment in the United Kingdom and had never traded there.

24 The claims for relief were rejected on the ground that group relief could only be granted for losses recorded in the United Kingdom.

25 Marks & Spencer appealed against that refusal before the Special Commissioners of Income Tax, which dismissed the appeal.

26 Marks & Spencer appealed against that decision before the High Court of Justice of England and Wales, Chancery Division, which decided to stay proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) In circumstances where:

— Provisions of a Member State, such as the United Kingdom provisions on group relief, prevent a parent company which is resident for tax purposes in that State from reducing its taxable profits in that State by setting off losses incurred in other Member States by subsidiary companies which are resident for tax purposes in those States, where such set off would be possible if the losses were incurred by subsidiary companies resident in the State of the parent company;

— The Member State of the parent company:

— subjects a company resident within its territory to corporation tax on its total profits, including the profits of branches in other Member States, with arrangements for the availability of double taxation relief for those taxes incurred in another Member State and under which branch losses are taken account of in those taxable profits;

— does not subject the undistributed profits of subsidiaries resident in other Member States to corporation tax;

— subjects the parent company to corporation tax on any distributions to it by way of dividend by the subsidiaries resident in other Member States while not subjecting the parent company to corporation tax on distributions by way of dividend by subsidiary companies resident in the State of the parent;

— grants double taxation relief to the parent company by way of a credit in respect of withholding tax on dividends and foreign taxes paid on the profits in respect of which dividends are paid by subsidiary companies resident in other Member States;

is there a restriction under Article 43 EC, in conjunction with Article 48 EC? If so, is it justified under Community law?

(2) (a) What difference, if any, does it make to the answer to Question 1 that, depending on the law of the Member State of the subsidiary, it is or may be possible in certain circumstances to obtain relief for some or all of the losses incurred by the subsidiary against taxable profits in the State of the subsidiary?

(b) If it does make a difference, what significance, if any, is to be attached to the fact that:

— a subsidiary resident in another Member State has now ceased trading and, although there is provision for loss relief subject to certain conditions in that State, there is no evidence that in the circumstances such relief was obtained;

— a subsidiary resident in another Member State has been sold to a third party and, although there is provision under the law of that State for the losses to be used under certain conditions by a third party purchaser, it is uncertain whether they were so used in the circumstances of the case;

— the arrangements under which the Member State of the parent company takes account of the losses of UK resident companies apply regardless of whether the losses are also relieved in another Member State?

(c) Would it make any difference if there were evidence that relief had been obtained for the losses in the Member State in which the subsidiary was resident and, if so, would it matter that the relief was obtained subsequently by an unrelated group of companies to which the subsidiary was sold?'

Question 1

27 By its first question, the High Court seeks essentially to ascertain whether Articles 43 EC and 48 EC preclude provisions of a Member State which prevent a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary.

28 In other words, the question is whether such provisions constitute a restriction on freedom of establishment, contrary to Articles 43 EC and 48 EC.

29 In that regard, it must be borne in mind that, according to settled case-law, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law (see, in particular, Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 37 and the case-law cited).

30 Freedom of establishment, which Article 43 EC grants to Community nationals and which includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, entails, in accordance with Article 48 EC, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Community, the right to exercise their activity in the Member State concerned through a subsidiary, a branch or an agency (see, in particular, Case C-307/97 *Saint Gobain ZN* [1999] ECR I-6161, paragraph 35).

31 Even though, according to their wording, the provisions concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (see, in particular, *ICI*, cited above, paragraph 21).

32 Group relief such as that at issue in the main proceedings constitutes a tax advantage for the companies concerned. By speeding up the relief of the losses of the loss-making companies by allowing them to be set off immediately against the profits of other group companies, such relief confers a cash advantage on the group.

33 The exclusion of such an advantage in respect of the losses incurred by a subsidiary established in another Member State which does not conduct any trading activities in the parent company's Member State is of such a kind as to hinder the exercise by that parent company of its freedom of establishment by deterring it from setting up subsidiaries in other Member States.

34 It thus constitutes a restriction on freedom of establishment within the meaning of Articles 43 EC and 48 EC, in that it applies different treatment for tax purposes to losses incurred by a resident subsidiary and losses incurred by a non-resident subsidiary.

35 Such a restriction is permissible only if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective thus pursued and not go beyond what is necessary to attain it (see, to that effect, Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 26, and Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 49).

36 The United Kingdom and the other Member States which submitted observations in the present proceedings claim that, from the aspect of a group relief system such as that at issue in the main proceedings, resident subsidiaries and non-resident subsidiaries are not in comparable tax situations. In accordance with the principle of territoriality applicable both in international law and in Community law, the Member State in which the parent company is established has no tax jurisdiction over non-resident subsidiaries. As regards the latter, tax competence belongs in principle, in accordance with the usual allocation of competence in such matters, to the States on whose territory they are established and carry out commercial activities.

37 In that regard, it must be noted that, in tax law, the taxpayers' residence may constitute a factor that might justify national rules involving different treatment for resident and non-resident taxpayers. However, residence is not always a proper factor for distinction. In effect, acceptance of the proposition that the Member State in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its registered office is situated in another Member State would deprive Article 43 EC of all meaning (see Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 18).

38 In each specific situation, it is necessary to consider whether the fact that a tax advantage is available solely to resident taxpayers is based on relevant objective elements apt to justify the difference in treatment.

39 In a situation such as that in the proceedings before the national court, it must be accepted that by taxing resident companies on their worldwide profits and non-resident companies solely on the profits from their activities in that State, the parent company's Member State is acting in accordance with the principle of territoriality enshrined in international tax law and recognised by Community law (see, in particular, *Futura Participations and Singer*, paragraph 22).

40 However, the fact that it does not tax the profits of the non-resident subsidiaries of a parent company established on its territory does not in itself justify restricting group relief to losses incurred by resident companies.

41 In order to ascertain whether such a restriction is justified, it is necessary to consider what the consequences would be if an advantage such as that at issue in the main proceedings were to be extended unconditionally.

42 On that point, the United Kingdom and the other Member States which submitted observations put forward three factors to justify the restriction.

43 First, in tax matters profits and losses are two sides of the same coin and must be treated symmetrically in the same tax system in order to protect a balanced allocation of the power to impose taxes between the different Member States concerned. Second, if the losses were taken into consideration in the parent company's Member State they might well be taken into account twice. Third, and last, if the losses were not taken into account in the Member State in which the subsidiary is established there would be a risk of tax avoidance.

44 As regards the first justification, it must be borne in mind that the reduction in tax revenue cannot be regarded as an overriding reason in the public interest which may be relied on to justify a measure which is in principle contrary to a fundamental freedom (see, in particular, Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 49 and the case-law cited).

45 None the less, as the United Kingdom rightly observes, the preservation of the allocation of the power to impose taxes between Member States might make it necessary to apply to the economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses.

46 In effect, to give companies the option to have their losses taken into account in the Member State in which they are established or in another Member State would significantly jeopardise a balanced allocation of the power to impose taxes between

Member States, as the taxable basis would be increased in the first State and reduced in the second to the extent of the losses transferred.

47 As regards the second justification, relating to the danger that losses would be used twice, it must be accepted that Member States must be able to prevent that from occurring.

48 Such a danger does in fact exist if group relief is extended to the losses of non-resident subsidiaries. It is avoided by a rule which precludes relief in respect of those losses.

49 As regards, last, the third justification, relating to the risk of tax avoidance, it must be accepted that the possibility of transferring the losses incurred by a non-resident company to a resident company entails the risk that within a group of companies losses will be transferred to companies established in the Member States which apply the highest rates of taxation and in which the tax value of the losses is therefore the highest.

50 To exclude group relief for losses incurred by non-resident subsidiaries prevents such practices, which may be inspired by the realisation that the rates of taxation applied in the various Member States vary significantly.

51 In the light of those three justifications, taken together, it must be observed that restrictive provisions such as those at issue in the main proceedings pursue legitimate objectives which are compatible with the Treaty and constitute overriding

reasons in the public interest and that they are apt to ensure the attainment of those objectives.

52 That analysis is not affected by the indications, set out in the second part of the first question, relating to the arrangements applicable in the United Kingdom:

— to the profits and losses of a foreign subsidiary of a company established in that Member State;

— to the dividends distributed to a company established in that State by a subsidiary established in another Member State.

53 None the less, the Court must ascertain whether the restrictive measure goes beyond what is necessary to attain the objectives pursued.

54 Marks & Spencer and the Commission contended that measures less restrictive than a general exclusion from group relief might be envisaged. By way of example, they referred to the possibility of making relief conditional upon the foreign subsidiary's having taken full advantage of the possibilities available in its Member State of residence of having the losses taken into account. They also referred to the possibility that group relief might be made conditional on the subsequent profits of the non-resident subsidiary being incorporated in the taxable profits of the company which benefited from group relief up to an amount equal to the losses previously set off.

55 In that regard, the Court considers that the restrictive measure at issue in the main proceedings goes beyond what is necessary to attain the essential part of the objectives pursued where:

— the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods, if necessary by transferring those losses to a third party or by offsetting the losses against the profits made by the subsidiary in previous periods, and

— there is no possibility for the foreign subsidiary's losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

56 Where, in one Member State, the resident parent company demonstrates to the tax authorities that those conditions are fulfilled, it is contrary to Articles 43 EC and 48 EC to preclude the possibility for the parent company to deduct from its taxable profits in that Member State the losses incurred by its non-resident subsidiary.

57 It is also important, in that context, to make clear that Member States are free to adopt or to maintain in force rules having the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose is to circumvent or escape national tax law (see, to that effect, *ICI*, paragraph 26, and *De Lasteyrie du Saillant*, paragraph 50).

58 Furthermore, in so far as it may be possible to identify other, less restrictive measures, such measures in any event require harmonisation rules adopted by the Community legislature.

59 Accordingly, the answer to the first question must be that, as Community law now stands, Articles 43 EC and 48 EC do not preclude provisions of a Member State which generally prevent a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary. However, it is contrary to Articles 43 EC and 48 EC to prevent the resident parent company from doing so where the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods and where there are no possibilities for those losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

Question 2

60 In the light of the answer to the first question, there is no need to answer the second question.

Costs

61 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

As Community law now stands, Articles 43 EC and 48 EC do not preclude provisions of a Member State which generally prevent a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary. However, it is contrary to Articles 43 EC and 48 EC to prevent the resident parent company from doing so where the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods and where there are no possibilities for those losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

[Signatures]

Reports of Cases

JUDGMENT OF THE COURT (Fifth Chamber)

5 March 2015*

(Reference for a preliminary ruling — Rules on mergers of public limited liability companies — Directive 78/855/EEC — Merger by acquisition — Article 19 — Effects — Transfer of all the assets and liabilities of the company being acquired to the acquiring company — Infringement by the company being acquired prior to its acquisition — Administrative decision confirming infringement post-acquisition — National law — Transfer of the acquired company's liability for administrative offences — Lawfulness)

In Case C-343/13,

REQUEST for a preliminary ruling under Article 267 TFEU from the Tribunal do Trabalho de Leiria (Portugal), made by decision of 14 March 2013, received at the Court on 24 June 2013, in the proceedings

Modelo Continente Hipermercados SA

v

Autoridade para as Condições de Trabalho — Centro Local do Lis (ACT),

THE COURT (Fifth Chamber),

composed of T. von Danwitz, President of the Chamber, C. Vajda (Rapporteur), A. Rosas, E. Juhász and D. Šváby, Judges,

Advocate General: M. Wathelet,

Registrar: M. Ferreira, Principal Administrator,

having regard to the written procedure and further to the hearing on 3 September 2014,

after considering the observations submitted on behalf of:

— Modelo Continente Hipermercados SA, by D. Abrunhosa e Sousa, advogado,

— the Portuguese Government, by M. Perestrelo de Oliveira, and subsequently by L. Inez Fernandes and F. Figueiroa Quelhas, acting as Agents,

— the German Government, by T. Henze and D. Kuon, acting as Agents,

— the Hungarian Government, by K. Szíjjártó, acting as Agent,

* Language of the case: Portuguese.

— the Austrian Government, by C. Pesendorfer, acting as Agent,

— the European Commission, by P. Guerra e Andrade and H. Støvlbæk, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 12 November 2014,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Article 19(1) of Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies (OJ 1978 L 295, p. 36), as amended by Directive 2009/109/EC of the European Parliament and of the Council of 16 September 2009 (OJ 2009 L 259, p. 14) ('Directive 78/855').

2 The request has been made in proceedings between Modelo Continente Hipermercados SA ('MCH') and the Autoridade para as Condições de Trabalho — Centro Local do Lis (Authority for Working Conditions — Municipality of Lis) ('the ACT'), concerning the latter's decision to fine MCH for infringements of Portuguese employment law committed by Good and Cheap — Comércio Retalhista SA ('Good and Cheap') before being acquired by MCH.

Legal context

EU Law

3 The third and sixth recitals in the preamble to Directive 78/855 stated:

'… the protection of the interests of members and third parties requires that the laws of the Member States relating to mergers of public limited liability companies be coordinated and … provision for mergers should be made in the laws of all the Member States.

...

… creditors, including debenture holders, and persons having other claims on the merging companies should be protected so that the merger does not adversely affect their interests.'

4 Article 3(1) of the Directive provided:

'For the purposes of this Directive, "merger by acquisition" shall mean the operation whereby one or more companies are wound up without going into liquidation and transfer to another all their assets and liabilities in exchange for the issue to the shareholders of the company or companies being acquired of shares in the acquiring company and a cash payment, if any, not exceeding 10% of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value.'

5 Article 13(1) and (2) of the Directive read as follows:

'1. The laws of the Member States must provide for an adequate system of protection of the interests of creditors of the merging companies whose claims antedate the publication of the draft terms of merger and have not fallen due at the time of such publication.

2. To that end, the laws of the Member States shall at least provide that such creditors shall be entitled to obtain adequate safeguards where the financial situation of the merging companies makes such protection necessary and where those creditors do not already have such safeguards.

Member States shall lay down the conditions for the protection provided for in paragraph 1 and in the first subparagraph of this paragraph. In any event, Member States shall ensure that the creditors are authorised to apply to the appropriate administrative or judicial authority for adequate safeguards provided that they can credibly demonstrate that due to the merger the satisfaction of their claims is at stake and that no adequate safeguards have been obtained from the company.'

6 Article 19(1) of Directive 78/855 stated:

'A merger shall have the following consequences ipso jure and simultaneously:

(a) the transfer, both as between the company being acquired and the acquiring company and as regards third parties, to the acquiring company of all the assets and liabilities of the company being acquired;

(b) the shareholders of the company being acquired become shareholders of the acquiring company;

(c) the company being acquired ceases to exist.'

7 Directive 78/855 was repealed as from 1 July 2011 by Directive 2011/35/EU of the European Parliament and of the Council of 5 April 2011 concerning mergers of public limited liability companies (JO 2011 L 110, p. 1). As is apparent from the first recital in its preamble, Directive 2011/35/EU seeks in the interests of clarity and consistency to codify Directive 78/855, which had been substantially amended several times. Article 19(1) of Directive 2011/35 reproduces Article 19(1) of Directive 78/855 in identical terms.

Portuguese Law

8 Article 112 of the Commercial Companies Code (Código das Sociedades Comerciais) ('the CSC') states:

'Upon registration of the merger in the commercial register:

(a) the companies being acquired or, in the case of incorporation of a new company, all the merged companies, shall be wound up and their rights and obligations transferred to the acquiring company or to the new company;

(b) the members of the liquidated companies shall become members of the acquiring company or of the new company.'

The dispute in the main proceedings and the questions referred for a preliminary ruling

9 On 15 February 2011, the ACT conducted an inspection of the records of hours of work performed by Good and Cheap's workers during the months December 2010 and January 2011. It found that Good and Cheap had infringed certain provisions of Portuguese employment law concerning both the number of uninterrupted hours worked by certain workers and the minimum number of hours of rest between two consecutive work periods in certain cases.

10 According to the documents before the Court, MCH and Good and Cheap registered the draft terms of their merger at the relevant office of the Commercial Registry on 22 February 2011, which were published on the Portuguese Ministry of Justice's publications website.

11 On 7 March 2011, the ACT drew up two official reports against Good and Cheap in relation to the infringements. However, the ACT did not notify Good and Cheap of those reports until 4 April 2011.

12 On 31 March 2011, the merger of Good and Cheap and MCH by way of the latter's acquisition of the former's assets and liabilities was registered and, having been absorbed by MCH, Good and Cheap was consequently wound up.

13 In a decision of 24 September 2012, the ACT confirmed the initial findings and fined MCH for each of the administrative offences committed.

14 In its appeal against the ACT's decision before the Tribunal do Trabalho de Leiria, MCH raised the issue of the compatibility of Article 112 of the CSC, as interpreted by the ACT, with Article 19 of Directive 2011/35. In that regard, the Tribunal do Trabalho de Leiria asks whether, in the case of merger by acquisition, the transfer to the acquiring company of all the assets and liabilities of the company being acquired as laid down in Article 19(1)(a) of that directive can include the transfer to the acquiring company of liability to pay fines for administrative offences committed by the acquired company prior to its acquisition.

15 In those circumstances, the Tribunal do Trabalho de Leiria decided to stay the proceedings and refer the following questions to the Court of Justice for a preliminary ruling:

'(1) In the light of [EU] law and, in particular, [Article 19(1)(a) of Directive 2011/35], does the merger by acquisition of companies entail a system of transfer of liability for administrative offences to the acquiring company for acts committed by the company being acquired before registration of the merger?

(2) For the purposes of the application of Directive 2011/35, can a fine for an administrative offence be considered a liability owed to a third party, namely one owed to the State for the infringement of provisions of employment law, whereby, as a fine for the commission of an administrative offence, the liability at issue owed to the State would be transferred to the acquiring company?

(3) By constituting too broad an interpretation, contrary to the principles of EU law and, in particular, Article 19 of the Directive, is not an interpretation of Article 112 of the Commercial Companies Code according to which neither proceedings to prosecute an administrative offence committed before the merger are discontinued nor a fine imposed or to be imposed lifted contrary to the consequences of a company merger laid down in Directive 2011/35?

(4) Does that interpretation not offend against the principle that an administrative offence cannot be committed by the acquiring company without an express provision for (mitigated) strict liability or fault on the acquiring company's part?'

Consideration of the questions referred

Admissibility

16 In their written observations to the Court, the German and the Austrian Governments express doubts as to the admissibility of some of the questions posed by the national court. The German Government considers that the third and fourth questions concern an interpretation of national law. For its part, the

Austrian Government submits that the second question relates to a situation in which, contrary to the facts of the case in the main proceedings, the fine has already been imposed prior to the merger and that it is, thus, hypothetical in nature. Moreover, it submits that the issue of criminal liability raised in the fourth question is not governed by Directive 2011/35 and does not therefore present any connection with EU law as required by Article 51 of the Charter of Fundamental Rights of the European Union.

17 In that regard, the Court notes, first, that although it is clear from the facts of the main proceedings as set out by the national court that the fines were imposed as a result of a decision adopted after the acquisition of Good and Cheap by MCH, it does not, however, follow from the wording of the second question referred that that question does not relate to a case such as that at issue in the main proceedings. Consequently, the second question cannot be regarded as being hypothetical.

18 Secondly, rather than seeking an interpretation of national law, by its third question the national court manifestly seeks an interpretation of Directive 2011/35, in particular Article 19 thereof, in order to establish whether the interpretation of Article 112 of the CSC adopted, in particular, by the ACT is contrary to EU law.

19 Finally, as the Advocate General observed in point 34 of his Opinion, the fourth question appears to relate to an interpretation of principles of Portuguese law and lacks any reference to EU law. It should be noted that, according to settled case-law, the procedure laid down in Article 267 TFEU is based on a clear separation of functions between the courts and tribunals of the Member States and the Court of Justice. The Court is empowered to rule only on the interpretation or the validity of the acts of EU law referred to in Article 267 TFEU. In that context, it is not for the Court to rule on the interpretation of provisions of national law or to decide whether the referring court's interpretation of them is correct (see judgment in *Texdata Software*, C-418/11, EU:C:2013:588, paragraph 28 and the case-law cited).

20 It follows that, with the exception of the fourth question, the questions referred by the national court are admissible.

Substance

21 As a preliminary matter, the Court points out that Directive 2011/35, an interpretation of which is sought by the first three questions, was not in force at the time of the facts of the case in the main proceedings. In those circumstances, the questions referred must be examined solely on the basis of Directive 78/855.

22 Accordingly, by the first three questions referred, which it is appropriate to examine together, the national court seeks, in essence, to ascertain whether Article 19(1) of Directive 78/855 must be interpreted as meaning that a 'merger by acquisition' within the meaning of Article 3(1) of the directive results in the transfer to the acquiring company of the obligation to pay a fine imposed by final decision adopted after the merger by acquisition for employment law offences committed by the acquired company prior to that merger.

23 In accordance with Article 19(1)(a) of Directive 78/855, merger by acquisition results ipso jure in the transfer to the acquiring company of all the assets and liabilities of the company being acquired.

24 In order to answer the questions referred by the national court, it is thus necessary to examine whether the liability of a company resulting from the commission of an administrative offence, namely the obligation to pay a fine imposed after the company's acquisition for offences committed prior to its merger by acquisition, must be considered as a liability of the company within the meaning of Article 19(1)(a) of the directive.

25 It is common ground among the interested parties referred to in Article 23 of the Statute of the Court of Justice of the European Union which made submissions before the Court on this issue that a fine imposed by final decision prior to, but not paid at the time of, a merger by acquisition of two companies is a liability of the acquired company in so far as the amount of such a fine must be considered as a debt, payable by the company to the relevant Member State. However, in relation to the facts of the case in the main proceedings, which concern a fine which was imposed only after the merger of the two companies at issue in the main proceedings, only the Portuguese and Hungarian Governments and the European Commission take the view that the obligation to pay such a fine forms part of the liabilities of the company being acquired, whereas MCH and the German Government argue to the contrary.

26 In that regard, the notion of 'assets and liabilities', as referred to, in particular, in Article 19(1)(a) of Directive 78/855, is not defined by the directive itself. Nor does that article make any reference to the laws of the Member States as regards such a definition.

27 However, in accordance with settled case-law, the need for a uniform application of EU law and the principle of equality require that the terms of a provision of EU law which makes no express reference to the law of the Member States for the purpose of determining its meaning and scope must normally be given an autonomous and uniform interpretation throughout the European Union, which must take into account the context of that provision and the purpose of the legislation in question (see, inter alia, judgments in *Fish Legal and Shirley*, C-279/12, EU:C:2013:853, paragraph 42, and *Deckmyn and Vrijheidsfonds*, C-201/13, EU:C:2014:2132, paragraph 14).

28 As for the context in which the notion of 'liabilities' is used, Article 19(1) of Directive 78/855 lays down that a merger by acquisition results ipso jure, and thus automatically, not only in the transfer of the assets and liabilities of the company being acquired to the acquiring company, but also, in accordance with Article 19(1)(c), in the company being acquired ceasing to exist. As a consequence, the liability for an administrative offence would be extinguished if it were not transferred to the acquiring company as part of the liabilities of the company being acquired.

29 As the Advocate General observed in point 61 of his Opinion, extinguishing such a liability would run contrary to the very notion of merger by acquisition as defined in Article 3(1) of Directive 78/855 to the extent that, in accordance with that provision, such an acquisition consists in the transfer to the acquiring company of all the acquired company's assets and liabilities as a result of the latter being wound up without going into liquidation.

30 This interpretation of the notion of liabilities is consistent with the purpose of Directive 78/855. In that regard, the third recital in the preamble to the directive states that the coordination of the laws of the Member States relating to mergers of public limited liability companies by the introduction into the Member States' laws of the legal institution of mergers aims notably at protecting the interests of members and third parties upon merger by acquisition.

31 The notion of third parties is broader than that of 'creditors, including debenture holders, and persons having other claims on the merging companies' contained in the sixth recital in the preamble to Directive 78/855, specific provisions having been put in place to protect those creditors and debenture holders, notably in Articles 13 to 15 Directive 78/855.

32 It is therefore necessary to consider as third parties, whose interests the directive is intended to protect, those entities which though not yet creditors or debenture holders at the date of the acquisition may become such post-acquisition as a result of situations antedating the acquisition. This is the case, for instance, for infringements of employment law provisions which are found to have been committed in a decision adopted after the merger by acquisition had taken place. If liability for the payment of a fine

for administrative offences committed by the company being acquired were not transferred to the acquiring company, the interest of the Member State the competent authorities of which have imposed the fine would not be protected.

33 In that context, it should be noted, as the Portuguese and Hungarian Governments and the European Commission have submitted, that if such liability were not transferred, a company could use a merger by acquisition as a means of escaping the legal consequences of offences it has committed to the detriment of the Member State concerned or other potential interested parties.

34 That conclusion is not called into question by MCH's argument that, in the case of a merger, the transfer of an acquired company's liability for an administrative offence would prejudice the interests of the creditors and shareholders of the acquiring company, since the creditors and shareholders of the acquiring company would not be able to evaluate the economic consequences of that merger, nor its effect upon the acquiring company's assets and liabilities. First of all, such creditors are, in accordance with Article 13(2) of Directive 78/855, entitled to obtain adequate safeguards where the financial situation of the merging companies makes such protection necessary and, where appropriate, are authorised to apply to the appropriate administrative or judicial authority in order to obtain such safeguards. Secondly, as the Advocate General observed in point 61 of his Opinion, the shareholders of the acquiring company can be protected notably through the inclusion of terms of disclosure and warranties in the acquisition agreement. Thirdly, in addition to the documents and information available in accordance with the relevant legislative provisions, an acquiring company is not precluded from conducting a detailed audit of the economic and legal situation of the company to be acquired before the merger by acquisition in order to obtain a more complete picture of that company's liabilities.

35 Consequently, the answer to the first three questions referred is that Article 19(1) of Directive 78/855 must be interpreted as meaning that a 'merger by acquisition' in Article 3(1) of the directive results in the transfer to the acquiring company of the obligation to pay a fine imposed by final decision adopted after the merger by acquisition for infringements of employment law committed by the acquired company prior to that merger.

Costs

36 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Fifth Chamber) hereby rules:

Article 19(1) of Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies, as amended by Directive 2009/109/EC of the European Parliament and of the Council of 16 September 2009, must be interpreted as meaning that a 'merger by acquisition' in Article 3(1) of the directive results in the transfer to the acquiring company of the obligation to pay a fine imposed by final decision adopted after the merger by acquisition for infringements of employment law committed by the acquired company prior to that merger.

[Signatures]

Reports of Cases

JUDGMENT OF THE COURT (Second Chamber)

30 January 2020*

(Reference for a preliminary ruling — Directive 82/891/EEC — Articles 12 and 19 — Division of limited liability companies — Protection of the interests of the creditors of the company being divided — Nullity of the division — *Actio pauliana*)

In Case C-394/18,

REQUEST for a preliminary ruling under Article 267 TFEU from the Corte d'appello di Napoli (Court of Appeal, Naples, Italy), made by decision of 27 February 2018, received at the Court on 14 June 2018, in the proceedings

I.G.I. Srl

v

Maria Grazia Cicenia,

Mario Di Pierro,

Salvatore de Vito,

Antonio Raffaele,

intervener:

Costruzioni Ing. G. Iandolo Srl,

THE COURT (Second Chamber),

composed of A. Arabadjiev, President of the Chamber, P.G. Xuereb (Rapporteur), T. von Danwitz, C. Vajda and A. Kumin, Judges,

Advocate General: M. Szpunar,

Registrar: R. Schiano, Administrator,

having regard to the written procedure and further to the hearing on 5 June 2019,

after considering the observations submitted on behalf of:

– I.G.I. Srl, by S. Ietti, avvocatessa,

* Language of the case: Italian.

– Costruzioni Ing. G. Iandolo Srl, by S. Pierro and S. Ietti, avvocatesse,

– the European Commission, by L. Malferrari, W. Mölls and H. Støvlbæk, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 26 September 2019,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Articles 12 and 19 of Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54(3)(g) of the Treaty, concerning the division of public limited liability companies (OJ 1982 L 378, p. 47), as amended by Directive 2007/63/EC of the European Parliament and of the Council of 13 November 2007 (OJ 2007 L 300, p. 47) ('the Sixth Directive').

2 The request has been made in proceedings between I.G.I. Srl, on the one hand, and Maria Grazia Cicenia, Mario Di Pierro, Salvatore de Vito and Antonio Raffaele, on the other hand, concerning the possibility for the latter, as creditors of a company being divided which had a part of its assets transferred to I.G.I., to bring an *actio pauliana* so as to have the instrument of division declared without effect vis-à-vis them, and to bring enforcement or protective actions in relation to the assets transferred to I.G.I.

Legal context

European Union law

Third Directive 78/855/EEC

3 Article 1 of Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies (OJ 1978 L 295, p. 36), as amended by Directive 2007/63 ('the Third Directive'), entitled 'Scope', provides, in paragraph 1:

'The coordination measures laid down by this Directive shall apply to the laws, regulations and administrative provisions of the Member States relating to the following types of company:

…

– Italy:

la società per azioni,

…'

4 Article 13(3) of the Third Directive states:

'Such protection may be different for the creditors of the acquiring company and for those of the company being acquired.'

The Sixth Directive

5 The eighth recital of the Sixth Directive states:

'… creditors, including debenture holders, and persons having other claims on the companies involved in a division, must be protected so that the division does not adversely affect their interests'.

6 The eleventh recital of that directive states:

'… to ensure certainty in the law as regards relations between the companies involved in the division, between them and third parties, and between the members, the cases in which nullity can arise must be limited by providing that defects be remedied wherever that is possible and by restricting the period within which nullification proceedings may be commenced'.

7 Article 1 of that directive provides:

'1. Where Member States permit the companies referred to in Article 1(1) of [the Third Directive] coming under their laws to carry out division operations by acquisition as defined in Article 2 of this Directive, they shall subject those operations to the provisions of Chapter I of this Directive.

2. Where Member States permit the companies referred to in paragraph 1 to carry out division operations by the formation of new companies as defined in Article 21, they shall subject those operations to the provisions of Chapter II of this Directive.

…'

8 Article 2 of the Sixth Directive provides:

'1. For the purposes of this Directive, "division by acquisition" shall mean the operation whereby, after being wound up without going into liquidation, a company transfers to more than one company all its assets and liabilities in exchange for the allocation to the shareholders of the company being divided of shares in the companies receiving contributions as a result of the division (hereinafter referred to as "recipient companies") and possibly a cash payment not exceeding 10% of the nominal value of the shares allocated or, where they have no nominal value, of their accounting par value.

…

3. In so far as this Directive refers to [the Third Directive], the expression "merging companies" shall mean "the companies involved in a division", the expression "company being acquired" shall mean "the company being divided", the expression "acquiring company" shall mean "each of the recipient companies" and the expression "draft terms of merger" shall mean "draft terms of division".'

9 Article 12 of the Sixth Directive is worded as follows:

'1. The laws of Member States must provide for an adequate system of protection for the interests of the creditors of the companies involved in a division whose claims antedate publication of the draft terms of division and have not yet fallen due at the time of such publication.

2. To that end, the laws of Member States shall at least provide that such creditors shall be entitled to obtain adequate safeguards where the financial situation of the company being divided and that of the company to which the obligation will be transferred in accordance with the draft terms of division make such protection necessary and where those creditors do not already have such safeguards.

3. In so far as a creditor of the company to which the obligation has been transferred in accordance with the draft terms of division has not obtained satisfaction, the recipient companies shall be jointly and severally liable for that obligation. Member States may limit that liability to the net assets allocated to each of those companies other than the one to which the obligation has been transferred. However, they need not apply this paragraph where the division operation is subject to the supervision of a judicial authority in accordance with Article 23 and a majority in number representing three-fourths in value of the creditors or any class of creditors of the company being divided have agreed to forego such joint and several liability at a meeting held pursuant to Article 23(l)(c).

4. Article 13(3) of [the Third Directive] shall apply.

5. Without prejudice to the rules governing the collective exercise of their rights, paragraphs 1 to 4 shall apply to the debenture holders of the companies involved in the division except where the division has been approved by a meeting of the debenture holders, if such a meeting is provided for under national laws, or by the debenture holders individually.

6. Member States may provide that the recipient companies shall be jointly and severally liable for the obligations of the company being divided. In such case they need not apply the foregoing paragraphs.

7. Where a Member State combines the system of creditor protection set out in paragraph 1 to 5 with the joint and several liability of the recipient companies as referred to in paragraph 6, it may limit such joint and several liability to the net assets allocated to each of those companies.'

10 Article 15 of the Sixth Directive provides:

'The laws of Member States shall determine the date on which a division takes effect.'

11 Under Article 17(1) of that directive:

'A division shall have the following consequences *ipso jure* and simultaneously:

(a) the transfer, both as between the company being divided and the recipient companies and as regards third parties, to each of the recipient companies of all the assets and liabilities of the company being divided; such transfer shall take effect with the assets and liabilities being divided in accordance with the allocation laid down in the draft terms of division or in Article 3(3);

(b) the shareholders of the company being divided become shareholders of one or more of the recipient companies in accordance with the allocation laid down in the draft terms of division;

(c) the company being divided ceases to exist.'

12 Article 19 of that directive is worded as follows:

'1. The laws of Member States may lay down nullity rules for divisions in accordance with the following conditions only:

(a) nullity must be ordered in a court judgment;

(b) divisions which have taken effect pursuant to Article 15 may be declared void only if there has been no judicial or administrative preventive supervision of their legality, or if they have not been drawn up and certified in due legal form, or if it is shown that the decision of the general meeting is void or voidable under national law;

(c) nullification proceedings may not be initiated more than six months after the date on which the division becomes effective as against the person alleging nullity or if the situation has been rectified;

(d) where it is possible to remedy a defect liable to render a division void, the competent court shall grant the companies involved a period of time within which to rectify the situation;

(e) a judgment declaring a division void shall be published in the manner prescribed by the laws of each Member State in accordance with Article 3 of [First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (OJ, English Special Edition 1968 (I), p. 41)];

(f) where the laws of a Member State permit a third party to challenge such a judgment, he may do so only within six months of publication of the judgment in the manner prescribed by Directive 68/151/EEC;

(g) a judgment declaring a division void shall not of itself affect the validity of obligations owed by or in relation to the recipient companies which arose before the judgment was published and after the date referred to in Article 15;

(h) each of the recipient companies shall be liable for its obligations arising after the date on which the division took effect and before the date on which the decision pronouncing the nullity of the division was published. The company being divided shall also be liable for such obligations; Member States may provide that this liability be limited to the share of net assets transferred to the recipient company on whose account such obligations arose.

2. By way of derogation from paragraph 1(a), the laws of a Member State may also provide for the nullity of a division to be ordered by an administrative authority if an appeal against such a decision lies to a court. Subparagraphs (b), (d), (e), (f), (g), and (h) shall apply by analogy to the administrative authority. Such nullification proceedings may not be initiated more than six months after the date referred to in Article 15.

3. The foregoing shall not affect the laws of the Member States on the nullity of a division pronounced following any supervision of legality.'

13 Articles 2 to 19 of the Sixth Directive are found in Chapter I of that directive, entitled 'Division by acquisition'.

14 Under Chapter II of that directive, entitled 'Division by the formation of new companies', Article 21(1) of the directive provides:

'For the purposes of this Directive, "division by the formation of new companies" means the operation whereby, after being wound up without going into liquidation, a company transfers to more than one newly-formed company all its assets and liabilities in exchange for the allocation to the shareholders of the company being divided of shares in the recipient companies, and possibly a cash payment not exceeding 10% of the nominal value of the shares allocated or, where they have no nominal value, of their accounting par value.'

15 Article 22(1) of that directive, also in Chapter II thereof, provides:

‘Articles 3, 4, 5 and 7, 8(1) and (2) and 9 to 19 of this Directive shall apply, without prejudice to Articles 11 and 12 of Directive 68/151/EEC, to division by the formation of new companies. For this purpose, the expression “companies involved in a division” shall refer to the company being divided and the expression “recipient companies” shall refer to each of the new companies.’

16 Article 25 of the Sixth Directive, contained in Chapter IV of that directive which is entitled ‘Other operations treated as divisions’, provides:

‘Where the laws of a Member State permit one of the operations specified in Article 1 without the company being divided ceasing to exist, Chapters I, II and III shall apply, except for Article 17(1)(c).’

Italian law

17 Article 2503 of the Codice Civile (Civil Code), entitled ‘Objection by creditors’, provides:

‘A merger may be implemented only 60 days after the last of the registrations required under Article 2502-bis, unless (i) the merger has the consent of the creditors of the companies involved in the merger who have claims existing before the registration or publication required under Article 2501-ter(3), (ii) payment is made to creditors that have not given their consent, (iii) the corresponding sums are deposited with a bank, or (iv) the report required under Article 2501-sexies, which has been drafted, for all companies involved in the merger, by a single auditing company, in accordance with its liability under the sixth paragraph of Article 2501-sexies, has certified that the assets and liabilities and financial situation of the companies involved in the merger are such that it is not necessary to provide safeguards for the protection of the aforementioned creditors.

If none of those exceptions applies, the creditors referred to in the previous paragraph may file an objection within the period of 60 days indicted above. In such a case, the final paragraph of Article 2445 shall apply.’

18 Article 2504-quater of that code, entitled ‘Invalidity of the merger’, states that:

‘Once the instrument of merger has been registered in accordance with the second paragraph of Article 2504, that instrument may not be ruled invalid.

This does not affect the right to compensation for prejudice that may be caused to shareholders or to third parties harmed by the merger.’

19 Article 2506 of that code, entitled ‘Forms of division’, provides:

‘In a division, a company allocates all of its assets to more than one company, either pre-existing or newly formed, or a part of its assets, in that case possibly to only one company, and the corresponding shares or units to its shareholders.

A cash payment is authorised where it does not exceed 10% of the nominal value of the allocated shares or units. Further, it is permitted that, by unanimous consent, some shareholders do not receive shares or units of one of the recipient companies but shares or units of the company being divided.

By the division, the company being divided can be either wound up without going into liquidation or continue its activity.

Participating in a division is prohibited for companies in liquidation that have started to distribute their assets.'

20 The final paragraph of Article 2506-ter of the Civil Code, entitled 'Applicable legislation', provides:

'The division is also subject to Articles 2501-septies, 2502, 2502-bis, 2503, 2503-bis, 2504, 2504-ter, 2504-quater, 2505 (first and second paragraphs), 2505-bis and 2505-ter. All references to a merger contained in those articles shall be understood as also referring to a division.'

21 Article 2506-quater of that code, entitled 'Effects of the division', provides, in its final paragraph:

'Each company is jointly and severally liable, up to the effective value of the net assets transferred to it or remaining with it, for the debts of the company being divided that are not satisfied by the company on whose account such obligations arose.'

22 Under Article 2901 of that code, which is contained in a section entitled 'On the action to set aside':

'Even where the credit is subject to conditions or deadlines, a creditor may request that transfers of assets through which a debtor causes a prejudice to its interests be declared without effect vis-à-vis that creditor, where the following conditions are met:

(1) the debtor is aware of the prejudice that the act has caused to the interests of the creditor or, in the case of an act antedating the existence of the credit, the act was deliberately planned to prejudice the settlement of the claim;

(2) furthermore, in relation to an act for consideration, the third party was aware of the prejudice and, in the case of an act antedating the existence of the credit, was a party to the deliberate planning of that act.

…'

23 If follows from the first paragraph of Article 2902 of the Civil Code that a creditor that has obtained a declaration of ineffectiveness in relation to the instrument disposing of the debtor's assets causing prejudice to the creditor's security over the assets of the debtor can bring enforcement or protective action against the purchaser third parties in respect of the assets forming the subject of the contested instrument.

24 Finally, it follows from Article 2903 of that code that the action to set aside is subject to a limitation period of 5 years running from completion of the act.

The dispute in the main proceedings and the questions referred for a preliminary ruling

25 By notarised instrument of 16 September 2009, Costruzioni Ing. G. Iandolo Srl transferred, within the context of a division, a part of its assets to I.G.I., established for that purpose by means of the same notarised instrument.

26 Taking the view that that division had caused Costruzioni Ing. G. Iandolo to lose a large part of its assets and that the company now owned only land plots of low value, Ms Cicenia, Mr Di Pierro, Mr de Vito and Mr Raffaele brought an action against I.G.I. and Costruzioni Ing. G. Iandolo before the Tribunale di Avellino (District Court, Avellino, Italy), in which they claimed that they are creditors of Costruzioni Ing. G. Iandolo. Principally, they brought an action to set aside, a so-called *actio pauliana*, under Article 2901 of the Civil Code, requesting that the instrument of division in

question be declared without effect vis-à-vis themselves. In the alternative, they requested that Costruzioni Ing. G. Iandolo and I.G.I. be declared jointly and severally liable for the debts of Costruzioni Ing. G. Iandolo, pursuant to Article 2506-quater of the Civil Code.

27 By judgment of 11 December 2015, the Tribunale di Avellino (District Court, Avellino) allowed the principal claim of the creditors and declared the asset transfer instrument contained in the instrument of division without effect vis-à-vis them 'in relation to the assets referred to in the revoked instrument still in the possession of I.G.I.'.

28 I.G.I. and Costruzioni Ing. G. Iandolo lodged an appeal against that judgment before the Corte d'Appello di Napoli (Court of Appeal, Naples, Italy), arguing that the *actio pauliana* brought by the creditors concerned is inadmissible on the ground that the objection referred to in Article 2503 of the Civil Code is the sole judicial remedy of which creditors of companies involved in a division may avail themselves, and that, where no such objection is made, the effects of the division become definitive vis-à-vis those creditors. Those companies also stated that Article 2504-quater of the Civil Code precludes situations in which an instrument of division is declared invalid after the publication formalities have been complied with.

29 The referring court states that Articles 12 and 19 of the Sixth Directive were transposed into Italian law by Articles 2503, 2504-quater, 2506-ter and 2506-quater (final paragraph) of the Civil Code.

30 In particular, the referring court states that, in order to implement Article 12 of the Sixth Directive, which relates to the protection of the interests of the creditors of the companies involved in a division whose claims antedate publication of the draft terms of division, the Italian legislature provided that creditors whose rights antedate the division can, within a short period of time, file an objection to the division. It also provided that each company is jointly and severally liable, up to the effective value of the net assets transferred to it or remaining with it, for the debts of the company being divided that are not satisfied by the company on whose account such obligations arose. Finally, it made provision, where the instrument of division can no longer be declared invalid, for a right to compensation for the prejudice that may be caused to the shareholders or to third parties harmed by the division.

31 The referring court also notes that, in order to implement Article 19 of the Sixth Directive, which lays down nullity rules for divisions, the Italian legislature provided that the instrument of division cannot be declared invalid where it has been registered with the Register of Companies.

32 The referring court also states that, as regards the question whether an *actio pauliana* brought by the creditors of a company being divided is admissible, there are two opposing lines of case-law which have been developed by the lower courts.

33 According to one line of case-law, such an action is admissible on the ground that, although both the objection provided for in Article 2503 of the Civil Code and the action to set aside provided for in Article 2901 of that code are aimed at safeguarding the creditors' security over the assets of the debtor, those actions are not comparable. Thus, they differ as to the persons who can rely on them, the time when they can be brought, the time limit in which they can be brought, the fact that the action to set aside seeks to penalise fraudulent conduct, and, finally, their effects.

34 According to the second line of case-law, an action to set aside on the part of the creditors of a company being divided must be ruled out in the light of the objective of the Sixth Directive aimed at ensuring that the effects of the division become definitive and irrevocable vis-à-vis the creditors, within a short period of time, so as to safeguard the interests of the various interested parties concerned by the division, other than the creditors of the company being divided.

35 In that regard, the referring court observes that the preservation of certainty in the law in respect of the effects of the division and the interests of the parties interested in the division, which is one of the objectives of the Sixth Directive, cannot be ensured unless a failure to bring those actions provided for in Article 12 of the Sixth Directive has the effect of precluding any possibility for the creditors to subsequently bring other actions with a view to safeguarding their security over the assets of the debtor. Thus, according to that court, the concept of 'nullity' referred to in Article 19 of the Sixth Directive should encompass all actions that result in the instrument of division being rendered without effect, whether absolute or relative, and irrespective of the validity, in this latter case, of the instrument of division.

36 The referring court nevertheless indicates that Article 12 of the Sixth Directive does not preclude the bringing of any subsequent action intended to safeguard the creditors' security over the assets of the debtor, and that there are a number of differences, under national law, between nullification proceedings and an *actio pauliana*.

37 In those circumstances, the Corte d'appello di Napoli (Court of Appeal, Naples) decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

'(1) Can the creditors of the company being divided, whose credit interests antedate the division, who have not taken advantage of the remedy of lodging an objection under Article 2503 of the Civil Code (and therefore of the protection tool introduced in implementation of Article 12 of [the Sixth Directive]), use an action to set aside under Article 2901 of the Civil Code after the division has been implemented, in order to obtain a declaration that the division in question has no effect against them and, therefore, to take precedence in enforcement over the creditors of the recipient company or companies and to be placed in a preferential position before the shareholders of those companies?

(2) Does the notion of nullity, provided for by Article 19 of [the Sixth Directive], refer only to actions affecting the validity of the instrument of division or also to actions which, despite not affecting its validity, result in its relative lack of effect or unenforceability?'

Consideration of the questions referred

The applicable directive

38 In the request for a preliminary ruling, the referring court refers both to the Sixth Directive and Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (OJ 2017 L 169, p. 46), which repealed the Sixth Directive with effect from its entry into force on 20 July 2017. Given that all the facts of the main proceedings predate the date of entry into force of Directive 2017/1132, the Sixth Directive applies.

The jurisdiction of the Court

39 The Commission has expressed doubts as to the Court's jurisdiction to hear and determine the present request for a preliminary ruling on the ground that the dispute in the main proceedings does not fall within the scope of the Sixth Directive, since only a part of the assets of Costruzioni Ing. G. Iandolo was transferred to I.G.I.

40 According to the Commission, it is apparent from Article 21(1) of the Sixth Directive, read in conjunction with Article 2(1) thereof, that that directive does not apply to divisions by the formation of new companies unless all assets and liabilities of the company being divided are transferred.

41 As the Advocate General noted in point 43 of his Opinion, it is apparent from the title of the Sixth Directive that that directive concerns divisions of public limited liability companies. It is also apparent from Article 1 of that directive, read in conjunction with Article 1(1) of the Third Directive, that the Sixth Directive applies, in respect of the Italian Republic, to 'società per azioni' (public limited liability companies). However, Costruzioni Ing. G. Iandolo and I.G.I. are not public limited liability companies but limited liability companies.

42 Moreover, under Article 21 of the Sixth Directive, division by the formation of new companies means the operation whereby, after being wound up without going into liquidation, a company transfers to more than one newly formed company all its assets. However, Costruzioni Ing. G. Iandolo did not transfer all its assets to more than one company but only a part of its assets to one company, I.G.I.

43 Consequently, the division operation at issue in the main proceedings does not directly fall within the scope of the Sixth Directive.

44 In accordance with Article 267 TFEU, the Court has jurisdiction to give preliminary rulings concerning the interpretation of the Treaties and acts of the EU institutions. In the context of cooperation between the Court and the national courts, established by Article 267 TFEU, it is for the national courts alone to assess, in view of the special features of each case, both the need for a preliminary ruling in order to enable them to give their judgment and the relevance of the questions which they put to the Court. Consequently, where questions submitted by national courts concern the interpretation of a provision of EU law, the Court is, in principle, obliged to give a ruling (judgment of 31 May 2018, *Ernst & Young*, C-633/16, EU:C:2018:371, paragraph 29 and the case-law cited).

45 Applying that case-law, the Court has repeatedly held that it has jurisdiction to give preliminary rulings on questions concerning EU provisions in situations where the facts of the cases being considered by the national courts were outside the scope of EU law but where those provisions had been rendered applicable by domestic law due to a reference made by that law to the content of those provisions. In that case, even though the facts of the main proceedings were outside the direct scope of EU law, the provisions of EU law had been made applicable by national legislation, which, in dealing with purely internal situations, follows the same approach as that provided for by EU law (see, to that effect, judgments of 18 October 1990, *Dzodzi*, C-297/88 and C-197/89, EU:C:1990:360, paragraph 37; of 17 July 1997, *Leur-Bloem*, C-28/95, EU:C:1997:369, paragraphs 27 and 32; and of 15 November 2016, *Ullens de Schooten*, C-268/15, EU:C:2016:874, paragraph 53).

46 When, in regulating purely internal situations, domestic legislation seeks to adopt the same solutions as those adopted in EU law in order, for example, to avoid discrimination against foreign nationals or any distortion of competition or to provide for a single procedure in comparable situations, it is clearly in the interest of the Union that, in order to forestall future differences of interpretation, provisions or concepts taken from EU law should be interpreted uniformly, irrespective of the circumstances in which they are to apply. Thus, an interpretation by the Court of provisions of EU law in purely internal situations is warranted on the ground that they have been made applicable by national law directly and unconditionally, in order to ensure that internal situations and situations governed by EU law are treated in the same way (judgments of 21 December 2011, *Cicala*, C-482/10, EU:C:2011:868, paragraphs 18 and 19, and of 21 November 2019, *Deutsche Post and Others*, C-203/18 and C-374/18, EU:C:2019:999, paragraph 37).

47 Where a national court refers a question to the Court in connection with a situation that is outside the direct scope of EU law, the Court cannot, where the referring court does not indicate something other than that the national legislation in question applies without distinction to situations governed by the provisions of EU law in question and to purely internal situations, consider that the request for a preliminary ruling on the interpretation of the provisions of that law is necessary to enable that court to give judgment in the case pending before it (see, to that effect, judgment of 15 November 2016, *Ullens de Schooten*, C-268/15, EU:C:2016:874, paragraph 54).

48 The specific factors that allow it to be established that the provisions of EU law have been made applicable by national law directly and unconditionally, in order to ensure that internal situations and situations governed by EU law are treated in the same way, must be apparent from the order for reference (judgment of 20 September 2018, *Fremoluc*, C-343/17, EU:C:2018:754, paragraph 21).

49 To that end, the referring court must indicate, in accordance with Article 94 of the Rules of Procedure of the Court, in what way the dispute pending before it, despite its purely domestic character, has a connecting factor with the provisions of EU law that makes the preliminary ruling on interpretation necessary for it to give judgment in that dispute. Those requirements also appear in the recommendations of the Court of Justice of the European Union to national courts and tribunals in relation to the initiation of preliminary ruling proceedings (OJ 2019 C 380, p. 1).

50 In the present case, the referring court, which has exclusive jurisdiction to interpret national law under the system of judicial cooperation established in Article 267 TFEU, stated that Articles 2503, 2504-quater, 2506-ter and the final paragraph of Article 2506-quater of the Civil Code, the application of which is sought by the parties to the main proceedings in the present case, transpose Articles 12 and 19 of the Sixth Directive into national law. That is apparent, as noted by the Commission, from decreto legislativo n. 22 — Attuazione delle direttive n. 78/855/CEE e n. 82/891/CEE in materia di fusioni e scissioni societarie, ai sensi dell'art. 2, comma 1, della legge 26 marzo 1990, n. 69 (Legislative Decree No 22 implementing Directives 78/855/EEC and 82/891/EC on mergers and divisions, in accordance with Article 2(1) of Law No 69 of 26 March 1990) of 16 January 1991 (GURI No 19 of 23 January 1991).

51 It is also apparent from the order for reference that those articles of the Civil Code which transpose Articles 12 and 19 of the Sixth Directive into national law apply, pursuant to Article 2506 of the Civil Code, to both division operations by which a company transfers only a part of its assets to one or more companies and division operations by which a company transfers all its assets to one or more companies; that is the case as regards both public limited liability companies and limited liability companies.

52 In transposing the Sixth Directive in that manner, the Italian legislature therefore decided to apply Articles 12 and 19 of the Sixth Directive directly and unconditionally also to division operations involving limited liability companies by which a company transfers only a part of its assets to another company.

53 It must be further noted that Article 25 of the Sixth Directive, invoked by the Commission in its written observations, does not prohibit national legislatures from applying the rules on divisions laid down in the Sixth Directive to division operations involving limited liability companies by which a company transfers only a part of its assets to another company, as the Commission acknowledged at the hearing.

54 In those circumstances, it must be held that, contrary to the submissions of the Commission, the Court has jurisdiction to answer the questions submitted by the referring court.

Admissibility of the request for a preliminary ruling

55 I.G.I. submits that the request for a preliminary ruling is inadmissible on the ground that it does not contain a description of the factual and legal context of the questions submitted to the Court, contrary to what is required by Article 94 of the Rules of Procedure of the Court. Furthermore, I.G.I. and Costruzioni Ing. G. Iandolo maintain that the questions referred are irrelevant given that the claims that the respondents in the main proceedings sought to protect by bringing an *actio pauliana*

have all been extinguished. At the hearing, the Commission also stated that if the claims have in fact been extinguished, the request for a preliminary ruling is devoid of purpose and must be declared inadmissible.

56 In that regard, it should be noted that, according to settled case-law, questions on the interpretation of EU law referred by a national court in the factual and legislative context which that court is responsible for defining, and the accuracy of which is not a matter for the Court to determine, enjoy a presumption of relevance. The Court may refuse to rule on a question referred for a preliminary ruling by a national court only where it is quite obvious that the interpretation of EU law that is sought bears no relation to the actual facts of the main action or its purpose, where the problem is hypothetical, or where the Court does not have before it the factual or legal material necessary to give a useful answer to the questions submitted to it (judgment of 10 July 2019, *Federal Express Corporation Deutsche Niederlassung*, C-26/18, EU:C:2019:579, paragraph 32 and the case-law cited).

57 According also to settled case-law, the need to provide an interpretation of EU law which will be of use to the national court makes it necessary for the national court to define the factual and legal context of the questions it is asking or, at the very least, to explain the factual circumstances on which those questions are based. The order for reference must also set out the precise reasons why the national court is unsure as to the interpretation of EU law and considers it necessary to refer a question to the Court for a preliminary ruling (judgment of 19 December 2018, *Stanley International Betting and Stanleybet Malta*, C-375/17, EU:C:2018:1026, paragraph 29 and the case-law cited).

58 In the request for a preliminary ruling, the referring court sufficiently describes the legal and factual context of the main proceedings and makes clear that the questions referred to the Court are necessary to enable it to decide whether the *actio pauliana* brought before it is consistent with EU law.

59 Furthermore, as regards the information provided by the referring court, which has exclusive jurisdiction to interpret national law under the system of judicial cooperation established in Article 267 TFEU, it cannot be held that the questions submitted to the Court bear no relation to the actual facts of the main action or its purpose or concern a hypothetical problem.

60 The request for a preliminary ruling is therefore admissible.

The first question

61 By its first question, the referring court asks, in essence, whether Article 12 of the Sixth Directive must be interpreted as precluding the creditors of the company being divided whose credit interests antedate that division, who did not take advantage of the creditor protection tools provided for in the national legislation implementing that article, from bringing an *actio pauliana* after the division has been implemented, in order to obtain a declaration that the division in question has no effect against them and to bring enforcement or protective action in relation to the assets transferred to the recipient company.

62 As a preliminary point, it must be noted that, under Article 22(1) of the Sixth Directive, Articles 12 and 19 of that directive are to apply to divisions by the formation of new companies within the meaning of Article 21(1) of the Sixth Directive. It is apparent from Article 22(1) that, for this purpose, the expression ‘companies involved in a division’ is to refer to the company being divided and the expression ‘recipient companies’ is to refer to each of the new companies.

63 Under Article 12(1) of the Sixth Directive, the Member States must provide for an adequate system of protection for the interests of the creditors of the companies involved in a division whose claims antedate publication of the draft terms of division and have not yet fallen due at the time of such publication.

64 Article 12(2) of the Sixth Directive provides that, for the purpose of paragraph 1, the Member States are to at least provide that such creditors are to be entitled to obtain adequate safeguards where the financial situation of the company being divided and that of the company to which the obligation will be transferred in accordance with the draft terms of division make such protection necessary and where those creditors do not already have such safeguards.

65 Furthermore, it follows from Article 12(3) and (6) of the Sixth Directive, read in conjunction with Article 22(1) of that directive, that the Member States may provide that the newly formed companies are to be jointly and severally liable for the obligations of the company being divided.

66 It is true that the *actio pauliana* is not listed amongst the tools for protecting the creditors of a company being divided set out in Article 12 of the Sixth Directive.

67 However, as the Advocate General noted in points 59 and 60 of his Opinion, the use of the expression 'at least' in Article 12(2) of the Sixth Directive indicates that that article provides for a minimum system of protection for the interests of the creditors of the companies involved in a division whose claims antedate publication of the draft terms of division and have not yet fallen due at the time of such publication. Therefore, that paragraph does not prevent the Member States from providing for tools for protecting the interests of those additional creditors in relation to those claims.

68 Furthermore, it is not apparent from Article 12 of the Sixth Directive that a failure to avail oneself of one of the tools for protecting the creditors of the company being divided, provided for in the national legislation implementing that article, prevents those creditors from making use of protection tools other than the ones set out in that article.

69 In those circumstances, it must be held, in the light of the objective set out in the eighth recital of that directive consisting in protecting creditors, including debenture holders, and persons having other claims on the companies involved in a division, from any prejudice that may result from the division, that Article 12 of the Sixth Directive does not exclude the possibility, for the creditors of a company being divided, to bring an *actio pauliana*, such as the one at issue in the main proceedings, where the financial situation of the company being divided and that of the company to which the obligation will be transferred in accordance with the draft terms of division make such protection necessary. However, the effects of such an action must not run counter to the purpose of that provision.

70 In that context, it must be noted that it is apparent from the very wording of the first question that an *actio pauliana*, such as that provided for in in Article 2901 of the Civil Code, brought by the creditors of a company being divided, can allow them to take precedence in enforcement over the creditors of the recipient company or companies and to be placed in a preferential position before the shareholders of those companies. Given that the division operation at issue in the main proceedings is a division operation by the formation of a new company, the expression 'the recipient company or companies' employed by the referring court must be understood as designating the newly formed company or companies.

71 Nevertheless, the minimum system of protection for the interests of the creditors, provided for in Article 12(1) of the Sixth Directive, read in conjunction with Article 22(1) of that directive, concerns creditors of a company being divided and not creditors of newly formed companies or the shareholders of those companies, as those companies do not exist prior to a division.

72 Furthermore, it follows from Article 12(4) of the Sixth Directive, read in conjunction with Article 2(3) of that directive and Article 13(3) of the Third Directive, that protection 'may be different' for the creditors of newly formed companies and the creditors of a company being divided.

73 Therefore, Article 12 of the Sixth Directive does not require the protection for the creditors of newly formed companies provided for by the Member States to be equivalent to that provided for the creditors of a company being divided.

74 It therefore follows from all those provisions that the minimum harmonisation, under the Sixth Directive, of the protection of the interests of the creditors of companies involved in a division does not preclude, within the context of a division by the formation of a new company, as is the case in the main proceedings, priority being given to the protection of the interests of the creditors of the company being divided.

75 In the light of all of the foregoing considerations, the answer to the first question is that Article 12 of the Sixth Directive, read in conjunction with Articles 21 and 22 of that directive, must be interpreted as not precluding the creditors of the company being divided whose credit interests antedate that division, who did not take advantage of the creditor protection tools provided for in the national legislation implementing that Article 12, from bringing an *actio pauliana* after the division has been implemented, in order to obtain a declaration that the division in question has no effect against them and to bring enforcement or protective action in relation to the assets transferred to the newly formed company.

The second question

76 By its second question, the referring court asks, in essence, whether Article 19 of the Sixth Directive, which lays down nullity rules for divisions, must be interpreted as precluding the creditors of the company being divided from bringing, after the division has been implemented, an *actio pauliana* which does not affect the validity of that division but merely allows for that division to be rendered unenforceable against those creditors.

77 Article 19 of the Sixth Directive lays down nullity rules for divisions. In particular, that article limits the cases in which nullity can arise, restricts the period within which nullification proceedings may be commenced and provides that, where it is possible to remedy a defect liable to render a division void, a period of time is to be granted to the companies involved to rectify the situation.

78 The concept of 'nullity' is not defined in the Sixth Directive.

79 Since that concept is not defined, its meaning and scope must, as the Court has consistently held, be determined by considering its usual meaning, while also taking into account the context in which it occurs and the purposes of the rules of which it is part (judgment of 26 July 2017, *Jafari*, C-646/16, EU:C:2017:586, paragraph 73 and the case-law cited).

80 The concept of 'nullity', in its usual meaning, refers to actions seeking the annulment of an act, that result in its elimination and that have an effect *erga omnes*.

81 That meaning of the concept of 'nullity' is confirmed by the context surrounding that concept and by the objectives pursued by the Sixth Directive, as noted by the Advocate General in points 73 to 75 of his Opinion.

82 As regards the context of that concept, it must be noted that Article 19(1)(b) of the Sixth Directive states that divisions which have taken effect may be declared void in three cases only, namely if there has been no judicial or administrative preventive supervision of their legality, if they have not been drawn up and certified in due legal form, or if it is shown that the decision of the general meeting which approved the draft terms of division is void or voidable under national law.

83 Those three cases in which nullity can arise concern the coming into being of the division and affect its very existence. Therefore, these are cases which result in the elimination of the division.

84 As regards the objectives pursued by the Sixth Directive, it is apparent from the eleventh recital of the Sixth Directive that the EU legislature considered it necessary to limit the cases in which nullity can arise, to provide that defects are to be remedied wherever that is possible, and to restrict the period within which nullification proceedings may be commenced in order to ensure certainty in the law as regards relations between the companies involved in the division, between them and third parties, and between the members. That objective of the Sixth Directive, which was given effect in Article 19 thereof, confirms that the nullity of a division has an effect *erga omnes*.

85 However, as noted by the Advocate General in point 79 of his Opinion, while nullification proceedings seek to penalise failure to comply with the requirements for the coming into being of the instrument of division, an *actio pauliana* such as that at issue in the main proceedings has the sole aim of protecting creditors to whose rights the division has caused harm.

86 It follows from the order for reference that the *actio pauliana* brought by the respondents in the main proceedings under Article 2901 of the Civil Code only allows for the division in question, in particular the transfer of certain assets referred to in the instrument of division, to be declared unenforceable against those respondents. That action does not affect the validity of that division, does not result in its elimination and does not have an effect *erga omnes*.

87 Therefore, that action is not covered by the concept of 'nullity' referred to in Article 19 of the Sixth Directive.

88 In the light of all of the foregoing considerations, the answer to the second question is that Article 19 of the Sixth Directive, read in conjunction with Articles 21 and 22 of that directive, which lays down nullity rules for divisions, must be interpreted as not precluding the creditors of the company being divided from bringing, after the division has been implemented, an *actio pauliana* which does not affect the validity of that division but merely allows for that division to be rendered unenforceable against those creditors.

Costs

89 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Second Chamber) hereby rules:

1. **Article 12 of Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54(3)(g) of the Treaty, concerning the division of public limited liability companies, as amended by Directive 2007/63/EC of the European Parliament and of the Council of 13 November 2007, read in conjunction with Articles 21 and 22 of Directive 82/891, must be interpreted as not precluding the creditors of the company being divided whose credit interests antedate that division, who did not take advantage of the creditor protection tools provided for in the national legislation implementing that article, from bringing an *actio***

pauliana **after the division has been implemented, in order to obtain a declaration that the division in question has no effect against them and to bring enforcement or protective action in relation to the assets transferred to the newly formed company.**

2. **Article 19 of Directive 82/891, as amended by Directive 2007/63, read in conjunction with Articles 21 and 22 of Directive 82/891, which lays down nullity rules for divisions, must be interpreted as not precluding the creditors of the company being divided from bringing, after the division has been implemented, an *actio pauliana* which does not affect the validity of that division but merely allows for that division to be rendered unenforceable against those creditors.**

[Signatures]

9th assignment (Conversions)

After completing this seminar, students should have acquired knowledge in the following main issue of the topic:

Cross-Border Conversions Overview – Directive (EU) 2019/2121 facilitates the process of cross-border conversions, allowing companies to change their legal form across member states while maintaining their legal identity. This aligns with the EU's goal of enhancing the mobility and flexibility of companies within the single market.

Conditions for Cross-Border Conversion – The directive establishes a framework for cross-border conversions, ensuring that companies can transfer their registered office to another EU country, provided they comply with national regulations, obtain shareholder approval, and meet the requirements for safeguarding employees' rights.

Safeguards for Creditors and Employees – To protect creditors and employees, the directive mandates that companies disclose relevant financial and legal information during the conversion process. Creditors must be notified, and employee rights must be preserved, with mechanisms in place to challenge the conversion if their interests are affected.

Procedure and Reporting Requirements – The directive outlines detailed procedures for cross-border conversions, including the need for a conversion plan, legal verification of the conversion, and notification to the relevant authorities in both the company's home and destination member states. The procedure also includes the requirement for an independent expert report to ensure compliance.

Cross-Border Conversion and Post-Conversion Effects – After completing the conversion, the company retains its legal personality and continues its operations under the new legal form in the new member state. The directive ensures that the conversion does not disrupt the continuity of the company's business, contracts, or assets.

Compulsory reading materials:

- GARCIMARTÍN, F. and GANDÍA E. Cross-Border Conversions in the EU

Voluntary reading materials:

- COSTAMAGNA, F.: At the Roots of Regulatory Competition in the EU
- SCHENKELBERG, A.: The Cadbury Schweppes judgment and its implications on profit shifting activities within Europe

Related case studies (facultative):

- C-81/87 Daily Mail
- C-196/04 Cadbury Schweppes
- C-210/06 Cartesio
- C-378/10 VALE
- C-106/16 Polbud

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CROSS-BORDER CONVERSIONS

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1

Freedom of establishment

Funded by the European Union

- **Articles 49 and 54 TFEU – provisions on the freedom of establishment**
  - there is a general prohibition of restrictions on the freedom of establishment of the nationals in the territory of other Member States;
  - **there is a prohibition of restrictions on the setting up agencies, branches or subsidiaries by companies in the territory of any Member State**
  - freedom of establishment shall inhere a right to take up and pursue activities as self employed person and to set up and manage undertakings, **in particular companies** under the conditions laid down by the law of the country where such establishment is affected for its own nationals
  - **companies and firms, that were established in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the European Union, shall be treated in the same way as the natural persons who are nationals of the Member State**

2

Incorporation theory

Funded by the European Union

- determines the applicable law by the state of incorporation
- creates a bound between state and company (connecting factor) which is the registered office
- allows founders of companies to determine the most suitable and usually the less restrictive company law regime
- Consequence:
  - this can lead to abuse of rights through the formation of the letterbox companies, which conduct the whole business outside the territory of the state of incorporation and use this state for their incorporation just for the most favorable company law provisions
  - such behavior can harm the creditors and shareholders of the particular company.

3

Real seat theory I.

Funded by the European Union

- determines the applicable law on companies by the place of its real seat (central administration)

- founders of companies do not have any chance to decide for the most favorable company law as they are forced to comply with law of the state in which they wish to have their central administration

4

Real seat theory II.

Funded by the European Union

- Consequence:
  - prevents circumvention of national company law and creation of letterbox companies
  - company formed under the law of the state governed by the real seat theory cannot transfer its center of administration to other Member state without the consequence of losing the legal personality or facing a request to dissolve or wind-up
  - hinders mobility of the companies and can be used as a protectionist instrument in the hands of Member States to prevent the companies from conducting business within their territories, moving to the competing states, mainly because of their more favorable company law regimes
  - may result in petrification of company law as the companies cannot benefit from the competitive advantages and the companies established within the states governed by real seat theory are kept as hostages

5

Vale C-378/10

Funded by the European Union

Facts of the case:
The Italian company VALE CONSTRUCTIONI S.r.l. intended to transfer its seat from Italy to Hungary as well as to terminate all the activities in Italy and its legal existence under Italian law. Generally speaking, VALE had an intention to become Hungarian company operating under the name VALE Építségi Kft. and to be governed by Hungarian company law. The registration of the company was refused by the Hungarian court on the grounds that the present Hungarian company law does not allow the registration of a foreign company as a predecessor of a Hungarian company.
The case can be classified as inbound migration of the company, which had an intention to transfer its seat from one Member State to another, as well as to terminate all the activities in the home Member State and become a company governed by laws of the host Member State. The host Member State rejected the registration of such company.

6

Vale C-378/10

Funded by the European Union

Decision of the Court of Justice:

1. Articles 49 TFEU and 54 TFEU must be interpreted as precluding national legislation which enables companies established under national law to convert, but does not allow, in a general manner, companies governed by the law of another Member State to convert to companies governed by national law by incorporating such a company.

2. Articles 49 TFEU and 54 TFEU must be interpreted, in the context of cross-border company conversions, as meaning that the host Member State is entitled to determine the national law applicable to such operations and thus to apply the provisions of its national law on the conversion of national companies governing the incorporation and functioning of companies, such as the requirements relating to the drawing-up of lists of assets and liabilities and property inventories. However, the principles of equivalence and effectiveness, respectively, preclude the host Member State from

– refusing, in relation to cross-border conversions, to record the company which has applied to convert as the 'predecessor in law', if such a record is made of the predecessor company in the commercial register for domestic conversions, and

– refusing to take due account, when examining a company's application for registration, of documents obtained from the authorities of the Member State of origin.

7

Polbud C-106/16

Funded by the European Union

Facts of the case:

An extraordinary general meeting of shareholders in the Polish company Polbud – Wykanawstwo sp.z. o.o. ('Polbud') decided in 2011 to transfer the registered office of the company to Luxembourg, **hereby not deciding to transfer the company's place of management or place of carrying out the company's business**. According to Article 270 of the Polish Companies Code transferring the company's registered office abroad requires the winding up after liquidation of the company, and a liquidation procedure was in fact recorded and a liquidator appointed. However, the liquidation process was never properly ended. In 2013 the registered office of Polbud was transferred to Luxembourg while still maintaining its legal personality also in Poland. In Luxemburg the company was registered as Consoil Geotechnik SARL under Luxembourg law. Polbud applied for the removal from Poland's commercial register, but the application for removal was rejected, for the reason that the winding up and liquidation processes had never been properly ended, which was under Polish law regarded as a precondition for deregistering the company in Poland.

8

Polbud C-106/16

Funded by the European Union

Main legal problems:

1) Is the freedom of establishment applicable to only transferring the registered office when there was no change of location of the real head office?

2) Is a Polish law according to which winding up and liquidation would be a precondition to transferring the registered office, compatible with the freedom of establishment?

Decision of the Court of Justice:

Ad 1)

Articles 49 and 54 TFEU must be interpreted as meaning that freedom of establishment is applicable to the transfer of the registered office of a company formed in accordance with the law of one member state to the territory of another member state, for the purposes of its conversion, in accordance with the conditions imposed by the legislation of the other member state, into a company incorporated under the law of the latter member state, when there is no change in the location of the real head office of that company.

9

Polbud C-106/16

Funded by the European Union

Ad 2)

Articles 49 and 54 TFEU must be interpreted as precluding legislation of a member state which provides that the transfer of the registered office of a company incorporated under the law of one member state to the territory of another member state, for the purposes of its conversion into a company incorporated under the law of the latter member state, in accordance with the conditions imposed by the legislation of that member state, is subject to the liquidation of the first company.

10

New European legislation

Funded by the European Union

- DIRECTIVE (EU) 2019/2121 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 amending Directive (EU) 2017/1132 as regards **cross-border conversions**, mergers and divisions
- Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 31 January 2023

11

New definitions I.

Funded by the European Union

- "***cross-border conversion***"
  - an operation whereby a **company**, without being dissolved or wound up or going into liquidation, converts the legal form under which it is registered in a **departure Member State** into a legal form of the **destination Member State**, and transfers at least its registered office to the destination Member State, while retaining its legal personality
- "***company***"
  - a limited liability company
- "***converted company***"
  - a company formed in a destination Member State as a result of a cross-border conversion

12

New definitions II.

Funded by the European Union

- "***departure Member State***"
  - a Member State in which a company is registered prior to a cross-border conversion
  - its law shall govern those parts of the procedures and formalities to be complied with in connection with the cross-border conversion in order to obtain the pre-conversion certificate

- "***destination Member State***"
  - a Member State in which a converted company is registered as a result of a cross-border conversion
  - its law shall govern those parts of the procedures and formalities to be complied with after the receipt of the pre-conversion certificate

13

Procedures and formalities I. departure Member State

Funded by the European Union

- Draft terms of cross-border conversions
- Report of the administrative or management body for members and employees

14

Procedures and formalities II. departure Member State

Funded by the European Union

- **Independent expert report**
- **Disclosure of**
  - the draft terms of the cross-border conversion
  - a notice informing the members, creditors and employees or representatives of the employees of the company that they may submit to the company comments concerning the draft terms of the cross-border conversion (five working days before the date of the general meeting at the latest)

15

Procedures and formalities III. departure Member State

Funded by the European Union

- **Approval by the general meeting**
  → a majority of not less than two thirds but not more than 90 %
- **Protection of members**
  → right to dispose of their shares for adequate cash compensation

16

Procedures and formalities IV. departure Member State

Funded by the European Union

- **Protection of creditors**
  - adequate system of protection of the interests of creditors whose claims antedate the disclosure of the draft terms of the cross-border conversion and have not fallen due at the time of such disclosure

17

Procedures and formalities V. departure Member State

Funded by the European Union

- **Protection of employees**
  - employee information and consultation
  - employee participation

- **Pre-conversion certificate**
  - purpose: confirmation of compliance of the cross-border conversion with all procedures and formalities in the departure Member State
  - issued by a competent authority (court, notary or other authority or authorities competent to scrutinise the legality of cross-border conversions)

18

Procedures and formalities I. destination Member State

Funded by the European Union

- Scrutiny of the legality of the cross-border conversion – compliance with provisions of national law on the incorporation and registration of companies and on employee participation

19

Procedures and formalities VI. - destination Member State as well as departure Member State

Funded by the European Union

Obligation to disclose completion of the cross-border conversion in their registers

- Information in the register of the destination Member State:
  a. that the registration of the converted company is the result of a cross-border conversion
  b. the date of registration of the converted company
- Information in the register of the departure Member State:
  a. that the striking off or removal of the company from the register is the result of a cross-border conversion
  b. the date of striking off or removal of the company from the register

20

Procedures and formalities VII. - destination Member State as well as departure Member State

Funded by the European Union

Obligation to disclose completion of the cross-border conversion in their registers

- Information in the register of the departure Member State as well as in the register of the destination Member State:
  - the registration number, name and legal form of the company and the registration number, name and legal form of the converted company
- Exchange of informations between the registers of the Member States:
  - The register in the destination Member State notifies the register in the departure Member State, through the system of interconnection of registers, that the cross-border conversion has taken effect. Member States shall also ensure that the registration of the company is struck off or removed from the register immediately upon receipt of that notification.

21

Date on which the cross-border conversion takes effect

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- within the competence of the Member States
- but it shall be after the scrutiny of the legality of the cross-border conversion by the destination Member State as well as the departure Member State
- often: the date of the registration of the cross-border conversion in the register of the destination Member State

22

Consequences of a cross-border conversion

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- all the assets and liabilities of the company, including all contracts, credits, rights and obligations, shall be those of the converted company
- the members of the company shall continue to be members of the converted company, unless they have exercised their right to dispose of their shares
- the rights and obligations of the company arising from contracts of employment or from employment relationships and existing at the date on which the cross-border conversion takes effect shall be those of the converted company

23

Validity

Funded by the European Union

- A cross-border conversion which has taken effect in compliance with the procedures transposing this Directive may not be declared null and void.

24



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THANK YOU FOR YOUR ATTENTION!

Subject European Company Law was supported by project: Jean Monnet Actions - GRANT AGREEMENT - Project 101176603 — EU Tax and Corporate Law

25

JUDGMENT OF THE COURT
27 September 1988 *

In Case 81/87

REFERENCE to the Court under Article 177 of the EEC Treaty by the High Court of Justice, Queen's Bench Division, for a preliminary ruling in the proceedings pending before that court between

The Queen

and

H.M. Treasury and Commissioners of Inland Revenue ex parte Daily Mail and General Trust PLC

on the interpretation of Articles 52 and 58 of the EEC Treaty and the provisions of Council Directive 73/148 of 21 May 1973 on the abolition of restrictions on movement and residence within the Community for nationals of Member States with regard to establishment and the provision of services (Official Journal 1973, L 172, p. 14),

THE COURT

composed of: Lord Mackenzie Stuart, President, G. Bosco, O. Due and G. C. Rodríguez Iglesias (Presidents of Chambers), T. Koopmans, U. Everling, K. Bahlmann, Y. Galmot, R. Joliet, T. F. O'Higgins and F. A. Schockweiler, Judges,

Advocate General: M. Darmon
Registrar: D. Louterman, Administrator

* Language of the Case: English.

after considering the observations submitted on behalf of

Daily Mail and General Trust PLC, the applicant in the main proceedings, represented by David Vaughan, QC, and Derrick Wyatt, Barrister, instructed by F. Sandison, Solicitor, of Freshfields, London,

the United Kingdom, by S. J. Hay, Treasury Solicitor, Queen Anne's Chambers, acting as Agent, assisted by R. Buxton, QC, of Gray's Inn, and A. Moses and N. Green, Barristers,

the Commission, by its Legal Adviser D. Gilmour, acting as Agent,

having regard to the Report for the Hearing and further to the hearing on 22 March 1988,

after hearing the Opinion of the Advocate General delivered at the sitting on 7 June 1988,

gives the following

Judgment

1 By an order of 6 February 1987, which was received at the Court on 19 March 1987, the High Court of Justice, Queen's Bench Division, referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty four questions on the interpretation of Articles 52 and 58 of the Treaty and Council Directive 73/148 of 21 May 1973 on the abolition of restrictions on movement and residence within the Community for nationals of Member States with regard to establishment and the provision of services (Official Journal 1973, L 172, p. 14).

2 Those questions arose in proceedings between Daily Mail and General Trust PLC, the applicant in the main proceedings (hereinafter refered to as 'the applicant'), and H.M. Treasury for a declaration, *inter alia*, that the applicant is not required to obtain consent under United Kingdom tax legislation in order to cease to be

resident in the United Kingdom for the purpose of establishing its residence in the Netherlands.

3 It is apparent from the documents before the Court that under United Kingdom company legislation a company such as the defendant, incorporated under that legislation and having its registered office in the United Kingdom, may establish its central management and control outside the United Kingdom without losing legal personality or ceasing to be a company incorporated in the United Kingdom.

4 According to the relevant United Kingdom tax legislation, only companies which are resident for tax purposes in the United Kingdom are as a rule liable to United Kingdom corporation tax. A company is resident for tax purposes in the place in which its central management and control is located.

5 Section 482 (1) (a) of the Income and Corporation Taxes Act 1970 prohibits companies resident for tax purposes in the United Kingdom from ceasing to be so resident without the consent of the Treasury.

6 In 1984 the applicant, which is an investment holding company, applied for consent under the abovementioned national provision in order to transfer its central management and control to the Netherlands, whose legislation does not prevent foreign companies from establishing their central management there; the company proposed, in particular, to hold board meetings and to rent offices for its management in the Netherlands. Without waiting for that consent, it subsequently decided to open an investment management office in the Netherlands with a view to providing services to third parties.

7 It is common ground that the principal reason for the proposed transfer of central management and control was to enable the applicant, after establishing its residence for tax purposes in the Netherlands, to sell a significant part of its non-permanent assets and to use the proceeds of that sale to buy its own shares,

without having to pay the tax to which such transactions would make it liable under United Kingdom tax law, in regard in particular to the substantial capital gains on the assets which the applicant proposed to sell. After establishing its central management and control in the Netherlands the applicant would be subject to Netherlands corporation tax, but the transactions envisaged would be taxed only on the basis of any capital gains which accrued after the transfer of its residence for tax purposes.

8 After a long period of negotiations with the Treasury, which proposed that it should sell at least part of the assets before transferring its residence for tax purposes out of the United Kingdom, the applicant initiated proceedings before the High Court of Justice, Queen's Bench Division, in 1986. Before that court, it claimed that Articles 52 and 58 of the EEC Treaty gave it the right to transfer its central management and control to another Member State without prior consent or the right to obtain such consent unconditionally.

9 In order to resolve that dispute, the national court stayed the proceedings and referred the following questions to the Court of Justice:

'(1) Do Articles 52 and 58 of the EEC Treaty preclude a Member State from prohibiting a body corporate with its central management and control in that Member State from transferring without prior consent or approval that central management and control to another Member State in one or both of the following circumstances, namely where:

(a) payment of tax upon profits or gains which have already arisen may be avoided;

(b) were the company to transfer its central management and control, tax that might have become chargeable had the company retained its central management and control in that Member State would be avoided?

(2) Does Council Directive 73/148/EEC give a right to a corporate body with its central management and control in a Member State to transfer without prior consent or approval its central management and control to another Member State in the conditions set out in Question 1? If so, are the relevant provisions directly applicable in this case?

(3) If such prior consent or approval may be required, is a Member State entitled to refuse consent on the grounds set out in Question 1?

(4) What difference does it make, if any, that under the relevant law of the Member State no consent is required in the case of a change of residence to another Member State of an individual or firm?'

10 Reference is made to the Report for the Hearing for a fuller account of the facts and the background to the main proceedings, the provisions of national legislation at issue and the observations submitted to the Court, which are mentioned or discussed hereinafter only in so far as is necessary for the reasoning of the Court.

First question

11 The first question seeks in essence to determine whether Articles 52 and 58 of the Treaty give a company incorporated under the legislation of a Member State and having its registered office there the right to transfer its central management and control to another Member State. If that is so, the national court goes on to ask whether the Member State of origin can make that right subject to the consent of national authorities, the grant of which is linked to the company's tax position.

12 With regard to the first part of the question, the applicant claims essentially that Article 58 of the Treaty expressly confers on the companies to which it applies the same right of primary establishment in another Member State as is conferred on natural persons by Article 52. The transfer of the central management and control of a company to another Member State amounts to the establishment of the company in that Member State because the company is locating its centre of decision-making there, which constitutes genuine and effective economic activity.

13 The United Kingdom argues essentially that the provisions of the Treaty do not give companies a general right to move their central management and control from

one Member State to another. The fact that the central management and control of a company is located in a Member State does not itself necessarily imply any genuine and effective economic activity on the territory of that Member State and cannot therefore be regarded as establishment within the meaning of Article 52 of the Treaty.

14 The Commission emphasizes first of all that in the present state of Community law, the conditions under which a company may transfer its central management and control from one Member State to another are still governed by the national law of the State in which it is incorporated and of the State to which it wishes to move. In that regard, the Commission refers to the differences between the national systems of company law. Some of them permit the transfer of the central management and control of a company and, among those, certain attach no legal consequences to such a transfer, even in regard to taxation. Under other systems, the transfer of the management or the centre of decision-making of a company out of the Member State in which it is incorporated results in the loss of legal personality. However, all the systems permit the winding-up of a company in one Member State and its reincorporation in another. The Commission considers that where the transfer of central management and control is possible under national legislation, the right to transfer it to another Member State is a right protected by Article 52 of the Treaty.

15 Faced with those diverging opinions, the Court must first point out, as it has done on numerous occasions, that freedom of establishment constitutes one of the fundamental principles of the Community and that the provisions of the Treaty guaranteeing that freedom have been directly applicable since the end of the transitional period. Those provisions secure the right of establishment in another Member State not merely for Community nationals but also for the companies referred to in Article 58.

16 Even though those provisions are directed mainly to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation which comes within the definition contained in Article 58. As the Commission rightly observed, the rights guaranteed by Article 52 *et seq.* would be rendered meaningless if the Member State of origin could prohibit undertakings from leaving in order to establish themselves in another Member State. In regard to natural persons, the right to leave their territory for that purpose is expressly provided for in Directive 73/148, which is the subject of the second question referred to the Court.

17 In the case of a company, the right of establishment is generally exercised by the setting-up of agencies, branches or subsidiaries, as is expressly provided for in the second sentence of the first paragraph of Article 52. Indeed, that is the form of establishment in which the applicant engaged in this case by opening an investment management office in the Netherlands. A company may also exercise its right of establishment by taking part in the incorporation of a company in another Member State, and in that regard Article 221 of the Treaty ensures that it will receive the same treatment as nationals of that Member State as regards participation in the capital of the new company.

18 The provision of United Kingdom law at issue in the main proceedings imposes no restriction on transactions such as those described above. Nor does it stand in the way of a partial or total transfer of the activities of a company incorporated in the United Kingdom to a company newly incorporated in another Member State, if necessary after winding-up and, consequently, the settlement of the tax position of the United Kingdom company. It requires Treasury consent only where such a company seeks to transfer its central management and control out of the United Kingdom while maintaining its legal personality and its status as a United Kingdom company.

19 In that regard it should be borne in mind that, unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning.

20 As the Commission has emphasized, the legislation of the Member States varies widely in regard to both the factor providing a connection to the national territory required for the incorporation of a company and the question whether a company incorporated under the legislation of a Member State may subsequently modify that connecting factor. Certain States require that not merely the registered office but also the real head office, that is to say the central administration of the company, should be situated on their territory, and the removal of the central administration from that territory thus presupposes the winding-up of the company with all the consequences that winding-up entails in company law and tax law. The legislation of other States permits companies to transfer their central administration to a foreign country but certain of them, such as the United Kingdom, make that right subject to certain restrictions, and the legal consequences of a transfer, particularly in regard to taxation, vary from one Member State to another.

21 The Treaty has taken account of that variety in national legislation. In defining, in Article 58, the companies which enjoy the right of establishment, the Treaty places on the same footing, as connecting factors, the registered office, central administration and principal place of business of a company. Moreover, Article 220 of the Treaty provides for the conclusion, so far as is necessary, of agreements between the Member States with a view to securing *inter alia* the retention of legal personality in the event of transfer of the registered office of companies from one country to another. No convention in this area has yet come into force.

22 It should be added that none of the directives on the coordination of company law adopted under Article 54 (3) (g) of the Treaty deal with the differences at issue here.

23 It must therefore be held that the Treaty regards the differences in national legislation concerning the required connecting factor and the question whether — and if so how — the registered office or real head office of a company incorporated under national law may be transferred from one Member State to another as problems which are not resolved by the rules concerning the right of establishment but must be dealt with by future legislation or conventions.

24 Under those circumstances, Articles 52 and 58 of the Treaty cannot be interpreted as conferring on companies incorporated under the law of a Member State a right to transfer their central management and control and their central administration to another Member State while retaining their status as companies incorporated under the legislation of the first Member State.

25 The answer to the first part of the first question must therefore be that in the present state of Community law Articles 52 and 58 of the Treaty, properly construed, confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State.

26 Having regard to that answer, there is no need to reply to the second part of the first question.

Second question

27 In its second question, the national court asks whether the provisions of Council Directive 73/148 of 21 May 1973 on the abolition of restrictions on movement and residence within the Community for nationals of Member States with regard to establishment and the provision of services give a company a right to transfer its central management and control to another Member State.

28 It need merely be pointed out in that regard that the title and provisions of that directive refer solely to the movement and residence of natural persons and that the provisions of the directive cannot, by their nature, be applied by analogy to legal persons.

29 The answer to the second question must therefore be that Directive 73/148, properly construed, confers no right on a company to transfer its central management and control to another Member State.

Third and fourth questions

30 Having regard to the answers given to the first two questions referred by the national court, there is no need to reply to the third and fourth questions.

Costs

31 The costs incurred by the United Kingdom and the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, in so far as the parties to the main proceedings are concerned, in the nature of a step in the action pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT,

in answer to the questions referred to it by the High Court of Justice, Queen's Bench Division, by order of 6 February 1987, hereby rules:

(1) In the present state of Community law, Articles 52 and 58 of the Treaty, properly construed, confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State.

(2) Council Directive 73/148 of 21 May 1973 on the abolition of restrictions on movement and residence within the Community for nationals of Member States with regard to establishment and the provision of services, properly construed, confers no right on a company to transfer its central management and control to another Member State.

Mackenzie Stuart Bosco Due Rodríguez Iglesias Koopmans

Everling Bahlmann Galmot Joliet O'Higgins Schockweiler

Delivered in open court in Luxembourg on 27 September 1988.

J.-G. Giraud
Registrar

A. J. Mackenzie Stuart
President

JUDGMENT OF THE COURT (Grand Chamber)

16 December 2008 *

In Case C-210/06,

REFERENCE for a preliminary ruling under Article 234 EC from the Szegedi Ítélőtábla (Hungary), made by decision of 20 April 2006, received at the Court on 5 May 2006, in the proceedings in the case of

Cartesio Oktató és Szolgáltató bt,

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans (Rapporteur), A. Rosas, K. Lenaerts, A. Ó Caoimh and J.-C. Bonichot, Presidents of Chambers, K. Schiemann, J. Makarczyk, P. Kūris, E. Juhász, L. Bay Larsen and P. Lindh, Judges,

Advocate General: M. Poiares Maduro,
Registrar: B. Fülöp, Administrator,

* Language of the case: Hungarian.

having regard to the written procedure and further to the hearing on 10 July 2007,

after considering the observations submitted on behalf of:

— Cartesio Oktató és Szolgáltató bt, by G. Zettwitz and P. Metzinger, ügyvédek,

— the Hungarian Government, by J. Fazekas and P. Szabó, acting as Agents,

— the Czech Government, by T. Boček, acting as Agent,

— Ireland, by D. O'Hagan, acting as Agent, A. Collins SC and N. Travers BL,

— the Netherlands Government, by H.G. Sevenster and M. de Grave, acting as Agents,

— the Polish Government, by E. Ośniecka-Tamecka, acting as Agent,

— the Slovenian Government, by M. Remic, acting as Agent,

— the United Kingdom Government, by T. Harris, acting as Agent, and J. Stratford, Barrister,

— the Commission of the European Communities, by G. Braun and V. Kreuschitz, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 22 May 2008,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 43 EC, 48 EC and 234 EC.

2 The reference was made in the context of proceedings brought by Cartesio Oktató és Szolgáltató bt ('Cartesio'), a limited partnership established in Baja (Hungary), against the decision rejecting its application for registration in the commercial register of the transfer of its company seat to Italy.

National legal context

The law relating to civil procedure

3 Article 10(2) of Law No III of 1952 on civil procedure (a Polgári perrendtartásról szóló 1952. évi III. törvény: 'the Law on civil procedure') states:

'At second instance:

…

(b) appeals arising from cases dealt with by regional courts or courts of Budapest shall be heard by appeal courts.'

4 Article 155/A of the Law on civil procedure provides that:

'(1) The court may ask the Court of Justice of the European Communities for a preliminary ruling in accordance with the rules laid down in the Treaty establishing the European Community.

(2) The court shall make the reference for a preliminary ruling by order and shall stay the proceedings …

(3) An appeal may be brought against a decision to make a reference for a preliminary ruling. An appeal cannot be brought against a decision dismissing a request for a reference for a preliminary ruling.

…'

5 Under Article 233(1) of the Law on civil procedure:

'Save as otherwise provided, appeal proceedings may be brought against the decisions of courts of first instance …'

6 Article 233/A of that law provides that:

'An appeal may be brought against orders made at second instance in respect of which a right of appeal exists under the rules applicable to proceedings at first instance …'

7 Article 249/A of the Law on civil procedure states that:

'Appeal proceedings may also be brought against a decision made at second instance dismissing a request for a reference for a preliminary ruling (Article 155/A).'

8 Article 270 of the Law on civil procedure is worded as follows:

'(1) Save as otherwise provided, the Legfelsőbb Bíróság [Supreme Court] shall hear appeals on points of law. The general rules shall apply mutatis mutandis.

(2) The parties, interveners and persons affected by the decision may, in respect of the part of that decision which refers to them, bring an appeal on a point of law before the Legfelsőbb Bíróság against final judgments and orders which bring proceedings an end, pleading infringement of the law.

…'

9 Article 271(1) of the Law on civil procedure provides that:

‘No appeal shall lie:

(a) against decisions which have become final at first instance, except in cases which are permitted by law;

(b) where one party has failed to exercise the right to bring an appeal and the court of second instance, hearing the appeal brought by the other party, confirms the decision at first instance;

…’

10 Under Article 273(3) of that law:

‘The institution of appeal proceedings shall not have suspensory effect but, where a party so requests, the Legfelsőbb Bíróság may exceptionally suspend enforcement of the judgment …’

Company law

11 Article 1(1) of Law No CXLIV of 1997 on commercial companies (a gazdasági társaságokról szóló 1997. évi CXLIV. törvény) provides that:

'This Law shall govern the incorporation, organisation and functioning of commercial companies which have their seat in Hungary; the rights, duties and responsibilities of the founders and members (shareholders) of those companies; and the conversion, merger and demerger of commercial companies … and their liquidation.'

12 Under Article 11 of that law:

'The articles of association (the instrument of incorporation, the statutes of the company) shall specify:

(a) the name and seat of the commercial company

…'

13 Article 1(1) of Law No CXLV of 1997 on the commercial register, company advertising and legal procedures in commercial registration matters (a cégnyilvántartásról, a

cégnyilvánosságról és a bírósági cégeljárásról szóló 1997. évi CXLV. Törvény; 'the Law on the commercial register') provides that:

'A company is a commercial organisation … or other legal entity of a commercial nature … which, save where a law or government order provides otherwise, is incorporated through its registration in the commercial register for the purpose of carrying on a commercial activity for financial gain …'

14 Under Article 2(1) of that law:

'The legal entities referred to in Article 1 may be entered in the commercial register only if their registration is possible or compulsory under [Hungarian] law.'

15 Article 11 of the Law on the commercial register provides that:

'(1) The regional courts or the courts of Budapest, acting as commercial courts, shall register companies in the commercial registers which they are responsible for maintaining …

(2) … the courts within the jurisdiction of which a company has its seat shall have jurisdiction to register that company and to deal with any proceedings concerning such companies provided for by statute.

…’

16 Article 12(1) of that law provides that:

‘The information on companies referred to in this Law shall be entered in the commercial register. For all companies, the register shall specify:

…

(d) the company seat …’

17 Under Article 16(1) of the Law on the commercial register:

‘The seat … shall be the place where [the company’s] central administration is situated …’

18 Article 29(1) of that law provides that:

'Save as otherwise provided, any application for registration of amendments to information registered in relation to companies must be presented to the commercial court within 30 days of the event giving rise to the amendment.'

19 Article 34(1) of the Law provides that:

'Every transfer of a company seat to the jurisdiction of another court responsible for maintaining the commercial register must, by reason of the change entailed, be submitted to the court with jurisdiction in respect of the former seat. After examining the applications for amendment of the information in the register prior to the change of company seat, the latter court shall endorse the transfer.'

Private international law

20 Article 18 of Decree-Law No 13 of 1979 on private international law rules (a nemzetközi magánjogról szóló 1979. évi 13. törvényerejű rendelet) provides that:

'(1) The legal capacity of a legal person, its commercial status, the rights derived from its personality and the legal relationships between its members shall be determined in accordance with its personal law.

(2) The personal law of a legal person shall be the law of the State in the territory of which it is registered.

(3) If a legal person has been lawfully registered in accordance with the laws of several States or if, under the rules applicable in the place where the seat designated in its articles of association is situated, registration is not required, its personal law shall be that applicable in the State of the seat.

(4) If a legal person has no seat designated in its articles of association or has seats in several States, and, in accordance with the law of one of those States, registration is not required, its personal law shall be the law of the State in which its central administration is situated.'

The dispute in the main proceedings and the questions referred for a preliminary ruling

21 Cartesio was formed on 20 May 2004 as a 'betéti társaság' (limited partnership) under Hungarian law. Its seat was established in Baja (Hungary). Cartesio was registered in the commercial register on 11 June 2004.

22 Cartesio has two partners both of whom are natural persons resident in Hungary and holding Hungarian nationality: a limited partner, whose only commitment is to invest capital, and an unlimited partner, with unlimited liability for the company's debts. Cartesio is active, inter alia, in the field of human resources, secretarial activities, translation, teaching and training.

23 On 11 November 2005, Cartesio filed an application with the Bács-Kiskun Megyei Bíróság (Regional Court, Bács-Kiskun), sitting as a cégbíróság (commercial court), for registration of the transfer of its seat to Gallarate (Italy) and, in consequence, for amendment of the entry regarding Cartesio's company seat in the commercial register.

24 By decision of 24 January 2006, that application was rejected on the ground that the Hungarian law in force did not allow a company incorporated in Hungary to transfer its seat abroad while continuing to be subject to Hungarian law as its personal law.

25 Cartesio lodged an appeal against that decision with the Szegedi Ítélőtábla (Regional Court of Appeal, Szeged).

26 Relying on the judgment in Case C-411/03 *SEVIC Systems* [2005] ECR I-10805, Cartesio claimed before the Szegedi Ítélőtábla that, to the extent that Hungarian law draws a distinction between commercial companies according to the Member State in which they have their seat, that law is contrary to Articles 43 EC and 48 EC. It follows from those articles that Hungarian law cannot require Hungarian companies to choose to establish their seat in Hungary.

27 Cartesio also maintained that the Szegedi Ítélőtábla was required to refer that question for a preliminary ruling, since it constitutes a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law.

28 The Szegedi Ítélőtábla points out that, under Hungarian law, proceedings before the courts responsible for maintaining the commercial register and before courts hearing appeals against decisions of the commercial register courts are not *inter partes*. It therefore wishes to know whether it may be classified as a 'court or tribunal' within the meaning of Article 234 EC.

29 Moreover, if the answer to this question is in the affirmative, the Szegedi Ítélőtábla is of the view that it is still unclear whether, for the purposes of the third paragraph of Article 234 EC, it should be classified as a court or tribunal against whose decisions there is no judicial remedy under national law.

30 It states in that regard that although, according to Hungarian law, its decisions on appeal are final and enforceable, they may nevertheless be the subject of an extraordinary appeal — an appeal on a point of law — before the Legfelsőbb Bíróság.

31 However, as the purpose of an appeal on a point of law is to ensure the consistency of case-law, the possibility of bringing such an appeal is limited, in particular by the condition governing the admissibility of pleas, which is linked to the obligation to allege a breach of law.

32 The Szegedi Ítélőtábla further notes that, in Hungarian academic legal writing and case-law, questions have been raised as to the compatibility with Article 234 EC of the provisions laid down in Articles 155/A and 249/A of the Law on civil procedure concerning appeals against decisions by which a question is referred to the Court of Justice for a preliminary ruling.

33 In that regard, the Szegedi Ítélőtábla points out that those provisions might result in an appellate court preventing a court which has decided to make a reference to the Court from doing so, even though an interpretation by the Court of a provision of Community law is needed to resolve the dispute in the main proceedings.

34 As regards the merits of the case before it, the Szegedi Ítélőtábla, referring to the judgment in Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483, notes that the freedom of establishment laid down in Articles 43 EC and 48 EC does not include the right, for a company incorporated under the legislation of a Member State and registered therein, to transfer its central administration, and thus its principal place of business, to another Member State whilst retaining its legal personality and nationality of origin, should the competent authorities object to this.

35 However, according to the Szegedi Ítélőtábla, this principle may have been further refined in the later case-law of the Court.

36 In that regard, the Szegedi Ítélőtábla points out that, according to the case-law of the Court, all measures which prohibit, impede or render less attractive the exercise of the freedom of establishment constitute a restriction on that freedom, and it refers in that regard, inter alia, to Case C-442/02 *CaixaBank France* [2004] ECR I-8961, paragraphs 11 and 12).

37 The Szegedi Ítélőtábla moreover points out that, in *SEVIC Systems*, the Court ruled that Articles 43 EC and 48 EC preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State, whereas such

registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State.

38 Moreover, it is settled case-law of the Court that national laws cannot differentiate between companies according to the nationality of the person seeking their registration in the commercial register.

39 Lastly, the Szegedi Ítélőtábla states that Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG) (OJ 1985 L 199, p. 1) and Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) (OJ 2001 L 294, p. 1) lay down, for the forms of Community undertaking which they introduce, more flexible and less costly provisions which enable those undertakings to transfer their seat or establishment from one Member State to another without first going into liquidation.

40 In those circumstances, on the view that resolution of the dispute before it depended on the interpretation of Community law, the Szegedi Ítélőtábla decided to stay proceedings and to refer the following questions to the Court for a preliminary ruling:

‘(1) Is a court of second instance which has to give a decision on an appeal against a decision of a commercial court (cégbíróság) in proceedings to amend a registration [of a company] entitled to make a reference for a preliminary ruling under Article 234 [EC], where neither the action before the commercial court nor the appeal procedure is *inter partes*?

(2) In so far as an appeal court is included in the concept of a "court or tribunal which is entitled to make a reference for a preliminary ruling" under Article 234 [EC], must that court be regarded as a court against whose decisions there is no judicial remedy, which has an obligation, under Article 234 [EC], to submit questions on the interpretation of Community law to the Court of Justice of the European Communities?

(3) Does a national measure which, in accordance with domestic law, confers a right to bring an appeal against an order making a reference for a preliminary ruling limit the power of the Hungarian courts to refer questions for a preliminary ruling or could it limit that power — derived directly from Article 234 [EC] — if, in appeal proceedings, the national superior court may amend the order, render the request for a preliminary ruling inoperative and order the court which issued the order for reference to resume the national proceedings which had been suspended?

(4) (a) If a company, [incorporated] in Hungary under Hungarian company law and entered in the Hungarian commercial register, wishes to transfer its seat to another Member State of the European Union, is the regulation of this field within the scope of Community law or, in the absence of the harmonisation of laws, is national law exclusively applicable?

(b) May a Hungarian company request transfer of its seat to another Member State of the European Union relying directly on Community law (Articles 43 [EC] and 48 [EC])? If the answer is affirmative, may the transfer of the seat be made subject to any kind of condition or authorisation by the Member State of origin or the host Member State?

(c) May Articles 43 [EC] and 48 [EC] be interpreted as meaning that national rules or national practices which differentiate between commercial

companies with respect to the exercise of their rights, according to the Member State in which their seat is situated, are incompatible with Community law?

[(d)] May Articles 43 [EC] and 48 [EC] be interpreted as meaning that, in accordance with those articles, national rules or practices which prevent a Hungarian company from transferring its seat to another Member State of the European Union are incompatible with Community law?'

The application to have the oral procedure reopened

41 By document lodged at the Registry of the Court of Justice on 9 September 2008, Ireland requested the Court to order that the oral procedure be reopened, pursuant to Article 61 of the Rules of Procedure, with regard to the fourth question referred for a preliminary ruling.

42 In support of its request, Ireland states that, contrary to the view adopted by the Advocate General in his Opinion, the fourth question in the order for reference should not be understood as relating to the transfer of the seat, defined by Hungarian law as the place where the company has its central administration, and thus the real seat (*siège réel*) of the company.

43 According to Ireland, it follows from the English translation of the order for reference that that question concerns the transfer of the registered office (*siège statutaire*).

44 Thus, Ireland claims essentially that one of the factual premisses on which the Advocate General's analysis is based is incorrect.

45 Ireland is, moreover, of the view that, if the Court relies on the same premiss, it should reopen the oral procedure in order to give the interested parties an opportunity to submit observations on the basis of that premiss.

46 It is clear from the case-law that the Court may of its own motion, or on a proposal from the Advocate General, or at the request of the parties, order the reopening of the oral procedure in accordance with Article 61 of the Rules of Procedure if it considers that it lacks sufficient information or that the case must be dealt with on the basis of an argument which has not been debated between the parties (see, inter alia, Case C-284/06 *Burda* [2008] ECR I-4571, paragraph 37 and the case-law cited).

47 In that regard, it should be pointed out, first, that it is apparent from the order for reference as a whole that the fourth question relates not to the transfer of the registered office of the company concerned in the main proceedings but to the transfer of its 'real seat'.

48 As stated in the order for reference, it follows from the Hungarian legislation on company registration that, for the purposes of applying that legislation, a company's seat is defined as the place where it has its central administration.

49 Moreover, the referring court placed the case before it in the context of the situation at issue in *Daily Mail and General Trust*, which it describes as relating to a company, incorporated in accordance with the legislation of a Member State and registered therein, wishing to transfer its central administration, and thus its principal place of business, to another Member State whilst retaining its legal personality and nationality of origin, where the competent authorities object to this. More specifically, the referring court asks whether the principle laid down in that judgment — that Articles 43 EC and 48 EC do not confer on companies the right to transfer their central administration in such a way, whilst retaining their legal personality as conferred on them in the State under whose laws they were incorporated — has been further refined in the later case-law of the Court.

50 Secondly, the interested parties, including Ireland, were expressly requested by the Court to focus their pleadings on the premiss that the issue raised in the main proceedings related to the transfer to another Member State of the real seat of the company concerned, in other words, of the place where it has its administrative seat.

51 Although Ireland nevertheless focused in its pleadings on the premiss that the issue in the case before the referring court concerned the transfer of a company's registered office, it also set out its position — albeit briefly — on the basis that that issue concerned the transfer of the company's real seat, a position which, moreover, it set out again in its request that the oral procedure be reopened.

52 Against that background, the Court, having heard the Advocate General, considers that it has all the evidence necessary to enable it to reply to the questions referred and that the present case does not thereby fall to be decided on the basis of an argument which has not been debated between the parties.

53 Accordingly, it is not necessary to order that the oral procedure be reopened.

The questions referred for a preliminary ruling

The first question

54 By this question, the Court is essentially asked whether a court such as the referring court, hearing an appeal against a decision of a lower court, responsible for maintaining the commercial register, rejecting an application for amendment of information entered in that register, must be classified as a court or tribunal which is entitled to make a reference for a preliminary ruling under Article 234 EC, regardless of the fact that neither the decision of the lower court nor the consideration by the referring court of the appeal against that decision takes place in the context of *inter partes* proceedings.

55 In that regard, it should be borne in mind that, according to settled case-law, in order to determine whether the body making a reference is a 'court or tribunal' for the purposes of Article 234 EC, which is a question governed by Community law alone, the Court takes account of a number of factors, such as whether the body is established by law, whether it is permanent, whether its jurisdiction is compulsory, whether its procedure is *inter partes*, whether it applies rules of law and whether it is independent (see, inter alia, Case C-96/04 *Standesamt Stadt Niebüll* [2006] ECR I-3561, paragraph 12 and the case-law cited).

56 With regard to the *inter partes* nature of the proceedings before the national court, Article 234 EC does not make reference to the Court subject to those proceedings being

inter partes. None the less, it follows from that article that a national court may make a reference to the Court only if there is a case pending before it and if it is called upon to give judgment in proceedings intended to lead to a decision of a judicial nature (see to that effect, inter alia, Case C-182/00 *Lutz and Others* [2002] ECR I-547, paragraph 13 and the case-law cited).

57 Thus, where a court responsible for maintaining a register makes an administrative decision without being required to resolve a legal dispute, it cannot be regarded as exercising a judicial function. Such is the case, for example, where it decides an application for registration of a company in proceedings which do not have as their object the annulment of a measure which allegedly adversely affects the applicant (see to that effect, inter alia, *Lutz and Others*, paragraph 14 and the case-law cited).

58 In contrast, a court hearing an appeal which has been brought against a decision of a lower court responsible for maintaining a register, rejecting such an application, and which seeks the setting-aside of that decision, which allegedly adversely affects the rights of the applicant, is called upon to give judgment in a dispute and is exercising a judicial function.

59 Accordingly, in such a case, the appellate court must, in principle, be regarded as a court or tribunal within the meaning of Article 234 EC, with jurisdiction to refer a question to the Court for a preliminary ruling (see for similar situations, inter alia, Case C-300/01 *Salzmann* [2003] ECR I-4899; *SEVIC Systems*; and Case C-117/06 *Möllendorf and Others* [2007] ECR I-8361).

60 It is apparent from the court file that, in the main proceedings, the referring court is sitting in an appellate capacity in an action for the setting-aside of a decision by which a lower court, responsible for maintaining the commercial register, rejected an application by a company for registration of the transfer of its seat, requiring the amendment of an entry in that register.

61 Accordingly, in the main proceedings, the referring court is hearing a dispute and is exercising a judicial function, regardless of the fact that the proceedings before that court are not *inter partes*.

62 Consequently, in the light of the case-law cited in paragraphs 55 and 56 above, the referring court must be regarded as a court or tribunal for the purposes of Article 234 EC.

63 In the light of the foregoing, the answer to the first question must be that a court such as the referring court, hearing an appeal against a decision of a lower court, responsible for maintaining the commercial register, rejecting an application for amendment of information entered in that register, must be classified as a court or tribunal which is entitled to make a reference for a preliminary ruling under Article 234 EC, regardless of the fact that neither the decision of the lower court nor the consideration of the appeal by the referring court takes place in the context of *inter partes* proceedings.

The second question

64 By this question, the Court is essentially being asked whether a court such as the referring court, whose decisions in disputes such as that in the main proceedings may be appealed on points of law, falls to be classified as a court or tribunal against whose decisions there is no judicial remedy under national law, within the meaning of the third paragraph of Article 234 EC.

Admissibility

65 The Commission of the European Communities contends that this question is inadmissible as it is manifestly irrelevant to the resolution of the dispute in the main proceedings, since the order for reference has already been submitted to the Court, rendering any examination of whether there is an obligation to make a reference devoid of interest.

66 That objection must be rejected.

67 According to settled case-law, there is a presumption of relevance in favour of questions on the interpretation of Community law referred by a national court, and it is a matter for the national court to define, and not for the Court to verify, in which factual and legislative context they operate. The Court declines to rule on a reference for a preliminary ruling from a national court only where it is quite obvious that the interpretation of Community law that is sought is unrelated to the actual facts of the main action or to its purpose, where the problem is hypothetical, or where the Court

does not have before it the factual or legal material necessary to give a useful answer to the questions submitted to it (see, to that effect, Joined Cases C-222/05 to C-225/05 *van der Weerd and Others* [2007] ECR I-4233, paragraph 22 and the case-law cited).

68 As stated in paragraph 27 above, Cartesio claimed before the referring court that that court was required to make a reference to the Court for a preliminary ruling, since it fell to be classified as a court or tribunal against whose decisions there is no judicial remedy under national law, within the meaning of the third paragraph of Article 234 EC.

69 As the referring court had doubts concerning that plea, it decided to refer a question on that issue to the Court for a preliminary ruling.

70 It would be contrary to the spirit of cooperation which must guide all relations between national courts and the Court of Justice, and contrary also to the requirements of procedural economy, to require a national court first to seek a preliminary ruling on the sole question whether that court is one of those referred to in the third paragraph of Article 234 EC, before, where appropriate, having to formulate — subsequently and by a second reference for a preliminary ruling — the questions concerning the provisions of Community law relating to the substance of the dispute before it.

71 Moreover, the Court has already replied to a question relating to the characteristics of national courts in the light of the third paragraph of Article 234 EC in a context offering certain similarities with that of the present reference for a preliminary ruling, without the admissibility of that question being disputed (Case C-99/00 *Lyckeskog* [2002] ECR I-4839).

72 In those circumstances, it does not appear — at least not prima facie — that the interpretation of Community law sought is unrelated to the actual facts of the main action or to its purpose.

73 Accordingly, the presumption of relevance in favour of references for a preliminary ruling is not, as regards the present question, rebutted by the objection put forward by the Commission (see, inter alia, *van der Weerd and Others*, paragraphs 22 and 23).

74 It follows that the second question is admissible.

Substance

75 The issue raised by this question is thus whether the referring court falls to be classified as 'a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law', within the meaning of the third paragraph of Article 234 EC. It is clear from the order for reference that this question is raised in view of the fact, referred to in paragraphs 30 and 31 above, that, although Hungarian law provides that decisions delivered on appeal by the referring court may be the subject of an extraordinary appeal — in other words, an appeal on a point of law before the Legfelsőbb Bíróság, the purpose of which is to ensure the consistency of the case-law — the possibilities of bringing such an appeal are limited, in particular, by the condition governing the admissibility of pleas, which is linked to the obligation to allege a breach of law, and in view of the fact, also pointed out in the order for reference, that under Hungarian law an appeal on a point of law does not, in principle, have the effect of suspending enforcement of the decision delivered on appeal.

76 The Court has already held that decisions of a national appellate court which can be challenged by the parties before a supreme court are not decisions of 'a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law' within the meaning of the third paragraph of Article 234 EC. The fact that the examination of the merits of such challenges is conditional upon a preliminary declaration of admissibility by the supreme court does not have the effect of depriving the parties of a judicial remedy (*Lyckeskog*, paragraph 16).

77 That is true a fortiori in the case of a procedural system such as that under which the case before the referring court must be decided, since that system makes no provision for a preliminary declaration by the supreme court that the appeal is admissible and, instead, merely imposes restrictions with regard, in particular, to the nature of the pleas which may be raised before such a court, which must allege a breach of law.

78 In common with the lack of suspensory effect of appeals on a point of law before the Legfelsőbb Bíróság, such restrictions do not have the effect of depriving the parties in a case before a court whose decisions are amenable to an appeal on a point of law of the possibility of exercising effectively their right to appeal the decision handed down by that court in a dispute such as that in the main proceedings. It does not follow, therefore, from those restrictions or from the lack of suspensory effect that that court falls to be classified as a court handing down a decision against which there is no judicial remedy.

79 In the light of the foregoing, the answer to the second question must be that a court such as the referring court, whose decisions in disputes such as that in the main proceedings may be appealed on points of law, cannot be classified as a court or tribunal against whose decisions there is no judicial remedy under national law, within the meaning of the third paragraph of Article 234 EC.

The third question

Admissibility

80 Ireland argues that this question is hypothetical, hence inadmissible, since no appeal on a point of law has been brought against the order for reference and, in consequence, an answer to that question would be of no use to the referring court.

81 The Commission also asks the Court to declare that it is not appropriate to give a reply to the third question because, given that the order for reference has the authority of *res judicata* and has reached the Court, that question is hypothetical.

82 Those objections cannot be upheld.

83 As was pointed out in paragraph 67 above, the presumption of relevance enjoyed by references for a preliminary ruling may, in certain circumstances, be rebutted, in particular where the Court holds that the problem is hypothetical.

84 Ireland and the Commission maintain that the problem raised by this question — the possible incompatibility with the second paragraph of Article 234 EC of national rules

governing appeals against a decision making a reference to the Court — is hypothetical, since, in fact, the order for reference has not been appealed against and now has the authority of *res judicata*.

85 However, neither that decision nor the file sent to the Court permits the inference that there has been no appeal against that decision or that there can no longer be any appeal against it.

86 In the light of the settled case-law cited in paragraph 67 above, since, in such a situation of uncertainty, responsibility for defining and verifying the factual and legislative context in which the question referred arises lies with the national court, the presumption of relevance which this question enjoys has not been rebutted.

87 It follows that the third question is admissible.

Substance

88 Article 234 EC gives national courts the right — and, where appropriate, imposes on them the obligation — to make a reference for a preliminary ruling, as soon as the national court perceives either of its own motion or at the request of the parties that the substance of the dispute raises one of the points referred to in the first paragraph of Article 234 EC. It follows that national courts have the widest discretion in referring matters to the Court if they consider that a case pending before them raises questions involving interpretation of provisions of Community law, or consideration of their validity, necessitating a decision on their part (Case 166/73 *Rheinmühlen-Düsseldorf* [1974] ECR 33, paragraph 3).

89 It is also clear from the case-law of the Court that, in the case of a court or tribunal against whose decisions there is a judicial remedy under national law, Article 234 EC does not preclude decisions of such a court by which questions are referred to the Court for a preliminary ruling from remaining subject to the remedies normally available under national law. Nevertheless, in the interests of clarity and legal certainty, the Court must abide by the decision to refer, which must have its full effect so long as it has not been revoked (Case 146/73 *Rheinmühlen-Düsseldorf* [1974] ECR 139, paragraph 3).

90 Moreover, the Court has already held that the system established by Article 234 EC with a view to ensuring that Community law is interpreted uniformly throughout the Member States instituted direct cooperation between the Court of Justice and the national courts by means of a procedure which is completely independent of any initiative by the parties (Case C-2/06 *Kempter* [2008] ECR I-411, paragraph 41).

91 The system of references for a preliminary ruling is based on a dialogue between one court and another, the initiation of which depends entirely on the national court's assessment as to whether a reference is appropriate and necessary (*Kempter*, paragraph 42).

92 It is clear from the order for reference that, under Hungarian law, a separate appeal may be brought against a decision making a reference to the Court for a preliminary ruling, although the main proceedings remain pending in their entirety before the referring court, proceedings being stayed until the Court gives a ruling. The appellate court thus seised has, under Hungarian law, power to vary that decision, to set aside the reference for a preliminary ruling and to order the first court to resume the domestic law proceedings.

93 As is clear from the case-law cited in paragraphs 88 and 89 above, concerning a national court or tribunal against whose decisions there is a judicial remedy under national law, Article 234 EC does not preclude a decision of such a court, making a reference to the Court, from remaining subject to the remedies normally available under national law. Nevertheless, the outcome of such an appeal cannot limit the jurisdiction conferred by Article 234 EC on that court to make a reference to the Court if it considers that a case pending before it raises questions on the interpretation of provisions of Community law necessitating a ruling by the Court.

94 It should be pointed out, moreover, that the Court has already held that, in a situation where a case is pending, for the second time, before a court sitting at first instance after a judgment originally delivered by that court has been quashed by a supreme court, the court at first instance remains free to refer questions to the Court pursuant to Article 234 EC, regardless of the existence of a rule of national law whereby a court is bound on points of law by the rulings of a superior court (Case 146/73 *Rheinmühlen-Düsseldorf*).

95 Where rules of national law apply which relate to the right of appeal against a decision making a reference for a preliminary ruling, and under those rules the main proceedings remain pending before the referring court in their entirety, the order for reference alone being the subject of a limited appeal, the autonomous jurisdiction which Article 234 EC confers on the referring court to make a reference to the Court would be called into question, if — by varying the order for reference, by setting it aside and by ordering the referring court to resume the proceedings — the appellate court could prevent the referring court from exercising the right, conferred on it by the EC Treaty, to make a reference to the Court.

96 In accordance with Article 234 EC, the assessment of the relevance and necessity of the question referred for a preliminary ruling is, in principle, the responsibility of the referring court alone, subject to the limited verification made by the Court in accordance with the case-law cited in paragraph 67 above. Thus, it is for the referring court to draw the proper inferences from a judgment delivered on an appeal against its

decision to refer and, in particular, to come to a conclusion as to whether it is appropriate to maintain the reference for a preliminary ruling, or to amend it or to withdraw it.

97 It follows that, in a situation such as that in the case before the referring court, the Court must — also in the interests of clarity and legal certainty — abide by the decision to make a reference for a preliminary ruling, which must have its full effect so long as it has not been revoked or amended by the referring court, such revocation or amendment being matters on which that court alone is able to take a decision.

98 In the light of the foregoing, the answer to the third question must be that, where rules of national law apply which relate to the right of appeal against a decision making a reference for a preliminary ruling, and under those rules the main proceedings remain pending before the referring court in their entirety, the order for reference alone being the subject of a limited appeal, the second paragraph of Article 234 EC is to be interpreted as meaning that the jurisdiction conferred by that provision of the Treaty on any national court or tribunal to make a reference to the Court for a preliminary ruling cannot be called into question by the application of those rules, where they permit the appellate court to vary the order for reference, to set aside the reference and to order the referring court to resume the domestic law proceedings.

The fourth question

99 By its fourth question, the referring court essentially asks whether Articles 43 EC and 48 EC are to be interpreted as precluding legislation of a Member State under which a

company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation.

100 It is clear from the order for reference that Cartesio — a company which was incorporated in accordance with Hungarian legislation and which, at the time of its incorporation, established its seat in Hungary — transferred its seat to Italy but wished to retain its status as a company governed by Hungarian law.

101 Under the Hungarian Law on the commercial register, the seat of a company governed by Hungarian law is to be the place where its central administration is situated.

102 The referring court states that the application filed by Cartesio for amendment of the entry in the commercial register regarding its company seat was rejected by the court responsible for maintaining that register on the ground that, under Hungarian law, a company incorporated in Hungary may not transfer its seat, as defined by the Law on the commercial register, abroad while continuing to be subject to Hungarian law as the law governing its articles of association.

103 Such a transfer would require, first, that the company cease to exist and, then, that the company reincorporate itself in compliance with the law of the country where it wishes to establish its new seat.

104 In that regard, the Court observed in paragraph 19 of *Daily Mail and General Trust* that companies are creatures of national law and exist only by virtue of the national legislation which determines its incorporation and functioning.

105 In paragraph 20 of *Daily Mail and General Trust*, the Court stated that the legislation of the Member States varies widely in regard to both the factor providing a connection to the national territory required for the incorporation of a company and the question whether a company incorporated under the legislation of a Member State may subsequently modify that connecting factor. Certain States require that not merely the registered office but also the real seat (*siège réel*) — that is to say, the central administration of the company — should be situated in their territory, and the removal of the central administration from that territory thus presupposes the winding-up of the company with all the consequences that winding-up entails under company law. The legislation of other States permits companies to transfer their central administration to a foreign country but certain of them make that right subject to certain restrictions, and the legal consequences of a transfer vary from one Member State to another.

106 The Court added, in paragraph 21 of *Daily Mail and General Trust*, that the EEC Treaty had taken account of that variety in national legislation. In defining, in Article 58 of that Treaty (later Article 58 of the EC Treaty, now Article 48 EC), the companies which enjoy the right of establishment, the EEC Treaty placed on the same footing, as connecting factors, the registered office, central administration and principal place of business of a company.

107 In Case C-208/00 *Überseering* [2002] ECR I-9919, paragraph 70, the Court, whilst confirming those dicta, inferred from them that the question whether a company formed in accordance with the legislation of one Member State can transfer its registered office or its actual centre of administration to another Member State without losing its legal personality under the law of the Member State of incorporation, and, in certain circumstances, the rules relating to that transfer, are determined by the national law in accordance with which the company was incorporated. The Court concluded that a Member State is able, in the case of a company incorporated under its law, to

make the company's right to retain its legal personality under the law of that Member State subject to restrictions on the transfer to a foreign country of the company's actual centre of administration.

108 It should be pointed out, moreover, that the Court also reached that conclusion on the basis of the wording of Article 58 of the EEC Treaty. In defining, in that article, the companies which enjoy the right of establishment, the EEC Treaty regarded the differences in the legislation of the various Member States both as regards the required connecting factor for companies subject to that legislation and as regards the question whether — and, if so, how — the registered office (*siège statutaire*) or real seat (*siège réel*) of a company incorporated under national law may be transferred from one Member State to another as problems which are not resolved by the rules concerning the right of establishment, but which must be dealt with by future legislation or conventions (see, to that effect, *Daily Mail and General Trust*, paragraphs 21 to 23, and *Überseering*, paragraph 69).

109 Consequently, in accordance with Article 48 EC, in the absence of a uniform Community law definition of the companies which may enjoy the right of establishment on the basis of a single connecting factor determining the national law applicable to a company, the question whether Article 43 EC applies to a company which seeks to rely on the fundamental freedom enshrined in that article — like the question whether a natural person is a national of a Member State, hence entitled to enjoy that freedom — is a preliminary matter which, as Community law now stands, can only be resolved by the applicable national law. In consequence, the question whether the company is faced with a restriction on the freedom of establishment, within the meaning of Article 43 EC, can arise only if it has been established, in the light of the conditions laid down in Article 48 EC, that the company actually has a right to that freedom.

110 Thus a Member State has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment, and that required if the company is to be able subsequently to maintain that status. That power includes the possibility

for that Member State not to permit a company governed by its law to retain that status if the company intends to reorganise itself in another Member State by moving its seat to the territory of the latter, thereby breaking the connecting factor required under the national law of the Member State of incorporation.

111 Nevertheless, the situation where the seat of a company incorporated under the law of one Member State is transferred to another Member State with no change as regards the law which governs that company falls to be distinguished from the situation where a company governed by the law of one Member State moves to another Member State with an attendant change as regards the national law applicable, since in the latter situation the company is converted into a form of company which is governed by the law of the Member State to which it has moved.

112 In fact, in that latter case, the power referred to in paragraph 110 above, far from implying that national legislation on the incorporation and winding-up of companies enjoys any form of immunity from the rules of the EC Treaty on freedom of establishment, cannot, in particular, justify the Member State of incorporation, by requiring the winding-up or liquidation of the company, in preventing that company from converting itself into a company governed by the law of the other Member State, to the extent that it is permitted under that law to do so.

113 Such a barrier to the actual conversion of such a company, without prior winding-up or liquidation, into a company governed by the law of the Member State to which it wishes to relocate constitutes a restriction on the freedom of establishment of the company concerned which, unless it serves overriding requirements in the public interest, is prohibited under Article 43 EC (see to that effect, inter alia, *CaixaBank France*, paragraphs 11 and 17).

114 It should also be noted that, following the judgments in *Daily Mail and General Trust* and *Ü̈berseering*, the developments in the field of company law envisaged in Articles 44(2)(g) EC and 293 EC, respectively, as pursued by means of legislation and agreements, have not as yet addressed the differences, referred to in those judgments, between the legislation of the various Member States and, accordingly, have not yet eradicated those differences.

115 The Commission maintains, however, that the absence of Community legislation in this field — noted by the Court in paragraph 23 of *Daily Mail and General Trust* — was remedied by the Community rules, governing the transfer of the company seat to another Member State, laid down in regulations such as Regulation No 2137/85 on the EEIG and Regulation No 2157/2001 on the SE or, moreover, Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European cooperative society (SCE) (OJ 2003 L 207, p. 1), as well as by the Hungarian legislation adopted subsequent to those regulations.

116 The Commission argues that those rules may — and should — be applied mutatis mutandis to the cross-border transfer of the real seat of a company incorporated under the law of a Member State.

117 In that regard, it should be noted that although those regulations, adopted on the basis of Article 308 EC, in fact lay down a set of rules under which it is possible for the new legal entities which they establish to transfer their registered office (*siège statutaire*) and, accordingly, also their real seat (*siège réel*) — both of which must, in effect, be situated in the same Member State — to another Member State without it being compulsory to wind up the original legal person or to create a new legal person, such a transfer nevertheless necessarily entails a change as regards the national law applicable to the entity making such a transfer.

118 That is clear, for example, in the case of a European company, from Articles 7 to 9(1)(c)(ii) of Regulation No 2157/2001.

119 As it is, in the case before the referring court, Cartesio merely wishes to transfer its real seat from Hungary to Italy, while remaining a company governed by Hungarian law, hence without any change as to the national law applicable.

120 Accordingly, the application mutatis mutandis of the Community legislation to which the Commission refers — even if it were to govern the cross-border transfer of the seat of a company governed by the law of a Member State — cannot in any event lead to the predicted result in circumstances such as those of the case before the referring court.

121 Further, as regards the implications of *SEVIC Systems* for the principle established in *Daily Mail and General Trust* and *Überseering*, it should be pointed out that those judgments do not relate to the same problem and that, consequently, *SEVIC Systems* cannot be said to have qualified the scope of *Daily Mail and General Trust* or *Überseering*.

122 The case which gave rise to the judgment in *SEVIC Systems* concerned the recognition, in the Member State of incorporation of a company, of an establishment operation carried out by that company in another Member State by means of a cross-border merger, which is a situation fundamentally different from the circumstances at issue in

the case which gave rise to the judgment in *Daily Mail and General Trust*, but similar to the situations considered in other judgments of the Court (see Case C-212/97 *Centros* [1999] ECR I-1459; *Überseering*; and Case C-167/01 *Inspire Art* [2003] ECR I-10155).

123 In such situations, the issue which must first be decided is not the question, referred to in paragraph 109 above, whether the company concerned may be regarded as a company which possesses the nationality of the Member State under whose legislation it was incorporated but, rather, the question whether or not that company — which, it is common ground, is a company governed by the law of a Member State — is faced with a restriction in the exercise of its right of establishment in another Member State.

124 In the light of all the foregoing, the answer to the fourth question must be that, as Community law now stands, Articles 43 EC and 48 EC are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation.

Costs

125 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

1. **A court such as the referring court, hearing an appeal against a decision of a lower court, responsible for maintaining the commercial register, rejecting an application for amendment of information entered in that register, must be classified as a court or tribunal which is entitled to make a reference for a preliminary ruling under Article 234 EC, regardless of the fact that neither the decision of the lower court nor the consideration of the appeal by the referring court takes place in the context of *inter partes* proceedings.**

2. **A court such as the referring court, whose decisions in disputes such as that in the main proceedings may be appealed on points of law, cannot be classified as a court or tribunal against whose decisions there is no judicial remedy under national law, within the meaning of the third paragraph of Article 234 EC.**

3. **Where rules of national law apply which relate to the right of appeal against a decision making a reference for a preliminary ruling, and under those rules the main proceedings remain pending before the referring court in their entirety, the order for reference alone being the subject of a limited appeal, the second paragraph of Article 234 EC is to be interpreted as meaning that the jurisdiction conferred on any national court or tribunal by that provision of the Treaty to make a reference to the Court for a preliminary ruling cannot be called into question by the application of those rules, where they permit the appellate court to vary the order for reference, to set aside the reference and to order the referring court to resume the domestic law proceedings.**

4. As Community law now stands, Articles 43 EC and 48 EC are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation.

[Signatures]

Reports of Cases

JUDGMENT OF THE COURT (Third Chamber)

12 July 2012*

(Articles 49 TFEU and 54 TFEU — Freedom of establishment — Principles of equivalence and effectiveness — Cross-border conversion — Refusal to add to register)

In Case C-378/10,

REFERENCE for a preliminary ruling under Article 267 TFEU from the Legfelsőbb Bíróság (Hungary), made by decision of 17 June 2010, received at the Court on 28 July 2010, in the context of an application to register a company in the commercial register made by

VALE Építési kft

THE COURT (Third Chamber),

composed of K. Lenaerts, President of the Chamber, J. Malenovský, R. Silva de Lapuerta, G. Arestis and T. von Danwitz (Rapporteur), Judges,

Advocate General: N. Jääskinen,

Registrar: A. Impellizzeri, Administrator,

having regard to the written procedure and further to the hearing on 14 September 2011,

after considering the observations submitted on behalf of:

— VALE Építési kft, by P. Metzinger, ügyvéd,

— the Hungarian Government, by M.Z. Fehér, K. Szíjjártó and K. Veres, acting as Agents,

— the German Government, by T. Henze and J. Kemper, acting as Agents,

— Ireland, by D. O'Hagan, acting as Agent, and by M. Collins SC, B. Doherty BL, J. Buttimore BL and L. Williams,

— the Italian Government, by G. Palmieri, acting as Agent, and by S. Fiorentino, avvocato dello Stato,

— the Austrian Government, by C. Pesendorfer, acting as Agent,

— the United Kingdom Government, by S. Hathaway and H. Walker, acting as Agents, and by K. Beal, Barrister,

— the European Commission, by G. Braun, A. Sipos and K. Talabér-Ritz, acting as Agents,

* Language of the case: Hungarian.

— the EFTA Surveillance Authority, by X. Lewis and F. Simonetti, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 15 December 2011,

gives the following

Judgment

1 The reference for a preliminary ruling on the interpretation of Articles 49 TFEU and 54 TFEU has been made in proceedings concerning a cross-border conversion of a company governed by Italian law into a company governed by Hungarian law.

National law

2 Paragraph 25 of Law V of 2006 on Company Information, Company Registration and Winding-up Proceedings (A cégnyilvánosságról, a bírósági cégeljárásról és a végelszámolásról szóló 2006. évi V. törvény) provides:

‘(1) Where applicable, the commercial register shall also include for all companies:

…

(g) the corporate name and registration number of any predecessor(s) and/or successor(s) in law of the company, and the date of conversion the company has designated, where applicable,

…’

3 Paragraph 57(4) of that law states:

‘Any application to change the form of a company shall fall within the competence of the court of registry responsible for the place where the predecessor company is established. That court shall cancel the registration of the predecessor company — indicating the successor in law — and register the successor company in the commercial register. Where appropriate, it shall forward the company documents to the competent commercial court for the place where the seat of the successor company is located.’

4 Paragraph 69(1) of Law IV of 2006 on Commercial Companies (A gazdasági társaságokról szóló 2006. évi IV. Törvény; ‘the Law on Commercial Companies’) provides:

‘Unless otherwise prescribed by the present law, with regard to the conversion of a commercial company into another form of company, the provisions on the formation of companies shall apply. The provisions of this law pertaining to the various corporate forms with regard to conversion shall also be applied.’

5 Pursuant to Paragraph 71 of that law:

‘(1) Unless stated otherwise in the company’s articles of association, the highest representation of the commercial company shall take a decision regarding conversion in two stages …

(2) … [D]uring the first stage, the representation assesses, on the basis of a proposal by the senior executives — after consulting the supervisory committee, if the commercial company has such a committee –, whether the partners (shareholders) of the company are in favour of the intention

to convert the company, then decide on the legal form of the company resulting from the conversion and identify the company partners (shareholders) who wish to become partners (shareholders) of the new company.

(3) If the intention to convert the commercial company is approved by the majority of the partners (shareholders) required for the form of the company in question, the highest representation shall determine the reference date for its balance sheets, appoint a certified accountant and entrust to the senior executives of the company the task of drawing up lists of assets and liabilities and property inventories, and all other documents necessary for taking the decision regarding conversion, whether required by law or determined by the highest representation.

(4) The senior executives shall draw up lists of assets and liabilities and property inventories of the commercial company to be converted, lists of assets and liabilities and (initial) property inventories of the company resulting from the conversion, the articles of association of the latter, and arrangements for those not wishing to become partners (shareholders) of the company resulting from the conversion.

…'

6 Paragraph 73 of the Law on Commercial Companies contains provisions on the drawing-up of lists of assets and liabilities and how they are to be audited by an independent certified accountant, and Paragraph 74 of that law governs the adoption, by the company, of its accounts and the division of capital within the new company.

7 Pursuant to Paragraph 75 of the Law on Commercial Companies, the bodies within a commercial company representing the company's staff are to be informed of the decision to convert the company, which is to be communicated in two successive editions of the *Companies Bulletin*, containing, inter alia, a notice to creditors.

8 Under Paragraph 76(2) of that law, creditors with claims that are not yet due against the company being converted which came into existence prior to the first communication regarding the conversion decision may demand from that company a guarantee in the amount of their claims.

The dispute in the main proceedings and the questions referred for a preliminary ruling

9 VALE Costruzioni Srl (a limited liability company governed by Italian law) ('VALE Costruzioni'), established on 27 September 2000, was registered in the Rome (Italy) commercial register on 16 November 2000. On 3 February 2006, VALE Costruzioni asked to be removed from that register on the ground that it intended to transfer its seat and its business to Hungary, and to discontinue business in Italy. In accordance with that request, the authority responsible for the commercial register in Rome deleted the entry relating to VALE Costruzioni from the register on 13 February 2006. As is apparent from the file, an entry was made in the register under the heading 'Removal and transfer of seat', stating that 'the company ha[d] moved to Hungary'.

10 Given that the company established originally in Italy under Italian law had decided to transfer its seat to Hungary and to operate there in accordance with Hungarian law, on 14 November 2006, the director of VALE Costruzioni and another natural person adopted, in Rome, the articles of association of VALE Építési kft (a limited liability company governed by Hungarian law) ('VALE Építési'), with a view to registration in the Hungarian commercial register. Moreover, the share capital was paid up to the extent required under Hungarian law for registration.

11 On 19 January 2007, the representative of VALE Építési applied to the Fővárosi Bíróság (Budapest Metropolitan Court), acting as the Cégbíróság (Commercial Court), to register the company in accordance with Hungarian law. In the application, the representative stated that VALE Costruzioni was the predecessor in law to VALE Építési.

12 The Fővárosi Bíróság, acting as a commercial court at first instance, rejected the application for registration. VALE Építési lodged an appeal before the Fővárosi Ítélőtábla (Regional Court of Appeal of Budapest), which upheld the order rejecting the registration. According to that court, a company which was incorporated and registered in Italy cannot, by virtue of Hungarian company law, transfer its seat to Hungary and cannot obtain registration there in the form requested. According to that court, under the Hungarian law in force, the only particulars which can be shown in the commercial register are those listed in Paragraphs 24 to 29 of Law V of 2006 and, consequently, a company which is not Hungarian cannot be listed as a predecessor in law.

13 VALE Építési brought an appeal on a point of law before the Legfelsőbb Bíróság (Supreme Court), seeking the annulment of the order rejecting registration and an order that the company be entered in the commercial register. It submits that the contested order infringes Articles 49 TFEU and 54 TFEU, which are directly applicable.

14 In that regard, it states that the order fails to recognise the fundamental difference between the international transfer of the seat of a company without changing the national law which governs that company, on the one hand, and the international conversion of a company, on the other. The Court clearly recognised that difference in Case C-210/06 *Cartesio* [2008] ECR I-9641.

15 The referring court upheld the assessment by the Fővárosi Ítélőtábla and states that the transfer of the seat of a company governed by the law of another Member State, in this instance the Italian Republic, entailing the reincorporation of the company in accordance with Hungarian law and a reference to the original Italian company, as requested by VALE Építési, cannot be regarded as a conversion under Hungarian law, since national law on conversions applies only to domestic situations. However, it harbours doubts as to the compatibility of such legislation with the freedom of establishment, while stressing that the present case differs from the case which gave rise to the judgment in *Cartesio*, since what is at issue here is a transfer of the seat of a company with a change of the applicable national law, while maintaining the legal personality of the company, that is to say, a cross-border conversion.

16 In those circumstances, the Legfelsőbb Bíróság decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

‘(1) Must the host Member State pay due regard to Articles [49 TFEU and 54 TFEU] when a company established in another Member State (the Member State of origin) transfers its seat to that host Member State and, at the same time and for this purpose, deletes the entry regarding it in the commercial register in the Member State of origin, and the company’s owners adopt a new instrument of constitution under the laws of the host Member State, and the company applies for registration in the commercial register of the host Member State under the laws of the host Member State?

(2) If the answer to the first question is yes, must Articles [49 TFEU and 54 TFEU] be interpreted in such a case as meaning that they preclude legislation or practices of such a (host) Member State which prohibit a company established lawfully in any other Member State (the Member State of origin) from transferring its seat to the host Member State and continuing to operate under the laws of that State?

(3) With regard to the response to the second question, is the basis on which the host Member State prohibits the company from registration of any relevance, specifically:

— if, in its instrument of constitution adopted in the host Member State, the company designates as its predecessor the company established and deleted from the commercial register in the Member State of origin, and applies for the predecessor to be registered as its own predecessor in the commercial register of the host Member State?

— in the event of international conversion within the Community, when deciding on the company's application for registration, must the host Member State take into consideration the instrument recording the fact of the transfer of company seat in the commercial register of the Member State of origin, and, if so, to what extent?

(4) Is the host Member State entitled to decide on the application for company registration lodged in the host Member State by the company carrying out international conversion within the Community in accordance with the rules of company law of the host Member State as they relate to the conversion of domestic companies, and to require the company to fulfil all the conditions (e.g. drawing up lists of assets and liabilities and property inventories) laid down by the company law of the host Member State in respect of domestic conversion, or is the host Member State obliged under Articles [49 TFEU and 54 TFEU] to distinguish international conversion within the Community from domestic conversion and, if so, to what extent?'

Consideration of the questions referred

Admissibility

17 The United Kingdom Government calls into question the admissibility of the reference for a preliminary ruling in its entirety, submitting that the questions referred are hypothetical. Indeed, those questions concern a case of cross-border conversion whereas, on the basis of the facts apparent from the order for reference, it must be found that the operation at issue does not correspond to such a cross-border conversion. The EFTA Surveillance Authority considers the third and fourth questions referred to be inadmissible, since the factual background is not set out in sufficient detail to enable the Court to provide a useful answer.

18 For the purposes of the examination, respectively, of the admissibility of the reference for a preliminary ruling in its entirety, and of the third and fourth questions referred, the Court recalls the settled case-law pursuant to which questions on the interpretation of European Union law referred by a national court, in the factual and legislative context which that court is responsible for defining and the accuracy of which is not a matter for the Court to determine, enjoy a presumption of relevance. The Court may refuse to rule on a question referred by a national court only where it is quite obvious that the interpretation of European Union law that is sought bears no relation to the actual facts of the main action or its purpose, where the problem is hypothetical, or where the Court does not have before it the factual or legal material necessary to give a useful answer to the questions submitted to it (Joined Cases C-188/10 and C-189/10 *Melki and Abdeli* [2010] ECR I-5667, paragraph 27 and the case-law cited).

19 In the present case, the questions referred concern the interpretation of Articles 49 TFEU and 54 TFEU in a real case regarding the registration of VALE Építési in the commercial register. Moreover, the referring court's characterisation of the operation at issue in the main proceedings as a cross-border conversion of a company does not appear to be irrelevant, since it is clear from the file

that the authority responsible for the commercial register in Rome deleted VALE Costruzioni from that register by entering, under the heading 'Removal and transfer of seat', that 'the company ha[d] moved to Hungary'.

20 For the same reason, in the light of the clear separation of the functions of national courts and this Court, it is not for the Court to conclude that VALE Costruzioni ceased to exist following its removal from the commercial register in Rome. In those circumstances, the interpretation requested cannot be regarded as bearing no relation to the actual facts of the main action or its purpose.

21 Finally, the order for reference provides a sufficient description of the facts at issue in the main proceedings and of the relevant national legislation, thereby enabling the Court to grasp the meaning and scope of the questions referred and to give a useful answer to them.

22 Consequently, the reference for a preliminary ruling must be considered admissible, as must the questions contained therein.

Substance

The first two questions referred

23 By the first two questions referred, which it is appropriate to examine together, the referring court asks, in essence, whether Articles 49 TFEU and 54 TFEU must be interpreted as precluding national legislation which, although enabling a company established under national law to convert, does not allow a company established in accordance with the law of another Member State to convert to a company governed by national law by incorporating such a company.

– The scope of Articles 49 TFEU and 54 TFEU

24 As regards the question whether such legislation falls within the scope of Articles 49 TFEU and 54 TFEU, it should be noted that the Court held, in paragraph 19 of its judgment in Case C-411/03 *SEVIC Systems* [2005] ECR I-10805, that company transformation operations are, in principle, amongst those economic activities in respect of which Member States are required to comply with the freedom of establishment.

25 However, the Hungarian, German and United Kingdom Governments and also Ireland submit that such legislation does not fall within the scope of Articles 49 TFEU and 54 TFEU since, unlike the cross-border merger at issue in *SEVIC Systems*, a cross-border conversion leads to the incorporation of a company in the host Member State.

26 Such reasoning cannot be accepted.

27 Indeed, according to settled case-law, companies are creatures of national law and exist only by virtue of the national legislation which determines their incorporation and functioning (see Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483, paragraph 19, and *Cartesio*, paragraph 104).

28 Similarly, it is not disputed that, in accordance with Article 54 TFEU, in the absence of a uniform definition in European Union law of the companies which may enjoy the right of establishment on the basis of a single connecting factor determining the national law applicable to a company, the question whether Article 49 TFEU applies to a company which seeks to rely on the fundamental freedom enshrined in that article is a preliminary matter which, as European Union law now stands, can be resolved only by the applicable national law (Case C-371/10 *National Grid Indus* [2011] ECR I-12273, paragraph 26 and the case-law cited).

29 Finally, a Member State thus unquestionably has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under its national law and as such capable of enjoying the right of establishment, and the connecting factor required if the company is to be able subsequently to maintain that status (*Cartesio*, paragraph 110, and *National Grid Indus*, paragraph 27).

30 In the light of the settled case-law set out above, the Court notes that any obligation, under Articles 49 TFEU and 54 TFEU, to permit a cross-border conversion neither infringes the power, referred to in the preceding paragraph, of the host Member State nor that State's determination of the rules governing the incorporation and functioning of the company resulting from a cross-border conversion.

31 As is apparent from the case-law set out in paragraph 27 above, such a company is necessarily governed solely by the national law of the host Member State, which determines the connecting factor required and the rules governing its incorporation and functioning.

32 It is thus apparent that the expression 'to the extent that it is permitted under that law to do so', in paragraph 112 of *Cartesio*, cannot be understood as seeking to remove, from the outset, the legislation of the host Member State on company conversions from the scope of the provisions of the Treaty on the Functioning of the European Union governing the freedom of establishment, but as reflecting the mere consideration that a company established in accordance with national law exists only on the basis of the national legislation which 'permits' the incorporation of the company, provided the conditions laid down to that effect are satisfied.

33 In the light of the foregoing, the Court concludes that national legislation which enables national companies to convert, but does not allow companies governed by the law of another Member State to do so, falls within the scope of Articles 49 TFEU and 54 TFEU.

– The existence of a restriction on the freedom of establishment and possible justification for such a restriction

34 As regards the existence of a restriction on the freedom of establishment, the Court notes that the concept of establishment within the meaning of the Treaty provisions on the freedom of establishment involves the actual pursuit of an economic activity through a fixed establishment in the host Member State for an indefinite period. Consequently, it presupposes actual establishment of the company concerned in that State and the pursuit of genuine economic activity there (Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 54 and the case-law cited).

35 In the present case, there has been nothing to suggest in the procedure before the Court that the activities of VALE Építési will be restricted to Italy and that the company will not actually seek to establish itself in Hungary, although that is a matter to be determined by the referring court.

36 The Court considers that, in so far as the national legislation at issue in the case in the main proceedings provides only for conversion of companies which already have their seat in the Member State concerned, that legislation treats companies differently according to whether the conversion is domestic or of a cross-border nature, which is likely to deter companies which have their seat in another Member State from exercising the freedom of establishment laid down by the Treaty and, therefore, amounts to a restriction within the meaning of Articles 49 TFEU and 54 TFEU (see, to that effect, *SEVIC Systems*, paragraphs 22 and 23).

37 In so far as concerns possible justification for the restriction at issue, it is true that the Court recognised, in paragraph 27 of *SEVIC Systems*, that cross-border mergers pose specific problems, which is also true of cross-border conversions. Indeed, such conversions presuppose the consecutive application of two national laws.

38 The Court notes, at the outset, that differences in treatment depending on whether a domestic or cross-border conversion is at issue cannot be justified by the absence of rules laid down in secondary European Union law. Even though such rules are indeed useful for facilitating cross-border conversions, their existence cannot be made a precondition for the implementation of the freedom of establishment laid down in Articles 49 TFEU and 54 TFEU (see, in relation to cross-border mergers, *SEVIC Systems*, paragraph 26).

39 In so far as concerns justification on the basis of overriding reasons in the public interest, such as protection of the interests of creditors, minority shareholders and employees, the preservation of the effectiveness of fiscal supervision and the fairness of commercial transactions, it is established that such reasons may justify a measure restricting the freedom of establishment on the condition that such a restrictive measure is appropriate for ensuring the attainment of the objectives pursued and does not go beyond what is necessary to attain them (see *SEVIC Systems*, paragraphs 28 and 29).

40 However, such justification is lacking in the present case. Hungarian law precludes, in a general manner, cross-border conversions, with the result that it prevents such operations from being carried out even if the interests, mentioned in the preceding paragraph, are not threatened. In any event, such a rule goes beyond what is necessary to protect those interests (see, as regards cross-border mergers, *SEVIC Systems*, paragraph 30).

41 In those circumstances, the answer to the first two questions is that Articles 49 TFEU and 54 TFEU must be interpreted as precluding national legislation which enables companies established under national law to convert, but does not allow, in a general manner, companies governed by the law of another Member State to convert to companies governed by national law by incorporating such a company.

The third and fourth questions referred

42 By its third and fourth questions, which it is appropriate to examine together, the referring court asks, in essence, whether Articles 49 TFEU and 54 TFEU must be interpreted, in the context of a cross-border conversion, as meaning that the host Member State is entitled to determine the national law applicable to such an operation and thus to apply the national law provisions on domestic conversions governing the incorporation and functioning of a company, such as the requirements of drawing up lists of assets and liabilities and property inventories. More specifically, it seeks to determine whether the host Member State may refuse, for cross-border conversions, the designation 'predecessor in law', such a designation in the commercial register being laid down for domestic conversions, and whether and to what extent it is required to take account of documents issued by the authorities of the Member State of origin when registering the company.

43 In that regard, the Court notes, first, that, since secondary law of the European Union, as it currently stands, does not provide specific rules governing cross-border conversions, the provisions which enable such an operation to be carried out can be found only in national law, namely the law of the Member State of origin of the company seeking to convert and the law of the host Member State in accordance with which the company resulting from that conversion will be governed.

44 The implementation of a cross-border conversion requires, as is apparent from paragraph 37 above, the consecutive application of two national laws to that legal operation.

45 Second, although specific rules capable of substituting national provisions cannot be inferred from Articles 49 TFEU and 54 TFEU, the application of such national provisions cannot escape all review in the light of those Treaty provisions.

46 As is apparent from the answer given to the first two questions referred, Articles 49 TFEU and 54 TFEU require Member States which make provision for the conversion of companies governed by national law to grant that same possibility to companies governed by the law of another Member State which are seeking to convert to companies governed by the law of the first Member State.

47 Consequently, provisions of national law must be applied consistently with that requirement, in accordance with Articles 49 TFEU and 54 TFEU.

48 In that regard, the Court notes that, in many areas, it is settled case-law that, in the absence of relevant European Union rules, the detailed procedural rules designed to ensure the protection of the rights which individuals acquire under European Union law are a matter for the domestic legal order of each Member State, provided that they are not less favourable than those governing similar domestic situations (principle of equivalence) and that they do not render impossible in practice or excessively difficult the exercise of rights conferred by the European Union legal order (principle of effectiveness) (see, to that effect, in relation to recovery of undue payments, Joined Cases C-10/97 to C-22/97 *IN. CO. GE.'90 and Others* [1998] ECR I-6307, paragraph 25; in relation to administrative law, Joined Cases C-222/05 to C-225/05 *van der Weerd and Others* [2007] ECR I-4233, paragraph 28; in relation to the non-contractual liability of a Member State, Case C-445/06 *Danske Slagterier* [2009] ECR I-2119, paragraph 31; and, in relation to the requirement of a certificate for a tax advantage, Case C-262/09 *Meilicke and Others* [2011] ECR I-5669, paragraph 55 and the case-law cited).

49 The Court notes that the logic underlying that case-law is also valid in the legal context of the case in the main proceedings. As in that case-law, the company concerned enjoys a right granted by the European Union legal order, in this instance, the right to carry out a cross-border conversion, the implementation of which depends, in the absence of European Union rules, on the application of national law.

50 In that regard, the Court notes that the determination, by the host Member State, of the applicable national law enabling the implementation of a cross-border conversion is not, in itself, capable of calling into question its compliance with the obligations resulting from Articles 49 TFEU and 54 TFEU.

51 It is not disputed that, in the host Member State, a cross-border conversion leads to the incorporation of a company governed by the law of that Member State. Indeed, companies are creatures of national law and exist only by virtue of the national legislation which determines their incorporation and functioning (see *Daily Mail and General Trust*, paragraph 19, and *Cartesio*, paragraph 104).

52 Thus, in the present case, the application by Hungary of the provisions of its national law on domestic conversions governing the incorporation and functioning of companies, such as the requirements to draw up lists of assets and liabilities and property inventories, cannot be called into question.

53 Third, in so far as concerns the questions of the referring court concerning the implementation of the operation at issue in the main proceedings, it is necessary to clarify the obligations resulting from the principles of equivalence and effectiveness which govern the application of national law.

54 As regards the principle of equivalence, the Court notes that, pursuant to that principle, a Member State is not required to treat cross-border operations more favourably than domestic operations. That principle merely implies that the detailed rules of national law aimed at safeguarding the rights which individuals derive from European Union law cannot be less favourable than those governing similar situations under national law.

55 Thus, in the context of a domestic conversion, if the legislation of a Member State requires strict legal and economic continuity between the predecessor company which applied to be converted and the converted successor company, such a requirement may also be imposed in the context of a cross-border conversion.

56 However, the refusal by the authorities of a Member State, in relation to a cross-border conversion, to record in the commercial register the company of the Member State of origin as the 'predecessor in law' to the converted company is not compatible with the principle of equivalence if, in relation to the registration of domestic conversions, such a record is made of the predecessor company. The Court notes, in that regard, that the recording of the 'predecessor in law' in the commercial register, irrespective of the domestic or cross-border nature of the conversion, may be useful, in particular, to inform the creditors of the company which has converted. Moreover, the Hungarian Government does not raise any argument to justify its recording of the names of only companies which convert domestically.

57 Consequently, the refusal to record VALE Costruzioni in the Hungarian commercial register as the 'predecessor in law' is incompatible with the principle of equivalence.

58 Next, so far as concerns the principle of effectiveness, the question arises in this instance as to the account which the host Member State must take, in the context of an application for registration, of documents obtained from the authorities of the Member State of origin. In the context of the dispute in the main proceedings, that question relates to the examination, to be made by the Hungarian authorities, of the issue whether VALE Costruzioni dissociated itself from Italian law, in accordance with the conditions laid down thereunder, while retaining its legal personality, thereby enabling it to convert into a company governed by Hungarian law.

59 Since that examination constitutes the indispensable link between the registration procedure in the Member State of origin and that in the host Member State, the fact remains that, in the absence of rules under European Union law, the registration procedure in the host Member State is governed by the law of that State, which thus also determines, in principle, the evidence which must be furnished by the company seeking to be converted, certifying that conditions compatible with European Union law and required by the Member State of origin have been satisfied in that regard.

60 However, a practice on the part of the authorities of the host Member State to refuse, in a general manner, to take account of documents obtained from the authorities of the Member State of origin during the registration procedure is liable to make it impossible for the company requesting to be converted to show that it actually complied with the requirements of the Member State of origin, thereby jeopardising the implementation of the cross-border conversion to which it has committed itself.

61 Consequently, the authorities of the host Member State are required, pursuant to the principle of effectiveness, to take due account, when examining a company's application for registration, of documents obtained from the authorities of the Member State of origin certifying that that company has indeed complied with the conditions laid down in that Member State, provided that those conditions are compatible with European Union law.

62 In the light of the foregoing, the answer to the third and fourth questions referred is that Articles 49 TFEU and 54 TFEU must be interpreted, in the context of cross-border company conversions, as meaning that the host Member State is entitled to determine the national law applicable to such operations and thus to apply the provisions of its national law on the conversion of national companies governing the incorporation and functioning of companies, such as the requirements relating to the drawing-up of lists of assets and liabilities and property inventories. However, the principles of equivalence and effectiveness, respectively, preclude the host Member State from

— refusing, in relation to cross-border conversions, to record the company which has applied to convert as the 'predecessor in law', if such a record is made of the predecessor company in the commercial register for domestic conversions, and

— refusing to take due account, when examining a company's application for registration, of documents obtained from the authorities of the Member State of origin.

Costs

63 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Third Chamber) hereby rules:

1. **Articles 49 TFEU and 54 TFEU must be interpreted as precluding national legislation which enables companies established under national law to convert, but does not allow, in a general manner, companies governed by the law of another Member State to convert to companies governed by national law by incorporating such a company.**

2. **Articles 49 TFEU and 54 TFEU must be interpreted, in the context of cross-border company conversions, as meaning that the host Member State is entitled to determine the national law applicable to such operations and thus to apply the provisions of its national law on the conversion of national companies governing the incorporation and functioning of companies, such as the requirements relating to the drawing-up of lists of assets and liabilities and property inventories. However, the principles of equivalence and effectiveness, respectively, preclude the host Member State from**

   — **refusing, in relation to cross-border conversions, to record the company which has applied to convert as the 'predecessor in law', if such a record is made of the predecessor company in the commercial register for domestic conversions, and**

   — **refusing to take due account, when examining a company's application for registration, of documents obtained from the authorities of the Member State of origin.**

[Signatures]

JUDGMENT OF THE COURT (Grand Chamber)

12 September 2006 *

In Case C-196/04,

REFERENCE for a preliminary ruling under Article 234 EC by the Special Commissioners of Income Tax, London (United Kingdom), made by decision of 29 April 2004, received at the Court on 3 May 2004, in the proceedings

Cadbury Schweppes plc,

Cadbury Schweppes Overseas Ltd

v

Commissioners of Inland Revenue,

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann and A. Rosas, Presidents of Chambers, J.N. Cunha Rodrigues, R. Silva de Lapuerta, K. Lenaerts (Rapporteur), E. Juhász, G. Arestis and A. Borg Barthet, Judges,

* Language of the case: English.

Advocate General: P. Léger,
Registrar: C. Strömholm, Administrator,

having regard to the written procedure and further to the hearing on 13 December 2005,

after considering the observations submitted on behalf of:

— Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd, by J. Ghosh, Barrister, and J. Henderson, adviser,

— the United Kingdom Government, by R. Caudwell, acting as Agent, and D. Anderson QC, M. Lester and D. Ewart, Barristers,

— the Belgian Government, by E. Dominkovits, acting as Agent,

— the Danish Government, by J. Molde, acting as Agent,

— the German Government, by A. Tiemann and U. Forsthoff, acting as Agents,

— the Spanish Government, by L. Fraguas Gadea and M. Muñoz Pérez, acting as Agents,

— the French Government, by G. de Bergues and C. Mercier, acting as Agents,

— Ireland, by D. O'Hagan, acting as Agent, and R.L. Nesbitt, A. Collins SC and P. McGarry BL,

— the Italian Government, by I.M. Braguglia, acting as Agent, assisted by A. Cingolo, avvocato dello Stato,

— the Cypriot Government, by A. Pantazi, acting as Agent,

— the Portuguese Government, by L. Fernandes and J. de Menezes Leitão, acting as Agents,

— the Finnish Government, by A. Guimaraes-Purokoski, acting as Agent,

— the Swedish Government, by A. Kruse and I. Willfors, acting as Agents,

— the Commission of the European Communities, by R. Lyal, acting as Agent,

after hearing the Opinion of the Advocate General at the sitting on 2 May 2006,

gives the following

Judgment

1 The reference for a preliminary ruling concerns the interpretation of Articles 43 EC, 49 EC and 56 EC.

2 The reference was made in proceedings between Cadbury Schweppes plc ('CS') and Cadbury Schweppes Overseas Ltd ('CSO') on the one hand and the Commissioners of Inland Revenue on the other hand concerning the taxation of CSO in respect of the profits made in 1996 by Cadbury Schweppes Treasury International ('CSTI'), a subsidiary of the Cadbury Schweppes group established in the International Financial Services Center in Dublin (Ireland) ('the IFSC').

National legislation

3 The tax legislation of the United Kingdom of Great Britain and Northern Ireland provides that a company resident in that Member State within the meaning of that legislation ('the resident company') is subject in that State to corporation tax on its worldwide profits. Those profits include the profits made by branches or agencies through which the resident company carries on its activities outside the United Kingdom.

4 On the other hand, the resident company is not generally taxed on the profits of its subsidiaries as they arise. Nor is it taxed on dividends distributed by a subsidiary established in the United Kingdom. Dividends distributed to a resident company by a subsidiary established abroad are taxed in the hands of that company. In order to prevent double taxation, the United Kingdom tax legislation provides, however, for the grant of a tax credit to the resident company up to the amount of the tax which was paid by the foreign subsidiary as the profits arose.

5 The United Kingdom legislation on controlled foreign companies ('CFCs') provides for an exception to the general rule that a resident company is not taxed on the profits of a subsidiary as they arise.

6 That legislation, which is contained in sections 747 to 756 and Schedules 24 to 26 of the Income and Corporation Taxes Act 1988, provides that the profits of a CFC — namely, under the version of that legislation applicable at the time of the facts in the main proceedings ('the legislation on CFCs'), a foreign company in which the resident company owns a holding of more than 50% — are attributed to the resident company and taxed in its hands, by means of a tax credit for the tax paid by the CFC in the State in which it is established. If those same profits are then distributed in the form of dividends to the resident company, the tax paid by the latter in the United Kingdom on the profits of the CFC is treated as additional tax paid by the latter abroad and gives rise to a tax credit payable in respect of the tax owed by the resident company on those dividends.

7 The legislation on CFCs is designed to apply when the CFC is subject, in the State in which it is established, to a 'lower level of taxation', which is the case, under that legislation, in respect of any accounting period in which the tax paid by the CFC is less than three quarters of the amount of tax which would have been paid in the United Kingdom on the taxable profits as they would have been calculated for the purposes of taxation in that Member State.

8 The taxation which is attributable to the application of the legislation on CFCs is accompanied by a number of exceptions. According to the version of that legislation in force at the time of the facts in the main proceedings, that taxation does not apply in any of the following cases:

— the CFC adopts an 'acceptable distribution policy', which means that a specified percentage (90% in 1996) of its profits are distributed within 18 months of their arising and taxed in the hands of a resident company;

— the CFC is engaged in 'exempt activities' within the meaning of that legislation, such as certain trading activities carried out from a business establishment;

— the CFC satisfies the 'public quotation condition', which means that 35% of the voting rights are held by the public, the subsidiary is quoted and its securities are dealt in on a recognised stock exchange, and

— the CFC's chargeable profits do not exceed an amount set at GBP 50 000 (de minimis exception).

9 The taxation provided for by the legislation on CFCs is also excluded when 'the motive test' is satisfied. The latter involves two cumulative conditions.

10 First, where the transactions which gave rise to the profits of the CFC for the accounting period in question produce a reduction in United Kingdom tax compared to that which would have been paid in the absence of those transactions and where the amount of that reduction exceeds a certain threshold, the resident company must show that such a reduction was not the main purpose, or one of the main purposes, of those transactions.

11 Secondly, the resident company must show that it was not the main reason, or one of the main reasons, for the SEC's existence in the accounting period concerned to achieve a reduction in United Kingdom tax by means of the diversion of profits. According to that legislation, there is a diversion of profits if it is reasonable to suppose that, had the SEC or any related company established outside the United Kingdom not existed, the receipts would have been received by, and been taxable in the hands of, a United Kingdom resident.

12 The decision making the reference also states that in 1996 the United Kingdom tax authorities published a list of States within which, subject to specified conditions, a CFC could be established and carry on its activities and be regarded as meeting the requirements for exemption from the taxation provided for by the legislation on CFCs.

The facts in the main proceedings and the question referred for a preliminary ruling

13 CS, a resident company, is the parent company of the Cadbury Schweppes group which consists of companies established in the United Kingdom, in other Member States and in third States. That group includes, inter alia, two subsidiaries in Ireland, Cadbury Schweppes Treasury Services ('CSTS') and CSTI, which CS owns indirectly through a chain of subsidiaries at the head of which is CSO.

14 CSTS and CSTI, which are established in the IFSC, were subject to a tax rate of 10% at the time of the facts in the main proceedings.

15 The business of CSTS and CSTI is to raise finance and to provide that finance to subsidiaries in the Cadbury Schweppes group.

16 According to the decision making the reference, CSTS replaced a similar structure which included a company established in Jersey. It was established for three purposes: first, to remedy a tax problem encountered by Canadian taxpayers holding CS preference shares, secondly, to avoid the need to obtain consent from the United Kingdom authorities for overseas lending transactions and, thirdly, to reduce the withholding tax on dividends paid within the group under the scheme of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6). According to that decision, those three objectives could have been achieved if CSTS had been incorporated in accordance with United Kingdom legislation and established in the United Kingdom.

17 CSTI is a subsidiary of CSTS. In the view of the national court, it was incorporated in Ireland in order not to fall within the application of certain United Kingdom tax provisions on exchange transactions.

18 According to the decision making the reference, it is common ground that CSTS and CSTI were established in Dublin solely in order that the profits related to the internal financing activities of the Cadbury Schweppes group could benefit from the tax regime of the IFSC.

19 Given the rate of tax applicable to companies established in the IFSC, the profits of CSTS and CSTI were subject to 'a lower level of taxation' within the meaning of the legislation on CFCs. The United Kingdom tax authorities took the view that, for the 1996 financial year, none of the conditions for exemption from taxation provided for by that legislation applied to those subsidiaries.

20 By decision of 18 August 2000, the Commissioners of Inland Revenue therefore claimed, under the CFC legislation, corporation tax from CSO in the sum of GBP 8 638 633.54 on the profits made by CSTI in the financial year ending 28 December 1996. The tax notice related only to the profits made by CSTI because, in that financial year, CSTS made a loss.

21 On 21 August 2000, CS and CSO appealed against that tax notice to the Special Commissioners of Income Tax, London. Before that body, they maintained that the legislation on CFCs was contrary to Articles 43 EC, 49 EC and 56 EC.

22 The national court states that it is faced with a series of uncertainties as to the application of Community law to the case before it.

23 First, it asks whether, in establishing and capitalising companies in another Member State solely to take advantage of a tax regime more favourable than that applicable in the United Kingdom, CS is abusing the freedoms introduced by the EC Treaty.

24 Secondly it asks whether, if CS is merely exercising those freedoms in a genuine manner, the correct approach in the circumstances of this case is to consider whether the legislation on CFCs may be viewed as a restriction on the exercise of those freedoms, or discrimination.

25 Should that legislation be viewed as involving a restriction on the freedoms enshrined by the Treaty, the national court asks, thirdly, whether the fact that CS may pay no more tax than what CSTS and CSTI would have paid if they had been established in the United Kingdom means that there is no such restriction. It also asks whether it is relevant that on the one hand there are differences in some respects between the rules for calculating the tax liability in respect of the income of CSTS and CSTI and the ordinary rules applicable to United Kingdom subsidiaries of CS and on the other the fact that losses of a CFC cannot be deducted from the profits of another CFC or from the profits of CS and its United Kingdom subsidiaries, whereas such a deduction would have been available if CSTS and CSTI had been established in the United Kingdom.

26 Should the legislation on CFCs be viewed as involving discrimination, it asks, fourthly, whether a parallel should be drawn between the facts in the main proceedings and the incorporation by CS of subsidiaries in the United Kingdom or the establishment by CS of subsidiaries in a Member State which does not charge a lower rate of tax as provided for in that legislation.

27 Should the legislation on CFCs be viewed as involving discrimination or a restriction on the freedom of establishment, it asks, fifthly, whether that legislation can be justified on grounds of prevention of tax avoidance, given its objective to prevent the reduction or diversion of profits liable to United Kingdom tax; and, if so, whether the legislation may be considered to be proportionate having regard to its purpose and the exemptions which may be obtained by companies which, unlike CS, succeed in proving under the motive test that their purpose does not relate to tax avoidance.

28 In the light of those questions, the Special Commissioners of Income Tax, London, decided to stay the proceedings and refer the following question to the Court for a preliminary ruling:

'Do Articles 43 EC, 49 EC and 56 EC preclude national tax legislation such as that in issue in the main proceedings, which provides in specified circumstances for the imposition of a charge upon a company resident in that Member State in respect of the profits of a subsidiary company resident in another Member State and subject to a lower level of taxation?'

The question referred for a preliminary ruling

29 By that question, the national court asks, essentially, whether Articles 43 EC, 49 EC and 56 EC preclude national tax legislation such as that in issue in the main proceedings, which provides under certain conditions for the imposition of a charge upon the parent company on the profits made by a CFC.

30 That question must be understood as referring also to Article 48 EC, under which companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community are to be treated in the same way as natural persons who are nationals of Member States, referred to in Article 43 EC, for the purposes of the provisions of the Treaty on freedom of establishment.

31 In accordance with settled case-law, national provisions which apply to holdings by nationals of the Member State concerned in the capital of a company established in another Member State, giving them definite influence on the company's decisions and allowing them to determine its activities come within the substantive scope of the provisions of the Treaty on freedom of establishment (see, to that effect, Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22, and Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 37).

32 In this case, the legislation on CFCs concerns the taxation, under certain conditions, of the profits of subsidiaries established outside the United Kingdom in which a resident company has a controlling holding. It must therefore be examined in the light of Articles 43 EC and 48 EC.

33 If, as submitted by the applicants in the main proceedings and Ireland, that legislation has restrictive effects on the free movement of services and the free movement of capital, such effects are an unavoidable consequence of any restriction on freedom of establishment and do not justify, in any event, an independent examination of that legislation in the light of Articles 49 EC and 56 EC (see, to that effect, Case C-36/02 *Omega* [2004] ECR I-9609, paragraph 27).

34 Before examining the legislation on CFCs in the light of Articles 43 EC and 48 EC, it is important to answer the national court's initial question seeking to ascertain whether the fact that a company established in a Member State establishes and capitalises companies in another Member State solely because of the more favourable tax regime applicable in that Member State constitutes an abuse of freedom of establishment.

35 It is true that nationals of a Member State cannot attempt, under cover of the rights created by the Treaty, improperly to circumvent their national legislation. They must not improperly or fraudulently take advantage of provisions of Community law (Case 115/78 *Knoors* [1979] ECR 399, paragraph 25; Case C-61/89 *Bouchoucha* [1990] ECR I-3551, paragraph 14; and Case C-212/97 *Centros* [1999] ECR I-1459, paragraph 24).

36 However, the fact that a Community national, whether a natural or a legal person, sought to profit from tax advantages in force in a Member State other than his State of residence cannot in itself deprive him of the right to rely on the provisions of the Treaty (see, to that effect, Case C-364/01 *Barbier* [2003] ECR I-15013, paragraph 71).

37 As to freedom of establishment, the Court has already held that the fact that the company was established in a Member State for the purpose of benefiting from more favourable legislation does not in itself suffice to constitute abuse of that freedom (see, to that effect, *Centros*, paragraph 27, and Case C-167/01 *Inspire Art* [2003] ECR I-10155, paragraph 96).

38 As noted by the applicants in the main proceedings and the Belgian Government, and by the Cypriot Government at the hearing, it follows that the fact that in this case CS decided to establish CSTS and CSTI in the IFSC for the avowed purpose of benefiting from the favourable tax regime which that establishment enjoys does not in itself constitute abuse. That fact does not therefore preclude reliance by CS on Articles 43 EC and 48 EC (see, to that effect, *Centros*, paragraph 18, and *Inspire Art*, paragraph 98).

39 It must therefore be examined whether Articles 43 EC and 48 EC preclude the application of legislation such as that on CFCs.

40 According to settled case-law, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law (Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, paragraph 19; Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 19; and Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 29).

41 Freedom of establishment, which Article 43 EC grants to Community nationals and which includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, entails, in accordance with Article 48 EC, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, the right to exercise their activity in the Member State concerned through a subsidiary, a branch or an agency (see, in particular, Case C-307/97 *Saint Gobain ZN* [1999] ECR I-6161, paragraph 35; *Marks & Spencer*, paragraph 30; and Case C-471/04 *Keller Holding* [2006] ECR I-2107, paragraph 29).

42 Even though, according to their wording, the provisions of the Treaty concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (see, in particular, Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 21, and *Marks & Spencer*, paragraph 31).

43 In this case, it is common ground that the legislation on CFCs involves a difference in the treatment of resident companies on the basis of the level of taxation imposed on the company in which they have a controlling holding.

44 Where the resident company has incorporated a CFC in a Member State in which it is subject to a lower level of taxation within the meaning of the legislation on CFCs, the profits made by such a controlled company are, pursuant to that legislation, attributed to the resident company, which is taxed on those profits. Where, on the other hand, the controlled company has been incorporated and taxed in the United Kingdom or in a State in which it is not subject to a lower level of taxation within the meaning of that legislation, the latter is not applicable and, under the United Kingdom legislation on corporation tax, the resident company is not, in such circumstances, taxed on the profits of the controlled company.

45 That difference in treatment creates a tax disadvantage for the resident company to which the legislation on CFCs is applicable. Even taking into account, as suggested by the United Kingdom, Danish, German, French, Portuguese, Finnish, and Swedish

Governments, the fact referred to by the national court that such a resident company does not pay, on the profits of a CFC within the scope of application of that legislation, more tax than that which would have been payable on those profits if they had been made by a subsidiary established in the United Kingdom, the fact remains that under such legislation the resident company is taxed on profits of another legal person. That is not the case for a resident company with a subsidiary taxed in the United Kingdom or a subsidiary established outside that Member State which is not subject to a lower level of taxation.

46 As submitted by the applicants in the main proceedings and by Ireland and the Commission of the European Communities, the separate tax treatment under the legislation on CFCs and the resulting disadvantage for resident companies which have a subsidiary subject, in another Member State, to a lower level of taxation are such as to hinder the exercise of freedom of establishment by such companies, dissuading them from establishing, acquiring or maintaining a subsidiary in a Member State in which the latter is subject to such a level of taxation. They therefore constitute a restriction on freedom of establishment within the meaning of Articles 43 EC and 48 EC.

47 Such a restriction is permissible only if it is justified by overriding reasons of public interest. It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective thus pursued and not go beyond what is necessary to attain it (Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 26; Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 49; and *Marks & Spencer*, paragraph 35).

48 The United Kingdom Government, supported by the Danish, German, French, Portuguese, Finnish and Swedish Governments, submits that the legislation on CFCs is intended to counter a specific type of tax avoidance involving the artificial transfer by a resident company of profits from the Member State in which they were made to a low-tax State by means of the establishment of a subsidiary in that State and the effecting of transactions intended primarily to make such a transfer to that subsidiary.

49 In that respect, it is settled case-law that any advantage resulting from the low taxation to which a subsidiary established in a Member State other than the one in which the parent company was incorporated is subject cannot by itself authorise that Member State to offset that advantage by less favourable tax treatment of the parent company (see, to that effect, Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 21; see also, by analogy, Case C-294/97 *Eurowings Luftverkehr* [1999] ECR I-7447, paragraph 44, and Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, paragraph 52). The need to prevent the reduction of tax revenue is not one of the grounds listed in Article 46(1) EC or a matter of overriding general interest which would justify a restriction on a freedom introduced by the Treaty (see, to that effect, Case C-136/00 *Danner* [2002] ECR I-8147, paragraph 56, and *Skandia and Ramstedt*, paragraph 53).

50 It is also apparent from case-law that the mere fact that a resident company establishes a secondary establishment, such as a subsidiary, in another Member State cannot set up a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty (see, to that effect, *ICI*, paragraph 26; Case C-478/98 *Commission* v *Belgium* [2000] ECR I-7587, paragraph 45; *X and Y*, paragraph 62; and Case C-334/02 *Commission* v *France* [2004] ECR I-2229, paragraph 27).

51 On the other hand, a national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at

circumventing the application of the legislation of the Member State concerned (see to that effect *ICI*, paragraph 26; Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779, paragraph 37; *De Lasteyrie du Saillant*, paragraph 50; and *Marks & Spencer*, paragraph 57).

52 It is necessary, in assessing the conduct of the taxable person, to take particular account of the objective pursued by the freedom of establishment (see, to that effect, *Centros*, paragraph 25, and *X and Y*, paragraph 42).

53 That objective is to allow a national of a Member State to set up a secondary establishment in another Member State to carry on his activities there and thus assist economic and social interpenetration within the Community in the sphere of activities as self-employed persons (see Case 2/74 *Reyners* [1974] ECR 631, paragraph 21). To that end, freedom of establishment is intended to allow a Community national to participate, on a stable and continuing basis, in the economic life of a Member State other than his State of origin and to profit therefrom (Case C-55/94 *Gebhard* [1995] ECR I-4165, paragraph 25).

54 Having regard to that objective of integration in the host Member State, the concept of establishment within the meaning of the Treaty provisions on freedom of establishment involves the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period (see Case C-221/89 *Factortame and Others* [1991] ECR I-3905, paragraph 20, and Case C-246/89 *Commission* v *United Kingdom* [1991] ECR I-4585, paragraph 21). Consequently, it presupposes actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there.

55 It follows that, in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory.

56 Like the practices referred to in paragraph 49 of *Marks & Spencer*, which involve arranging transfers of losses, within a group of companies, to companies established in the Member States which apply the highest rates of taxation and in which the tax value of those losses is therefore the highest, the type of conduct described in the preceding paragraph is such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to the activities carried out in their territory and thus to jeopardise a balanced allocation between Member States of the power to impose taxes (see *Marks & Spencer*, paragraph 46).

57 In the light of those considerations, it must be determined whether the restriction on freedom of establishment arising from the legislation on CFCs may be justified on the ground of prevention of wholly artificial arrangements and, if so, whether it is proportionate in relation to that objective.

58 That legislation covers situations in which a resident company has created a CFC which is subject, in the Member State in which it is established, to a level of taxation which is less than three quarters of the amount of tax which would have been paid in the United Kingdom if the profits of that CFC had been taxed in that Member State.

59 By providing for the inclusion of the profits of a CFC subject to very favourable tax regime in the tax base of the resident company, the legislation on CFCs makes it

possible to thwart practices which have no purpose other than to escape the tax normally due on the profits generated by activities carried on in national territory. As the French, Finnish and Swedish Governments stated, such legislation is therefore suitable to achieve the objective for which it was adopted.

60 It must further be determined whether that legislation goes beyond what is necessary to achieve that purpose.

61 The legislation on CFCs contains a number of exceptions where taxation of the resident company on the profits of CFCs does not apply. Some of those exceptions exempt the resident company in situations in which the existence of a wholly artificial arrangement solely for tax purposes appears to be excluded. Thus, the distribution by a CFC of almost the whole of its profits to a resident company reflects the absence of an intention by the latter to escape United Kingdom income tax. The performance by the CFC of trading activities excludes, for its part, the existence of an artificial arrangement which has no real economic link with the host Member State.

62 If none of those exceptions applies, the taxation provided for by the CFC legislation may not apply if the establishment and the activities of the CFC satisfy the motive test. That requires, essentially, that the resident company show, first, that the considerable reduction in United Kingdom tax resulting from the transactions routed between that company and the CFC was not the main purpose or one of the main purposes of those transactions and, secondly, that the achievement of a reduction in that tax by a diversion of profits within the meaning of that legislation was not the main reason, or one of the main reasons, for incorporating the CFC.

63 As stated by the applicants in the main proceedings and by the Belgian Government and the Commission, the fact that none of the exceptions provided for by the legislation on CFCs applies and that the intention to obtain tax relief prompted the incorporation of the CFC and the conclusion of the transactions between the latter and the resident company does not suffice to conclude that there is a wholly artificial arrangement intended solely to escape that tax.

64 In order to find that there is such an arrangement there must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment, as set out in paragraphs 54 and 55 of this judgment, has not been achieved (see, to that effect, Case C-110/99 *Emsland-Stärke* [2000] ECR I-11569, paragraphs 52 and 53, and Case C-255/02 *Halifax and Others* [2006] ECR I-1609, paragraphs 74 and 75).

65 In those circumstances, in order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality.

66 That incorporation must correspond with an actual establishment intended to carry on genuine economic activities in the host Member State, as is apparent from the case-law recalled in paragraphs 52 to 54 of this judgment.

67 As suggested by the United Kingdom Government and the Commission at the hearing, that finding must be based on objective factors which are ascertainable by

third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment.

68 If checking those factors leads to the finding that the CFC is a fictitious establishment not carrying out any genuine economic activity in the territory of the host Member State, the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement. That could be so in particular in the case of a 'letterbox' or 'front' subsidiary (see Case C-341/04 *Eurofood IFSC* [2006] ECR I-3813, paragraphs 34 and 35).

69 On the other hand, as pointed out by the Advocate General in point 103 of his Opinion, the fact that the activities which correspond to the profits of the CFC could just as well have been carried out by a company established in the territory of the Member State in which the resident company is established does not warrant the conclusion that there is a wholly artificial arrangement.

70 The resident company, which is best placed for that purpose, must be given an opportunity to produce evidence that the CFC is actually established and that its activities are genuine.

71 In the light of the evidence furnished by the resident company, the competent national authorities have the opportunity, for the purposes of obtaining the necessary information on the CFC's real situation, of resorting to the procedures for collaboration and exchange of information between national tax administrations introduced by legal instruments such as those referred to by Ireland in its written observations, namely Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States

in the field of direct taxation (OJ 1977 L 336, p. 15) and, in this case, the Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains of 2 June 1976.

72 In this case, it is for the national court to determine whether, as maintained by the United Kingdom Government, the motive test, as defined by the legislation on CFCs, lends itself to an interpretation which enables the taxation provided for by that legislation to be restricted to wholly artificial arrangements or whether, on the contrary, the criteria on which that test is based mean that, where none of the exceptions laid down by that legislation applies and the intention to obtain a reduction in United Kingdom tax is central to the reasons for incorporating the CFC, the resident parent company comes within the scope of application of that legislation, despite the absence of objective evidence such as to indicate the existence of an arrangement of that nature.

73 In the first case, the legislation on CFCs should be regarded as being compatible with Articles 43 EC and 48 EC.

74 In the second case, on the other hand, the view should be taken, as submitted by the applicants in the main proceedings, the Commission and, at the hearing, the Cypriot Government, that that legislation is contrary to Articles 43 EC and 48 EC.

75 In the light of the preceding considerations, the answer to the question referred must be that Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a CFC in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless

such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable. Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that CFC is actually established in the host Member State and carries on genuine economic activities there.

Costs

76 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a controlled foreign company in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable. Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that controlled company is actually established in the host Member State and carries on genuine economic activities there.

[Signatures]

Reports of Cases

JUDGMENT OF THE COURT (Grand Chamber)

25 October 2017*

(Reference for a preliminary ruling — Freedom of establishment — Cross-border conversion of a company — Transfer of its registered office without transfer of its real head office — Refusal to remove it from the commercial register — National legislation whereby removal from commercial register is dependent on the winding up of a company after a liquidation procedure — Scope of freedom of establishment — Restriction on freedom of establishment — Protection of the interests of creditors, minority shareholders and employees — Prevention of abusive practices)

In Case C-106/16,

REQUEST for a preliminary ruling under Article 267 TFEU from the Sąd Najwyższy (Supreme Court, Poland), made by decision of 22 October 2015, received at the Court on 22 February 2016, in the proceedings brought by

Polbud — Wykonawstwo sp. z o.o., in liquidation,

THE COURT (Grand Chamber),

composed of K. Lenaerts, President, A. Tizzano, Vice-President, T. von Danwitz, J. L. da Cruz Vilaça, A. Rosas, J. Malenovský and E. Levits, Presidents of Chambers, E. Juhász, A. Borg Barthet, D. Šváby M. Berger, K. Jürimäe (Rapporteur) and M. Vilaras, Judges,

Advocate General : J. Kokott,

Registrar: K. Malacek, Administrator,

having regard to the written procedure and further to the hearing on 6 March 2017,

after considering the observations submitted on behalf of:

– Polbud — Wykonawstwo sp. z o.o., by A. Gorzka-Augustynowicz, radca prawny,

– the Polish Government, by B. Majczyna, acting as Agent,

– the German Government, by T. Henze and M. Hellmann, acting as Agents,

– the Austrian Government, by C. Pesendorfer and B. Trefil, acting as Agents,

– the Portuguese Government, by L. Inez Fernandes, M. Figueiredo and F. de Figueiroa Quelhas, acting as Agents,

– the European Commission, by W. Mölls, L. Malferrari and J. Hottiaux, acting as Agents,

* Language of the case: Polish.

after hearing the Opinion of the Advocate General at the sitting on 4 May 2017,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Articles 49 and 54 TFEU.

2 The request has been made in the context of an action brought by Polbud — Wykonawstwo sp. z o.o. ('Polbud') against the decision to refuse its request that it be removed from the Polish commercial register, made following the transfer of its registered office to Luxembourg.

Polish law

The Companies Code

3 Article 270 of the Kodeks spółek handlowych (the Companies Code), of 15 September 2000, as amended (Dz. U. 2013, No 1030) ('the Companies Code'), provides:

'A company shall be wound up:

…

(2) pursuant to a shareholders' resolution to wind up the company or to transfer the company's registered office abroad, that resolution being confirmed by minutes drawn up by a notary;

…'

4 Article 272 of the Companies Code states:

'A company shall be wound up, after being liquidated, by being removed from the register.'

5 Article 288 of that code provides:

'§ 1. Upon approval by a shareholders' meeting of the financial statement as at the date preceding the distribution among the shareholders of assets remaining after satisfying or securing the creditors (liquidation statement) and upon completion of liquidation, the liquidators shall lodge the liquidation statement at the company's registered office and file it with the registry court together with an application for removal of the company from the register.

…

§ 3. The books and documents of the wound-up company shall be deposited with the person indicated in the articles of association or shareholders' decision. In the absence of such indication, the depositary shall be appointed by the registry court.

…'

6 Articles 551 to 568 of the Companies Code concern the conversion of a company. Article 562(1) of that code provides:

'The conversion of a company or partnership shall require a decision taken, in the case of a partnership, by the partners, and, in the case of a capital company, by a shareholders' meeting or general meeting …'.

The Law on private international law

7 Article 19(1) of the Ustawa — Prawo prywatne międzynarodowe (Law on Private International Law) of 4 February 2011 (Dz. U. No 80, position 432), states:

'Upon transfer of its head office to another State, a legal person shall be subject to the law of that State. The legal personality acquired in the State where it previously had its head office shall be retained, if the law of each of the States concerned so provides. Transfer of the head office within the European Economic Area shall not lead to the loss of legal personality.'

The dispute in the main proceedings and the questions referred for a preliminary ruling

8 Polbud is a limited company established in Łąck (Poland). By a resolution of 30 September 2011, an extraordinary general meeting of shareholders of that company decided, under Article 270, point 2, of the Companies Code, to transfer the registered office of that company to Luxembourg. According to the request for a preliminary ruling, that resolution made no reference to a transfer of either the place where Polbud's business is managed or the place where that company's business is actually carried out.

9 On the basis of that resolution, on 19 October 2011 Polbud lodged a request that the opening of a liquidation procedure be recorded by the court responsible for keeping the commercial register ('the registry court'). On 26 October 2011 the opening of the liquidation procedure was recorded in that register and the liquidator was appointed.

10 On 28 May 2013 the meeting of shareholders of Consoil Geotechnik Sàrl, whose registered office is in Luxembourg, adopted a resolution which, inter alia, implemented the resolution of 30 September 2011 and transferred the registered office of Polbud to Luxembourg, with a view to the application of Luxembourg law to it, without loss of its legal personality. According to the resolution of 28 May 2013, the transfer was to take effect on that date. On 28 May 2013, therefore, Polbud's registered office was transferred to Luxembourg and that company was no longer named 'Polbud' but became 'Consoil Geotechnik'.

11 On 24 June 2013, Polbud lodged an application at the registry court for its removal from the Polish commercial register. The reason stated for that application was the transfer of the company's registered office to Luxembourg. For the purposes of the removal procedure, by decision of 21 August 2013, Polbud was asked to produce (i) the resolution of the general meeting of shareholders containing the indication of the name of the depositary of the books and documents of the undertaking being wound up, (ii) the financial accounts relating to the periods from 1 January to 29 September 2011, 30 September to 31 December 2011, 1 January to 31 December 2012, and 1 January to 28 May 2013, signed by the liquidator and by the person responsible for keeping the accounts, and (iii) the resolution of the general meeting of shareholders approving the report on the process of liquidation.

12 Polbud stated that it did not see any need to produce those documents since it was not being wound up, its assets had not been distributed to the shareholders and the application for removal from the register had been lodged because of the transfer of the company's registered office to Luxembourg,

where it was continuing its existence as a company incorporated under Luxembourg law. In those circumstances, by decision of 19 September 2013 the registry court refused the application for removal on the ground that the abovementioned documents had not been submitted.

13 Polbud brought an action against that decision before the Sąd Rejonowy w Bydgoszczy (District Court of Bydgoszcz, Poland), which dismissed the action. The company brought an appeal against that dismissal before the Sąd Okręgowy w Bydgoszczy (Regional Court of Bydgoszcz, Poland), which dismissed the appeal by order of 4 June 2014. Polbud then brought an appeal on a point of law before the referring court.

14 Before that court, Polbud claims that, when its registered office was transferred to Luxembourg, it had lost its status as a company incorporated under Polish law and had become a company incorporated under Luxembourg law. Consequently, according to Polbud, the liquidation procedure should have been closed and its name should have been removed from the commercial register in Poland. In addition, Polbud states that compliance with the requirements of the liquidation procedure laid down under Polish law was neither necessary nor possible, since it had not lost its legal personality.

15 The referring court, for its part, states, first, that a liquidation procedure is focused on the end of a company's legal existence and implies certain obligations in that regard. In this case, however, the company is continuing its legal existence as a legal person under the law of a Member State other than the Republic of Poland. The referring court asks whether, therefore, the imposition on that company of obligations comparable to those required to bring its legal existence, as a company, to an end do not improperly restrict its freedom of establishment. Further, that court seeks to ascertain whether the fact of the company's reconstitution, based solely on the decision of shareholders to maintain the legal personality it had acquired in the Member State of origin, and of its being registered in the commercial register of the host Member State pursuant to that decision, can be relied upon against the Member State of origin, in spite of the ongoing liquidation procedure in the latter State.

16 Second, the referring court states that, while, as a general rule, a Member State may not refuse to recognise legal personality acquired in another Member State and may not undertake an assessment of the correctness of the measures adopted by the authorities of that Member State, removal from the former commercial register is a matter for the law of the Member State of origin, which must ensure that the interests of creditors, minority shareholders and employees are protected in the liquidation procedure. That court considers, consequently, that the registry court ought not to abandon that procedure.

17 Third, the referring court states that, according to the Court's case-law, it is, as a general rule, permissible to check whether an undertaking intends to establish a lasting economic connection with the host Member State and, for that purpose, to transfer its registered office, understood as meaning its place of actual management and the place where it carries on its business. It is unclear, however, whether it is the host Member State or the Member State of origin that should undertake that check.

18 In those circumstances, the Sąd Najwyższy (Supreme Court, Poland), decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) Do Articles 49 and 54 TFEU preclude the application, by the Member State in which a (private limited liability) company was initially incorporated, of provisions of national law which make removal from the commercial register conditional on that company being wound up after liquidation has been carried out, if that company has been reincorporated in another Member State pursuant to a shareholders' decision to continue the legal personality acquired in the State of initial incorporation?

If the answer to that question is in the negative:

(2) Can Articles 49 and 54 TFEU be interpreted as meaning that the requirement under national law that a process of liquidation of a company be carried out — including the conclusion of current business, recovery of debts, performance of obligations and sale of company assets, satisfaction or securing of creditors, submission of a financial statement on the conduct of that process, and indication of the person to whom the books and documents are to be entrusted — which precedes the winding-up of the company, that occurs on removal from the commercial register, is a measure which is appropriate, necessary and proportionate to a public interest deserving of protection that consists in the safeguarding of the interests of creditors, minority shareholders, and employees of the migrant company?

(3) Must Articles 49 and 54 TFEU be interpreted as meaning that restrictions on freedom of establishment cover a situation in which — for the purpose of its conversion to a company of another Member State — a company transfers its registered office to that other Member State without changing its main head office, which remains in the State of initial incorporation?'

The request to have the oral procedure reopened

19 By document lodged at the Registry of the Court on 28 June 2017, Polbud asked the Court to order the reopening of the oral part of the procedure, under Article 83 of the Court's Rules of Procedure.

20 In support of its request, Polbud claims, in essence, first, that, contrary to what is stated in the request for a preliminary ruling, its intention was to transfer to Luxembourg both its registered office and its real head office, as confirmed by the resolution of 28 May 2013. Second, Polbud states that the Opinion presented by the Advocate General, although the reservations expressed by Polbud at the hearing are noted therein, is nonetheless based on an erroneous finding of fact contained in that request. Consequently, Polbud considers that it is necessary to reopen the oral stage of the procedure so that it can clarify the facts of the main proceedings.

21 Pursuant to Article 83 of its Rules of Procedure, the Court may at any time, after hearing the Advocate General, order the reopening of the oral part of the procedure, in particular if it considers that it lacks sufficient information or where a party has, after the close of that part of the procedure, submitted a new fact which is of such a nature as to have a decisive bearing on the decision of the Court, or where the case must be decided on the basis of an argument which has not been debated between the parties or the interested persons referred to in Article 23 of the Statute of the Court of Justice of the European Union.

22 That is not the situation here. Polbud set out, at the hearing, its assessment of the facts at issue. In particular, Polbud had the opportunity to state its view of the presentation of the facts of the main proceedings as set out in the request for a preliminary ruling, and to explain that its intention was to transfer to Luxembourg both its registered office and its real head office. Accordingly, the Court considers, after hearing the Advocate General, that it has before it all the information necessary to give judgment.

23 Furthermore, as regards the criticisms made of the Advocate General's Opinion, it must be borne in mind, first, that the Statute of the Court of Justice of the European Union and the Rules of Procedure of the Court make no provision for interested parties to submit observations in response to the Advocate General's Opinion (judgment of 4 September 2014, *Vnuk*, C-162/13, EU:C:2014:2146, paragraph 30 and the case-law cited)..

24 Second, under the second paragraph of Article 252 TFEU, it is the duty of the Advocate General, acting with complete impartiality and independence, to make, in open court, reasoned submissions on cases which, in accordance with the Statute of the Court of Justice of the European Union, require the Advocate General's involvement. In this regard, the Court is not bound either by the Opinion delivered by the Advocate General or by the reasoning which led to that Opinion. As a consequence, the fact that a party disagrees with the Advocate General's Opinion, irrespective of the questions examined in the Opinion, cannot in itself constitute grounds justifying the reopening of the oral procedure (judgment of 4 September 2014, *Vnuk*, C-162/13, EU:C:2014:2146, paragraph 31 and the case-law cited).

25 In the light of the foregoing, the Court considers that there is no need to reopen the oral part of the procedure.

Consideration of the questions referred

Preliminary observations

26 At the outset, it must be observed that the questions referred for a preliminary ruling are based on the premiss, which Polbud disputes, that Polbud did not intend to transfer its real head office to Luxembourg.

27 In that regard, it should be observed that, according to settled case-law of the Court of Justice, Article 267 TFEU establishes a procedure for direct cooperation between the Court and the courts of the Member States. In that procedure, which is based on a clear separation of functions between the national courts and the Court, any assessment of the facts of the case is a matter for the national court, which must determine, in the light of the particular circumstances of the case, both the need for a preliminary ruling in order to enable it to deliver judgment and the relevance of the questions which it submits to the Court, whilst the Court is empowered to give rulings on the interpretation or the validity of an EU provision only on the basis of the facts which the national court puts before it (see, inter alia, judgment of 16 June 2015, *Gauweiler and Others*, C-62/14, EU:C:2015:400, paragraph 15).

28 Consequently, the questions referred must be answered on the basis of that premiss, the accuracy of which it is, however, for the referring court to check.

The third question

29 By its third question, which it is appropriate to examine first, the referring court seeks, in essence, to ascertain whether Articles 49 and 54 TFEU must be interpreted as meaning that freedom of establishment is applicable to the transfer of the registered office of a company incorporated under the law of one Member State to the territory of another Member State, with a view to that company being converted to a company under the law of that other Member State, when there is no change of location of the real head office of that company.

30 The Polish and Austrian governments submit that Articles 49 and 54 TFEU are not applicable to a company transfer such as that at issue in the main proceedings. According to the Austrian government, freedom of establishment cannot be relied on when the reason for the transfer of the registered office is not the pursuit of an actual business by means of a permanent establishment in the host Member State. The Polish Government relies, inter alia, on the judgments of 27 September 1988, *Daily Mail and General Trust* (81/87, EU:C:1988:456), and of 16 December 2008, *Cartesio* (C-210/06, EU:C:2008:723), in support of its conclusion that a transfer of a company such as that at issue in the main proceedings does not fall within the scope of Articles 49 and 54 TFEU.

31 That argument cannot be accepted.

32 It must be observed that Article 49 TFEU, read in conjunction with Article 54 TFEU, extends the benefit of freedom of establishment to companies or firms formed in accordance with the legislation of a Member State and having their registered office, their central administration or principal place of business within the European Union. Accordingly, a company such as Polbud, which was formed in accordance with the legislation of a Member State, in this case, with Polish legislation, may, in principle, rely on that freedom.

33 Under the second paragraph of Article 49 TFEU, read in conjunction with Article 54 TFEU, the freedom of establishment for companies or firms covered by the latter article includes, inter alia, the right to set up and manage such companies or firms under the conditions laid down, by the legislation of the Member State where such establishment is effected, for its own companies or firms. Freedom of establishment therefore encompasses the right of a company or firm formed in accordance with the legislation of a Member State to convert itself into a company or firm governed by the law another Member State (see, to that effect, judgment of 27 September 1988, *Daily Mail and General Trust*, 81/87, EU:C:1988:456, paragraph 17), provided that the conditions laid down by the legislation of that other Member State are satisfied and, in particular, that the test adopted by the latter State to determine the connection of a company or firm to its national legal order is satisfied.

34 In that regard, it must be recalled that, in the absence of harmonisation of EU law, the definition of the connecting factor that determines the national law applicable to a company or firm falls, in accordance with Article 54 TFEU, within the powers of each Member State, that article having placed on the same footing the registered office, the central administration and the principal place of business of a company or firm as such connecting factors (see, to that effect, judgment of 27 September 1988, *Daily Mail and General Trust*, 81/87, EU:C:1988:456, paragraphs 19 to 21).

35 It follows, in this case, that freedom of establishment confers on Polbud, a company incorporated under Polish law, the right to convert itself into a company incorporated under Luxembourg law, provided that the conditions laid down by Luxembourg legislation are satisfied and, in particular, that the test adopted by Luxembourg to determine the connection of a company or firm to its national legal order is satisfied.

36 That conclusion is not called into question by the arguments made by the Polish and Austrian governments.

37 First, the argument of the Austrian government that no business is actually being conducted by Polbud in the host Member State cannot be accepted.

38 The Court has held that freedom of establishment extends to a situation in which a company formed in accordance with the legislation of one Member State, where it has its registered office, wants to set up a branch in another Member State, even where that company was formed, in the first Member State, solely for the purpose of establishing itself in the second, where its main, or indeed entire, business is to be conducted (see, to that effect, judgment of 9 March 1999, *Centros*, C-212/97, EU:C:1999:126, paragraph 17). Equally, a situation in which a company formed in accordance with the legislation of one Member State wants to convert itself into a company under the law of another Member State, with due regard to the test applied by the second Member State in order to determine the connection of a company to its national legal order, falls within the scope of freedom of establishment, even though that company conducts its main, if not entire, business in the first Member State.

39 It must be recalled that the question of the applicability of Articles 49 and 54 TFEU is different from the question of whether a Member State may adopt measures in order to prevent attempts by certain of its nationals to evade domestic legislation, given that, in accordance with settled case-law, it is open

to a Member State to adopt such measures (judgments of 9 March 1999, *Centros*, C-212/97, EU:C:1999:126, paragraphs 18 and 24, and of 30 September 2003, *Inspire Art*, C-167/01, EU:C:2003:512, paragraph 98)

40 However, it must be observed that, as the Court has previously held, the fact that either the registered office or real head office of a company was established in accordance with the legislation of a Member State for the purpose of enjoying the benefit of more favourable legislation does not, in itself, constitute abuse (see, to that effect, judgments of 9 March 1999, *Centros*, C-212/97, EU:C:1999:126, paragraph 27, and of 30 September 2003, *Inspire Art*, C-167/01, EU:C:2003:512, paragraph 96).

41 It follows that, in the main proceedings, the fact that it was decided to transfer to Luxembourg the registered office alone of Polbud, that transfer not affecting the real head office of that company, cannot, in itself, mean that such a transfer does not fall within the scope of Articles 49 and 54 TFEU.

42 Second, as regards the judgments of 27 September 1988, *Daily Mail and General Trust* (81/87, EU:C:1988:456), and of 16 December 2008, *Cartesio* (C-210/06, EU:C:2008:723), it does not follow, contrary to the submissions of the Polish Government, that the transfer of the registered office of a company should necessarily be accompanied by the transfer of its real head office in order to fall within the scope of freedom of establishment.

43 On the contrary, it follows from those judgments, and from the judgment of 12 July 2012, *VALE* (C-378/10, EU:C:2012:440), that, as EU law currently stands, each Member State has the power to define the connecting factor required of a company if that company is to be regarded as incorporated in accordance with its national legislation. In the event that a company governed by the law of one Member State converts itself into a company under the law of another Member State while satisfying the conditions imposed by the legislation of the latter if it is to exist within its legal order, that power, far from implying that the legislation of the Member State of origin on the incorporation or winding-up of companies enjoys any immunity from the rules relating to freedom of establishment, cannot provide justification for that Member State preventing or deterring the company concerned from undertaking a cross-border conversion by means of, in particular, the imposition, with respect to such a cross-border conversion, of conditions that are more restrictive than those that apply to the conversion of a company within that Member State itself (see, to that effect, judgments of 27 September 1988, *Daily Mail and General Trust*, 81/87, EU:C:1988:456, paragraphs 19 to 21; of 16 December 2008, *Cartesio*, C-210/06, EU:C:2008:723, paragraphs 109 to 112; and of 12 July 2012, *VALE*, C-378/10, EU:C:2012:440, paragraph 32).

44 In the light of the foregoing, the answer to the third question is that Articles 49 and 54 TFEU must be interpreted as meaning that freedom of establishment is applicable to the transfer of the registered office of a company formed in accordance with the law of one Member State to the territory of another Member State, for the purposes of its conversion, in accordance with the conditions imposed by the legislation of the other Member State, into a company incorporated under the law of the latter Member State, when there is no change in the location of the real head office of that company.

The first and second questions

45 By its first and second questions, which can be examined together, the referring court seeks, in essence, to ascertain whether Articles 49 and 54 TFEU must be interpreted as precluding legislation of a Member State which provides that the transfer of the registered office of a company incorporated under the law of one Member State to the territory of another Member State, with a view to its conversion into a company under the law of the latter Member State, in accordance with the conditions imposed by the legislation of the latter Member State, is subject to the liquidation of the former company.

Whether there is a restriction on freedom of establishment

46 Article 49 TFEU requires the abolition of restrictions on freedom of establishment. It is settled case-law that all measures which prohibit, impede or render less attractive the exercise of freedom of establishment must be considered to be restrictions on that freedom (judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraph 36 and the case-law cited).

47 In this case, it is apparent from the request for a preliminary ruling that the transfer of the registered office of a company incorporated under Polish law to a Member State other than the Republic of Poland does not entail, in accordance with Article 19(1) of the Law on private international law, the loss of legal personality. As stated by the Advocate General in point 46 of her Opinion, Polish law accordingly recognises, in this case, that Polbud's legal personality may, in principle, be continued by Consoil Geotechnik.

48 Nonetheless, under Article 270, point 2, of the Companies Code and Article 272 of that code, a resolution of the shareholders on the transfer of the registered office to a Member State other than the Republic of Poland, adopted pursuant to Article 562(1) of that code, entails the winding-up of the company on the conclusion of a liquidation procedure. In addition, the effect of Article 288(1) of that code is that, if it is not liquidated, a company that wishes to transfer its registered office to another Member State other than the Republic of Poland cannot be removed from the commercial register.

49 Accordingly, although it may in principle transfer its registered office to a Member State other than the Republic of Poland without the loss of its legal personality, a company incorporated under Polish law, such as Polbud, that wishes to make such a transfer, can obtain the removal of its name from the Polish commercial register only if it has been liquidated.

50 It must, in that regard, be made clear that, according to the request for a preliminary ruling, the process of liquidation extends to the completion of current business, recovery of debts owed to the company, performance of its obligations and sale of its assets, satisfaction or securing of its creditors, submission of a financial statement on the conduct of that process and indication of where the books and documents of the company in liquidation are to be deposited.

51 In those circumstances, the Court must hold that the national legislation at issue in the main proceedings, by requiring the liquidation of the company, is liable to impede, if not prevent, the cross-border conversion of a company. It therefore constitutes a restriction on freedom of establishment (see, to that effect, judgment of 16 December 2008 *Cartesio*, C-210/06, EU:C:2008:723, paragraphs 112 and 113).

Whether the restriction on freedom of establishment is justified

52 According to the Court's settled case-law, such a restriction on freedom of establishment is permissible only if it is justified by overriding reasons in the public interest. It is further necessary that it should be appropriate for ensuring the attainment of the objective in question and not go beyond what is necessary to attain that objective (judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraph 42 and the case-law cited).

53 First, the referring court considers that the restriction on freedom of establishment is justified, in this case, by the objective of protecting the interests of creditors, minority shareholders and employees of the company transferred.

54 In that regard, it must be recalled that the Court has recognised that overriding reasons in the public interest include the protection of the interests of creditors and minority shareholders (see, to that effect, judgment of 13 December 2005, *SEVIC Systems*, C-411/03, EU:C:2005:762, paragraph 28 and the case-law cited). The same is true of the protection of workers (see, to that effect, judgment of 21 December 2016, *AGET Iraklis*, C-201/15, EU:C:2016:972, paragraph 73 and the case-law cited).

55 Accordingly, Articles 49 and 54 TFEU do not, in principle, preclude measures of a Member State intended to ensure that the interests of creditors, minority shareholders and employees of a company, that has been incorporated under the law of that Member State and is to continue to carry on business in the national territory, are not improperly affected by the transfer of the registered office of that company and its conversion into a company under the law of another Member State.

56 However, in accordance with the settled case-law cited in paragraph 52 of the present judgment, it must also be determined whether the restriction at issue in the main proceedings is appropriate for securing the attainment of the objective of protecting the interests of creditors, minority shareholders and employees and does not go beyond what is necessary to achieve that objective.

57 In this case, the Polish legislation requires the mandatory liquidation of a company that wishes to transfer its registered office to a Member State other than the Republic of Poland.

58 It must be observed that that legislation prescribes, in general, mandatory liquidation, there being no consideration of the actual risk of detriment to the interests of creditors, minority shareholders and employees and no possibility of choosing less restrictive measures capable of protecting those interests. As regards, in particular, the interests of creditors, as stated by the European Commission, the provision of bank guarantees or other equivalent guarantees could offer adequate protection of those interests.

59 It follows that the mandatory liquidation required by the national legislation at issue in the main proceedings goes beyond what is necessary to achieve the objective of protecting the interests referred to in paragraph 56 of the present judgment.

60 Second, the Polish Government relies on the objective of preventing abusive practices in order to justify the national legislation at issue in the main proceedings.

61 In that regard, it is open to the Member States to adopt any appropriate measure for preventing or penalising fraud (judgment of 9 March 1999, *Centros*, C-212/97, EU:C:1999:126, paragraph 38).

62 However, in accordance with the case-law cited in paragraph 40 of the present judgment, the fact that either the registered office or real head office of a company was established in accordance with the legislation of a Member State for the purpose of enjoying the benefit of more favourable legislation does not, in itself, constitute abuse.

63 Moreover, the mere fact that a company transfers its registered office from one Member State to another cannot be the basis for a general presumption of fraud and cannot justify a measure that adversely affects the exercise of a fundamental freedom guaranteed by the Treaty (see, by analogy, judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraph 84).

64 Since a general obligation to implement a liquidation procedure amounts to establishing a general presumption of the existence of abuse, the Court must hold that legislation, such as that at issue in the main proceedings, which imposes such an obligation, is disproportionate.

65 In the light of the foregoing, the answer to the first and second questions is that Articles 49 and 54 TFEU must be interpreted as precluding legislation of a Member State which provides that the transfer of the registered office of a company incorporated under the law of one Member State to the

territory of another Member State, for the purposes of its conversion into a company incorporated under the law of the latter Member State, in accordance with the conditions imposed by the legislation of that Member State, is subject to the liquidation of the first company.

Costs

66 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

1. **Articles 49 and 54 TFEU must be interpreted as meaning that freedom of establishment is applicable to the transfer of the registered office of a company formed in accordance with the law of one Member State to the territory of another Member State, for the purposes of its conversion, in accordance with the conditions imposed by the legislation of the other Member State, into a company incorporated under the law of the latter Member State, when there is no change in the location of the real head office of that company.**

2. **Articles 49 and 54 TFEU must be interpreted as precluding legislation of a Member State which provides that the transfer of the registered office of a company incorporated under the law of one Member State to the territory of another Member State, for the purposes of its conversion into a company incorporated under the law of the latter Member State, in accordance with the conditions imposed by the legislation of that Member State, is subject to the liquidation of the first company.**

[Signatures]

Subject European Company Law was supported by project: Jean Monnet Actions - GRANT AGREEMENT - Project 101176603 — EU Tax and Corporate Law

28TH REGIME

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1

Current challenges and obstacles

Funded by the European Union

01 A Competitiveness Compass for the EU

02 Startup & Scale-up Strategy (Choose Europe to Start and Scale)

03 Public consultation – 28th regime: needs of entrepreneurs

04 28th regime as an EU-wide legal framework for businesses

2

A Competitiveness Compass for the EU

Funded by the European Union

- **For more than two decades, Europe has lagged behind major economies due to persistent productivity gaps**
- EU trails the USA in technology; China has caught up in many sectors and leads in emerging growth areas
- Key issue: **lack of innovation**
- **Company formation and scaling are hindered by legal fragmentation, limited access to venture capital, and insufficient innovation support**

3

Startup & Scaleup Strategy (Choose Europe to Start and Scale)

Funded by the European Union

- **30% of European unicorns (valuations over €1 billion) relocate to the USA**
- Need for measures to remove barriers to founding and growing innovative companies
- Need for the 28th regime as an optional EU-level framework parallel to national laws
  - Provides standardised and simplified rules – lower costs, faster incorporation, reduced fragmentation
  - Enables company formation within 48 hours with fewer administrative barriers

4

Public Consultation – 28th Regime (Company Formation in the EU) I.

Funded by the European Union

- … the process of founding a company is **an embarrassment** ... and an **insult** to any motivated individual…
- … the fact that we have to pay a notary who then proceeds to read aloud the founding contract is like a scene from a **grotesque movie**…
- …the process of founding a company his has been the an **extremely bad experience**...
- … starting a business has been a **messy and frustrating experience**…
- … the founding process is **plagued by a lack of clarity and coordination** between different jurisdictions…

5

Public Consultation – 28th Regime (Company Formation in the EU) II.

Funded by the European Union

- **Bureaucracy and inefficiency**
  - Outdated and slow procedures
  - Long incorporation times
  - Low level of digitalisation, mandatory physical presence (before a notary)
- **High costs and criticism of the role of notaries in the incorporation process**
  - Mandatory notaries (especially criticised in Germany) – high incorporation costs, unnecessary acts (reading the founding documents aloud, language barriers)
  - Notary fees often exceed the cost of the incorporation itself
  - Founders consider their role outdated and unnecessary

6

Public Consultation – 28th Regime (Company Formation in the EU) III.

Funded by the European Union

1. **Market and regulatory fragmentation**
   - Significant differences between EU countries in incorporation procedures
2. **Competitive disadvantage of the EU**
   - Startups prefer to incorporate in the USA (Delaware) or relocate during scaling (flips) to access growth capital
3. **Banks require physical presence when opening business accounts**
   - AML/KYC requirements further complicate the incorporation process

7

Public Consultation – 28th Regime: Entrepreneurs' Requirements

Funded by the European Union

- Single European legal form (28th regime) valid across all Member States
- **Fully digital process, available in English, lasting max. 2–5 days**
- **Low costs** (a few hundred euros)
- Automatic recognition across the EU
- **Modern framework built from scratch** (not a patchwork of national forms)
- **Banks identified as new bottlenecks** for cross-border incorporation

8

Directive 2019/1151 – First Major Step in Digitalising Company Formation

Funded by the European Union

- **Online company formation** without physical presence for certain legal forms and branches
  - Electronic submission of documents and information to registers
- **Templates for founding documents** (though not for supporting documents)
- Transparency and trustworthiness
- **Stronger interconnection of business registers**
  - Fraud prevention and protection against misuse
  - Prevention of company hijacking and abuse of digital processes
- **Balance between digitalisation and legal certainty**
  - Member States could retain certain safeguards (e.g., notaries or legal experts) if they do not hinder online formation

9

Objectives of Directive 25/2025

Funded by the European Union

- **Secure and accurate identification of founders and statutory representatives**
  - Reliable and up-to-date register data
  - Enhanced interconnection of registers
  - Wider publication of company and branch information
  - Elimination of the need for translations and apostilles

- **Tools introduced**
  - EU Digital Power of Attorney
  - EU Company Certificate
  - Once-Only Principle
  - Preliminary Verification

10

EU Digital Power of Attorney

Funded by the European Union

- Based on a multilingual common EU template
- Companies may use it to authorise a person to represent them in cross-border procedures
- Template includes at minimum: scope of representation, authorised person, type of authority
- Digital power of attorney must comply with national legal requirements

11

EU Company Certificate

Funded by the European Union

- New standardised document issued by national registers
- Confirms a company's existence and core data
- Available in all official EU languages
- Issued digitally and automatically recognised in all Member States without further authentication or apostille
- Facilitates cross-border company and branch formation and verification of legal existence for banks, investors, authorities

12

Once-Only Principle

Funded by the European Union

- Especially relevant for cross-border subsidiaries and branches
- Companies will not need to repeatedly submit identical data to multiple authorities or in different Member States
- Data submitted once (e.g., to the register) will be shared across the EU via interconnected business registers
- Reduces duplication and administrative costs
- Persisting language barrier – some documents may still require translations, but not full official translations of entire founding documents

13

28th Regime – EU Legal Framework for Businesses

Funded by the European Union

- Simplification and cost reduction in incorporation and operation of companies, especially innovative and scaling firms
- Elimination of legal fragmentation in company formation and operation
- Easier access to investment; increased investor confidence via unified rules
- Definition of key elements of a cross-border EU company (legal type, abbreviation, minimum capital)
- Lessons from previous initiatives: SPE (2008), SUP (2015–2018)
- Also addressing labour, insolvency, and tax law aspects
- Instrument: regulation / directive (to be determined)

14


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28TH REGIME

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28th company law regime

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- European Commission's expected proposal for a European company law framework designed specifically for 'innovative' companies (start-ups and scale-ups)
- European Commission's Project Group on Startups and Scaleups – goal: creation of an EU company form that exists alongside national company forms (hence the term '28th regime').
- BUT: it has inevitable impact in areas beyond company law, for example on **labour law (**workers' rights to information, consultation and participation, collective bargaining and enforcement of individual workers' rights)

2

Main idea of the 28th company law regime

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- an EU-wide private limited liability form for 'innovative' companies targeting start-ups and scale-ups;
- no minimum capital requirement and a single founder/shareholder resident anywhere in the EU;
- a fully digital establishment process in any Member State;
- registration in a new EU-level online registry;
- once-only' registration to operate across the EU
- registration approval within only 24 hours

3

Innovative company

Funded by the European Union

- no shared EU-wide definition of a start-up, scale-up or 'innovative company
- in general:
  a. 'start-ups' = companies that have yet to achieve commercial maturity
  b. 'scale-ups' = proven business models growing rapidly in revenue and/or employment
- problem: in the absence of clear eligibility criteria or caps, large groups could exploit the 28th regime to bypass national labour and creditor protections

4

Minimum capital requirements

Funded by the European Union

- attractive for founders
- problem: empirical evidence - forms with no minimum capital attract less sustainable businesses

5

One-stop, overnight company registration

Funded by the European Union

- proposal of the establishment of a new, single EU company registry – main argument: the intervention of national certifying authorities is too cumbersome
- access controls and revocation of an entry in the EU registry would be strictly limited – main argument: acceleration of the registration process
- problem:
  - limitation of the legitimate control by stakeholders and authorities and weakening existing national-level anti-abuse checks
  - no possible control by company registries and notaries, including checks related to creditor protection, insolvency, tax and social security
  - heightening the risk of letterbox companies that enable forum shopping and social dumping

6

Main problems I.

Funded by the European Union

- EU company law seeks to provide the legal framework needed to enable the freedom of movement of capital and services across the Union

- BUT because company law intersects with other areas of law – such as labour law, social security and taxation – changes in company law must also take into account their implications for other stakeholders, especially **workers and their trade unions**
- the 28th company law regime proposal would effectively undermine existing stakeholder protections at national level by putting them in regulatory competition with more robust national-level company law forms

7

Main problems II.

Funded by the European Union

- tension between uniformity of company law standards versus the need for stakeholder protections
- urgent need for anti-abuse provisions to prohibit regime shopping, social dumping and the evasion of workers' rights
- losing information and consultation rights in start-ups and scale-ups - information and consultation rights should apply only after a high threshold is reached, such as a certain number of employees (for example, 500) or a particular level of revenue; board-level employee representation and voting rights are excluded

8

Recommendations according to *Marcus Meyer-Erdmann* and *Aline Hoffmann*

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- A new company law framework for 'innovative' companies must ensure:
  - precise, enforceable eligibility criteria to prevent abuses;
  - anti-abuse rules that block 'letterbox' setups and the exploitation of known loopholes;
  - dynamic worker participation safeguards that cannot be frozen or evaded;
  - guardrails for any Employee Stock Ownership Plans (ESOPs) to protect wages and revenues;
  - a registration process that preserves real scrutiny over speed: a one-stop digital portal can be built while maintaining necessary checks and in a realistic verification timeframe using existing instruments.

9

Sources

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- Marcus Meyer-Erdmann and Aline Hoffmann: How a 28th company law regime jeopardises workers' rights. In: ETUI Policy Brief 2025.05 | September, p. 1 -11.

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ETUI Policy Brief

European Economic, Employment and Social Policy

2025.05 | September

How a 28th company law regime jeopardises workers' rights

Marcus Meyer-Erdmann and Aline Hoffmann

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Policy recommendations

The European Commission is soon expected to propose a European company law framework designed specifically for 'innovative' companies. The evidence shows that the Achilles heel of a '28th company law regime' is its inevitable impact in areas beyond company law, for example on labour law, taxation, insolvency and social security.

A new company law framework for 'innovative' companies must ensure:

- precise, enforceable eligibility criteria to prevent abuses;
- anti-abuse rules that block 'letterbox' setups and the exploitation of known loopholes;
- dynamic worker participation safeguards that cannot be frozen or evaded;
- guardrails for any Employee Stock Ownership Plans (ESOPs) to protect wages and revenues;
- a registration process that preserves real scrutiny over speed: a one-stop digital portal can be built while maintaining necessary checks and in a realistic verification timeframe using existing instruments.

Fostering innovation in the EU is possible without eroding workers' rights or regulatory integrity if the relevant measures reflect lessons derived from existing instruments, develop new instruments and ensure robust cross-border enforcement.

etui.

Introduction

This Policy Brief seeks to inform the upcoming debate on the European Commission's expected proposal for a European company law framework for 'innovative' companies (that is, start-ups and scale-ups). Company law governs the creation, operation and dissolution of companies, including the rights and responsibilities of shareholders, directors and other stakeholders, such as its workers. EU company law seeks to provide the legal framework needed to enable the freedom of movement of capital and services across the Union, while providing safeguards to protect the interests of key stakeholders, such as investors, creditors or workers. But because company law intersects with other areas of law – such as labour law, social security and taxation – changes in company law must also take into account their implications for other stakeholders, especially workers and their trade unions.

As part of its Competitiveness Compass roadmap, the European Commission plans to propose a new '28th company law regime' as early as the last quarter of 2025. Emanating from the European Commission's Project Group on Startups and Scaleups, this would be a third attempt – after the failed European private company (*Societas Privata Europaea*: SPE, 2008) and the withdrawn single-member private limited liability company (*Societas Unius Personae*: SUP, 2014) – to create an EU company form that sits alongside national company forms: hence the term '28th regime'. Both earlier attempts were shelved in the face of significant opposition from Member States and societal stakeholders.

This third proposal for a 28th regime resurrects these earlier attempts but this time targets 'innovative' companies, an undefined category apparently covering 'start-ups' (companies that have yet to achieve commercial maturity) and 'scale-ups' (proven business models growing rapidly in revenue and/or employment).

The European Commission acknowledges that a 28th regime would necessarily go beyond company law, with implications for insolvency, taxation and labour law, to name but a few. Because company law anchors these adjacent areas of law and overlapping topics (for example, employee stock options and individual and collective labour law), changes in company law have direct and indirect impacts on existing stakeholder rights that need safeguarding. These include workers' rights to information, consultation and participation, collective bargaining and (enforcement of) individual workers' rights, as well as creditor and shareholder protections. The proposal has accordingly set alarm bells ringing across Europe.

This Policy Brief explores what is known so far about the proposed 28th regime, draws lessons from the SPE/SUP failures and experience with the 2001 Statute for a European Company (*Societas Europaea*: SE), and assesses implications for substantive labour rights, while identifying solutions already in place or forthcoming.

Why is this proposal coming now?

Although Europe hosts approximately as many start-ups as the United States, the European Commission argues that fragmented company laws across the EU hamper the commercialisation of start-ups by, for example, limiting access to funding (venture capital) and research and development (R&D) clusters. The Commission's 'EU Startup and Scaleup Strategy' of May 2025 rightly identifies digitalisation, improving the ecosystem (R&D clusters, compute clusters) and funding opportunities for start-ups and scale-ups as measures to be pursued.

But the 28th company law regime proposal would effectively undermine existing stakeholder protections at national level by putting them in regulatory competition with more robust national-level company law forms.

It also remains unclear which firms qualify as 'innovative' — and when a start-up ceases to be one — raising the risk of abuses by existing companies and groups seeking to circumvent applicable rules, as seen for over 20 years with the SE. What is the justification for treating these companies — and their workers — differently from 'normal' companies?

Recent EU measures already advance the company law harmonisation agenda: the 2019 Directives on cross-border company mobility (2019/2121) and digitalisation of company law (2019/1151 and 2025/25) have accelerated mobility since the 2001 SE framework (2157/2001 and 2001/86) and the 2005 Cross-Border Mergers Directive (2005/56). This begs the question of whether a separate 28th regime is needed, especially given threats to stakeholder protections.

The failed attempts of the SPE and SUP yield important lessons on the pitfalls of legislative initiatives on pan-European company forms. They will be briefly revisited below. The existing framework on SEs and SCEs (*Societas Cooperativa Europaea*: SCE) provides important lessons, particularly on the use of these company forms in practice and empirical evidence concerning stakeholder protections in SEs and SCEs.

The failed attempts of the SPE and SUP

In 2008 the Commission proposed the European Private Company (*Societas Privata Europaea*: SPE) as part of its 'Small Business Act for Europe' to create a simple, EU-wide private-company form for small and medium-sized enterprises (SMEs), eliminating the need to reincorporate in each Member State and reducing administrative burdens. This goal is largely unchanged in the current proposal for the 28th regime. The European Parliament and trade unions sought stronger worker participation guarantees and a genuine cross-border component to employee participation. Critics warned that the absence of a cap on size or revenue for SPEs raised the risk that large corporations might abuse the SPE to sidestep national labour and creditor protections. Facing persistent opposition, the European Commission formally withdrew the SPE in 2014 under its regulatory fitness and performance programme (REFIT) review.

Shortly thereafter, the European Commission proposed the single-member private limited liability company (*Societas Unius Personae*: SUP): key features included online incorporation via standard template, €1 minimum capital, and

a carve-out approach harmonising only limited aspects while leaving most company law to Member States.

In 2015, the European Parliament's Employment and Social Affairs Committee urged rejection of the proposal. Its Opinion, adopted by a two-thirds majority, cited the SUP's potential to undercut labour standards, weaken creditor safeguards and spur forum-shopping for lax regimes. Some national parliaments also objected on subsidiarity grounds. The Council's compromise removed the separation of registered seat from principal place of business, but concerns over inadequate stakeholder safeguards persisted. The European Commission withdrew the SUP proposal in 2018.

Third time a charm?

The EU-Inc proposal as blueprint

A decade on, the European Commission has now embarked on a very similar exercise: key aspects of the 28th company law regime put forward as part of its Competitiveness Compass are unchanged compared with the ill-fated SPE/SUP proposals. It is therefore worth examining the arguments put forward in the debates around all three proposals together.

While many details are still unknown, it is clear from the broader discussions that a proposal put forward by 'EU-Inc.org' (2025), a lobbying initiative by start-ups and venture capital firms, has served as the blueprint for the Commission's 28th regime proposal. EU-Inc submitted their proposal directly to Commissioners Michael McGrath (responsible for Democracy, Justice, the Rule of Law and Consumer Protection) and Ekaterina Zaharieva (in charge of Startups, Research and Innovation), in February 2025 and have stated that they are in regular contact with the European Commission's Project Group on Startups and Scaleups.

EU-Inc's core ideas shape the discussions around the 28th company law regime. These include: (i) an EU-wide private limited liability form for 'innovative' companies targeting start-ups and scale-ups; (ii) no minimum capital requirement and a single founder/shareholder resident anywhere in the EU; (iii) a fully digital establishment process in any Member State; (iv) registration in a new EU-level online registry; (v) 'once-only' registration to operate across the EU; and (vi) registration approval within only 24 hours.

What's an innovative company?

The Commission's 'EU Startup and Scaleup Strategy' acknowledges that there is no shared EU-wide definition of a start-up, scale-up or 'innovative company'. Both the SPE and the SUP were ultimately undone by the lack of clarity about what companies would be targeted and this remains unresolved in the new proposal. Even though the SPE was designed for SMEs, there were no defined limits on company size or turnover.

In the absence of clear eligibility criteria or caps (repeating the SUP/SPE mistakes), large groups could exploit the 28th regime to bypass national labour and creditor protections. Minimum capital requirements also matter: in the context of the previous SUP debate, Teichmann (2016) already pointed to

empirical evidence that suggests that forms with no minimum capital attract less sustainable businesses, risking reputational harm to the 'EU' label.

One-stop, overnight company registration?

Incorporation involves more than issuing a birth certificate: it is crucial for ensuring compliance with legal and regulatory requirements protecting the business and its stakeholders, including its workers. Arguing that the intervention of national certifying authorities is too cumbersome, EU-Inc proposes the establishment of a new, single EU company registry. To further accelerate the registration process, access controls and revocation of an entry in the EU registry would be strictly limited, strongly curtailing legitimate scrutiny by stakeholders and authorities and undermining existing national-level anti-abuse checks.

But online registration is already enabled by the Digitalisation of Company Law Directives 1 (2019/1151) and 2 (2025/25). A one-stop digital portal could easily build on these existing provisions, without starting from scratch and introducing a new EU company form.

Under the initial SUP proposal, incorporation would be carried out within three days, but under pressure from Member States this was later increased to eight days to ensure adequate verification of information on both the company and its founder to protect stakeholders' interests. The EU-Inc proposal reduces this to 'under 24 hours'. It is understandable that registration should be easy, digital and 'once only', but no justification is provided regarding why it needs to be achieved overnight, thereby rendering the normal due diligence by company registries and notaries, including checks related to creditor protection, insolvency, tax and social security, virtually impossible. This heightens the risk of letterbox companies that enable forum shopping and social dumping.

Balancing company mobility with effective regulation

Attempts to enable company mobility across the EU have long been shaped by the dilemma of determining which laws apply to a company and the applicable rules concerning stakeholder protections: those of the state in which it is registered, or the laws of the place of economic activity? The SUP's envisaged split-seat approach drew criticism from some Member States as offering the opportunity to easily circumvent national rules on employee participation and other obligations. For example, an SUP formally registered in Ireland, but whose entire workforce was employed in Germany, would nonetheless not have been subject to German board-level employee representation.

While European Court of Justice case law (*Centros, Überseering, Inspire Art* and *Polbud*) has shown the need to balance freedom of establishment with the need for legal certainty, subsidiarity and regulatory effectiveness, the latest Company Law Package (2019/2121) and its anti-abuse clauses go some way towards balancing company law against stakeholder protections. The 28th regime would face the same unresolved tension between uniformity of company law standards versus the need for stakeholder protections and the urgent need for anti-abuse provisions to prohibit regime shopping, social dumping and the

evasion of workers' rights. Possible mismatches would be even more apparent in the case of small start-ups or rapidly growing scale-ups.

Losing information and consultation rights in start-ups and scale-ups?

Unsurprisingly perhaps, EU-Inc.org takes a dim view of worker participation. Seeking to ensure that employee information and consultation rights do not 'place an undue burden on companies moving in a fast-paced environment', EU-Inc proposes that information and consultation rights would apply only after a high threshold is reached, such as a certain number of employees (for example, 500) or a particular level of revenue. It should be noted that EU-Inc's proposed thresholds are far higher than existing information and consultation thresholds at national level, for instance in Austria and Germany (5), Luxembourg (15), Finland (20), France and the Netherlands (50), to name but a few. Furthermore, the framework Directive for informing and consulting employees (2002/14/EC) sets the general threshold at 20 or 50 employees.

Clearly, the European social model and the EU *acquis* foresee information and consultation rights even for employees in small companies. For EU-Inc, however, companies below the 500 employee threshold would engage with their workforce only 'informally, through newsletters, town halls, and occasional surveys, without the need for formal consultation'.

It is also noteworthy that board-level employee representation and voting rights are excluded from the EU-Inc. proposal, in favour of information and consultation in companies above a certain size or revenue threshold. As the EU-Inc coalition of entrepreneurs and investors put it, they seek to foster 'a culture of cooperation between employers and employees, based on mutual agreement rather than legal obligation'. This would directly undermine existing rules on board-level employee representation and those applicable to cross-border company transactions pursuant to Directive 2019/2121 or SE/SCE-formations, which specifically safeguard board-level employee representation.

The absence of organised structures at the incorporation of these companies could also have ripple effects on trade union recognition, representation and collective bargaining.

Worker participation rights for sale?

If EU-Inc's proposal would deprive workers of their rights to information and consultation rights and board-level employee representation just because they work for a start-up or scale-up, then perhaps the idea is to compensate them with Employee Stock Ownership Plans (ESOPs).

Seeking to address the lack of easily available venture capital in the EU, EU-Inc proposes a new pre-issuance investment instrument for outside investors; employees would also 'participate' in the company through share options issued to them by the company alongside their wages. As acknowledged by the Commission in its staff working document on the start-up and scale-up strategy, ESOPs carry risks to workers and public finances. Such stock options would not be taxable at issuance by the country of employment. Indeed, the stock options

would not be worth anything until they are sold, at which point they would be subject to (much lower) capital gains taxes. This would lead to significant losses in terms of income taxes and social security contributions for EU Member States compared with existing national company forms.

Financial participation schemes carry risks for employees (Pendleton 2019). The EU-Inc start-up ESOP would shift significant entrepreneurial risks onto workers in the context of a markedly higher start-up failure rate compared with 'regular' companies. A recent study found that less than half of start-ups survived the first five years (43 per cent; SMV Danmark 2023). In fact, in some sectors and countries, the failure rate is up to 90 per cent, with 10 per cent of start-ups not surviving the first year. EU-wide figures from the Commission/Eurostat show a one in five failure rate in the first year and a five-year failure rate overall of 55 per cent (Eurostat 2025).

Given that ESOPs are tied to a company's performance and share value, workers risk losing significant earnings. A particular danger arises where share ownership schemes make up a considerable portion of an employee's long-term savings. Company bankruptcy can wipe out employees' pensions. Finally, it is very difficult to ensure that ESOPs are not, in effect, calculated against collectively bargained wages or bonuses.

20 years of the European Company (SE): a lesson in circumvention?

The existing voluntarist SE regime and its uniform EU-wide core rules emerged from the search for a genuinely supranational corporate law regime that began in the 1970s. This culminated in the 2001 compromise, which paved the way for the first 'European company' form, in particular by leaving key aspects of workers' participation to negotiations between company-level social partners. As the main European company form, which has been in place for over two decades, the SE is a crucial point of reference in the current discussions on the 28th company law regime.

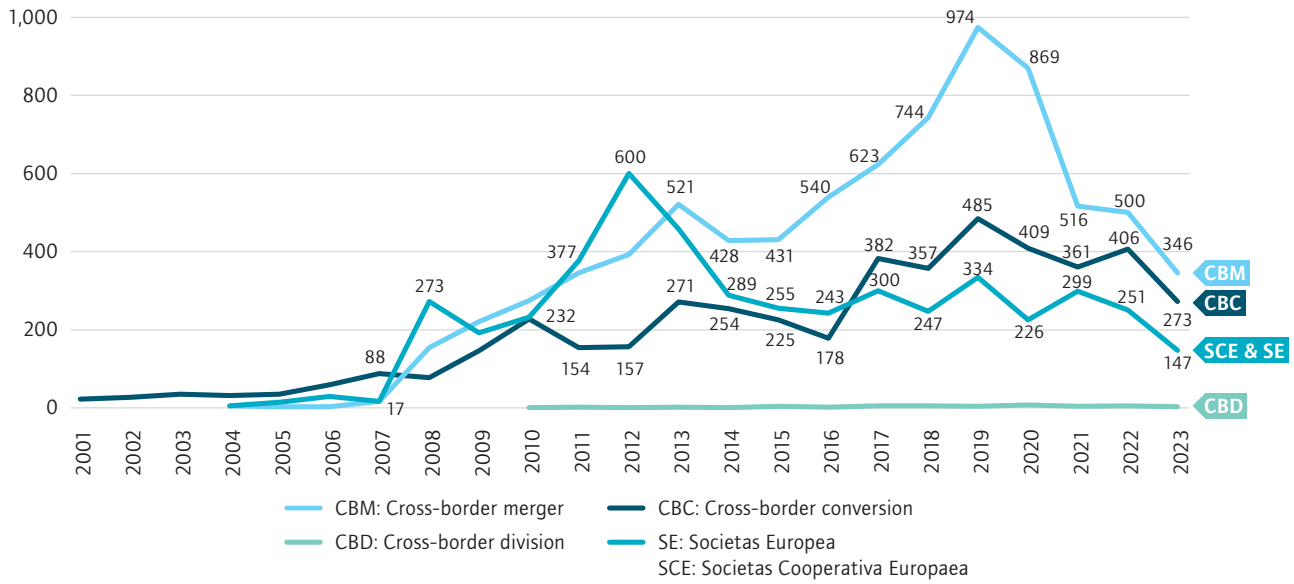
SEs have not driven cross-border company mobility in over a decade

Since the adoption of the SE Regulation and the accompanying SE Directive in 2001, the number of SEs/SCEs formed has increased every year, peaking at 600 new SEs created in 2012 alone (see Figure 1). The steadily declining trend in SE/SCE formations per year correlates with the introduction of the EU cross-border company mobility framework, which has covered mergers since 2008, as well as demergers and cross-border conversions/seat transfers since 2023. While the number of SE establishments has fallen significantly since 2012, cross-border mergers and conversions have continued to trend upwards overall.

As a result of this new possibility to move a company's seat across borders without establishing an SE, one of the main drivers of SE creation has disappeared. However, this has also exposed another key driver of SE creation. National board-level employee participation mechanisms and information and

consultation rights have been systematically circumvented through the use of the SE framework.

Figure 1 **Cross-border transactions and SE/SCE creations over time***



Note: * The ETUI-Erasmus University Cross-Border Company Mobility project tracks all cross-border company mobility and SE/SCE formations in the EU since 2001.

Source: ETUI-Erasmus University Cross-Border Company Mobility project (2025).

Shelf SEs are the key vehicle for circumventing the Directive's safeguards

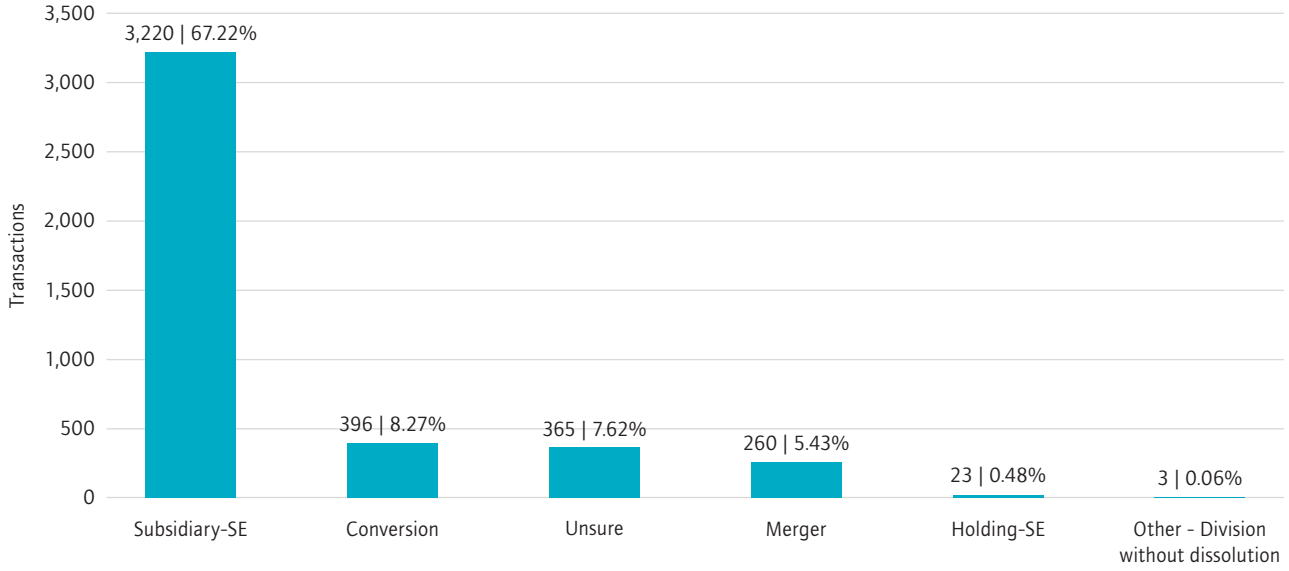
Fully two-thirds of all SEs have been set up as subsidiary SEs (see Figure 2). With very few exceptions, these can also be called 'shelf SEs', because they are empty company shells designed to be purchased 'off the shelf' and simply activated to be used as genuine EU companies under a new name rather than setting up a new company from scratch.

In this way, the shelf SE serves as a vehicle, but without requiring a cross-border element. The creation of shelf SEs through incubator SEs is particularly prevalent in the Czech Republic, Germany and Slovakia. At their peak in 2012, shelf SEs constituted nearly 90 per cent of all SE establishments and still account for the bulk of them in any given year.

How shelf SEs freeze out workers' rights

The so-called 'before-and-after principle' underpinning the SE Directive was intended to safeguard existing rights by ensuring that any board-level participation rights enjoyed 'before' the creation of the SE could be retained 'after' it. This principle was further accompanied by an agreement negotiated between employee representatives and management in a Special Negotiation Body (SNB).

Figure 2 **SE creations by type (aggregated)**



Note: * Subsidiary SEs are created by incubator SEs as 'shelf SEs' for later activation. Some data on SE creations prior to 2017 are unavailable (n.a. = 523, total N = 4790).

Source: ETUI-Erasmus University Cross-Border Company Mobility project (2025).

These safeguards are effective only at the moment of the SE's creation, however. The status quo of workers' participation at that moment is frozen indefinitely, with no trigger for future negotiations, even if an SE grows to exceed employee participation thresholds under national law.

This is the crippling weakness of the SE framework: by activating an empty shelf SE or converting an existing company just below the relevant national employee thresholds (for example, 25 employees in Swedish companies, 35 in Denmark, 100 in the Netherlands, 150 in Finland, 300 in Austria and 500/2000 in Germany), employee participation can be circumvented altogether. A particularly stark example is the proportion of companies with parity codetermined supervisory boards in Germany (that is, boards of companies with more than 2,000 employees, in which employee representatives hold half the seats) which fell from 68 per cent in 2019 to 61 per cent in 2022 (Sick 2024). Three-quarters of known cases of circumvention in Germany are based on structures that are facilitated by European company law. A striking statistic illustrates how systematic the circumvention is: five out of six SEs with over 2,000 domestic employees in Germany lack the parity codetermination they would have under German law (Sick 2024). The most recent *Olympus* judgment (2024) of the CJEU further aggravates this by concluding that the exclusion of renegotiation in the case of an SE without employee representatives is lawful in the case of the creation of a holding SE.

Furthermore, SE Works Councils and cross-border information and consultation rights can be circumvented by the same mechanism. Because they have no employees, empty shelf SEs are not required to establish an SNB to create an SE Works Council. SNBs were established only in companies that already had employees (and had usually set up a European Works Council under Directive 2009/38 EC and its predecessors), but it is extremely rare for

negotiations to be initiated after the activation of a shelf SE. This explains why, out of the total population of 4,900 SE creations, only 247 SE Works Councils have been identified.

There are over 3,220 shelf SEs across Europe, almost literally sitting on shelves waiting for another company to be subsumed under them, thereby shedding any previously existing employee participation obligations.

Returning to the envisaged 28th regime, 25 years of experience with SEs has shown that EU company forms are used systematically to circumvent national employee participation regimes. While the before-and-after principle initially seemed to provide a sufficient safeguard for existing employees' rights, combining it with freezing the status quo at the moment of creating the SE – or holding SE (see Olympus) – creates loopholes that allow companies to circumvent national stakeholder protections. This loophole is the main driver of SE creations in practice. Evidence suggests that cross-border mergers, divisions and conversions also provide ample opportunity to circumvent worker participation rights.

As was the case with the SPE and the SUP, nothing in the 28th regime proposals known so far addresses these well-documented loopholes. On the contrary, aside from current proposals that seek to exclude worker participation rights altogether (EU-Inc), what is known about the 28th regime risks making these loopholes even bigger by opening up new opportunities to weaken or circumvent workers' rights.

Conclusions and outlook

The impact of a new company framework would necessarily extend beyond company law, requiring safeguards for stakeholder rights in the areas of insolvency, taxation and labour law, among other things. Based on the evidence from the SPE/SUP debates and over two decades of SE/SCE practice, a future 28th company law regime risks repeating known pitfalls: vague eligibility criteria inviting regulatory arbitrage, the absence of worker participation safeguards (especially via shelf entities and 'freezing' effects), and insufficient space for due diligence if registration is rushed. A further concern is the facilitation of letterbox companies, which undercut labour, tax and social security obligations, incentivising forum shopping and social dumping.

Given existing tools on digitalisation and cross-border mobility, a new EU company form is not strictly necessary. If pursued, it must be narrowly scoped, enforceable across borders, and designed to safeguard stakeholder protections. Furthermore, the upcoming evaluation of the 2019 Company Mobility Package will surely yield important lessons.

Over the coming legislative cycle, the credibility of any 28th regime will turn on five tests: (i) precise, enforceable eligibility for 'innovative' firms; (ii) anti-abuse rules that block letterbox setups and shelf company gambits; (iii) dynamic worker participation safeguards that cannot be frozen or evaded, which could be achieved with the proposed horizontal framework Directive on information, consultation and participation; (iv) strong guarantees for the protection of collective bargaining rights; and (v) a company registration

process that preserves real scrutiny over speed. If early drafts fail these tests, EU policymakers can expect significant resistance from within Member States and trade unions; targeted improvements are possible without eroding workers' rights or regulatory integrity if they build on lessons derived from existing Directives, developing new instruments and ensuring robust cross-border enforcement.

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