

# Cross-Border Conversions in the EU: The EU Commission Proposal

by

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*In April 2018, the EU Commission presented a Proposal of Directive -amending Directive 2017/1132- on cross-border conversions, mergers and divisions ("The Proposal"). The Proposal lays down common rules and procedures at the EU level on how a company can move from a Member State to another Member State, merge or divide into two or more new companies across borders. This paper addresses this Proposal focusing mainly on the rules on cross-border conversions. After a brief introduction, Section 2 describes the background of the Proposal and analyses some general questions. Sections 3 through 6 examine the different phases in which a cross-border conversion is structured, with particular attention to the safeguards laid down by the Proposal aimed at the protection of minority shareholders, creditors and employees. Finally, Sections 7 and 8 provide a general assessment of the text and a series of conclusions.*

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ECFR 2019, 15–43

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## 1. Introduction

In April 2018, the EU Commission presented a Proposal of Directive -amending Directive 2017/1132- on cross-border conversions, mergers and divisions (“The Proposal”).<sup>1</sup> The Proposal lays down common rules and procedures at the EU level on how a company can move from a Member State to another Member State, merge or divide into two or more new companies across bor-

1 Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions, COM (2018) 241 final. For a preliminary analysis of this legislative proposal, see *Paul Davies/Susan Emmenegger/Eilís Ferran/Guido Ferrarini/Klaus J. Hopt/Niamh Moloney/Adam Opalski/Alain Pietrancosta/Markus Roth/Rolf Skog/Martin Winner/Jaap Winter/Eddy Wymeersch*, “The Commission’s 2018 Proposal on Cross-Border Mobility – An Assessment”, *ECFR* 2019, 197 (in this issue), as well retrievable here: <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3257846](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3257846)> last visited: January, 2019; *Juana Pulgar*, “El traslado del domicilio social: protección de socios y acreedores”, 309 *Revista de Derecho Mercantil* (online version) (2018), 13 *et seq.*; *Mónica Fuentes*, “El Company law package”, 53 *Revista de Derecho de Sociedades* (2018), 315, 316–331; *Segismundo Álvarez Royo-Villanova*, “La propuesta de la Comisión sobre fusiones, escisiones y transformaciones transfronterizas: un paso adelante y otro atrás”, 9223 *La Ley* (online version) (2018), *passim*; *Thomas Biermeyer/Marcus Meyer*, “European Commission Proposal on Corporate Mobility and Digitalization: Between Enabling (Cross-Border Corporate) Freedom and Fighting the ‘Bad Guy’”, 15(4) *European Company Law* (2018), 110, *passim*; and, in advance of its publication, *Id.*, “Chaos days and tragedy in EU legislation making on cross-border corporate mobility?”, 25(1) *Maastricht Journal of European and Comparative Law* (2018), 3, *passim*.

ders.<sup>2</sup> Other company structural modifications, such as global transfers of assets and liabilities, triangular mergers or divisions in which a company transfers assets and liabilities to existing companies, are not included in the new instrument (see Recital 38).<sup>3</sup> This text was accompanied by a parallel proposal –also amending Directive 2017/1132– establishing new rules regarding the use of digital tools and processes in company law, in particular promoting the creation of companies online.<sup>4</sup>

This paper addresses the first of these two proposals and focuses mainly on the rules on cross-border conversions. Following this brief introduction, Section 2 describes the background of the Proposal and analyses some general questions. Sections 3 through 6 examine the different phases in which a cross-border conversion is structured: (i) preparation and disclosure of the documentation, (ii) approval, (iii) issue of the pre-conversion certificate and (iv) registration in the destination Member State. Particular attention will be paid to the safeguards laid down by the Proposal aimed at the protection of minority shareholders, creditors and employees.<sup>5</sup> Finally, Sections 7 and 8 provide a general assessment of the text and a series of conclusions.

2 Since 2005, cross-border mergers of capital companies have been regulated at a European level through Directive 2005/56/EC of the European Parliament and of the Council of 26 October, currently recast in chapter 2 of Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law. However, there is no equivalent EU legislation for cross-border divisions or conversions. The first attempt to regulate the latter operations was the Proposal for a 14th Company Law Directive on Transfer of Seat, enacted in 1997 (Document No XV/D2/6002/97-EN REV.2). In 2007, after several initiatives aiming to establish a common legal framework for cross-border conversions, the Commission abruptly ceased this work. Through the Resolution of 2 February 2012 (2011/2046(INI)), the European Parliament once again urged the Commission to adopt measures to facilitate these operations. The idea of a legislative proposal was later on included in the 2012 Action Plan (COM(2012) 740 final), in the framework of which the Commission conducted a series of tasks that have led to the present Proposal for Directive.

3 See also *Davies/Emmenegger et al.* (fn. 1), 201. In Spain, these other operations are currently regulated by the Law 3/2009, of April 3, 2009, on Structural Modifications of Commercial Companies (herein after “LME”).

4 Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law, COM(2018) 239 final.

5 In the footnotes we provide references to the Spanish regime under the LME and compare it with the Proposal’s regime.

## 2. General Questions

### 2.1. Background

The Proposal is framed within the freedom of establishment guaranteed by Article 49 TFEU and the ECJ case law interpreting this provision.<sup>6</sup> According to this case law, Article 49 TFEU encompasses the right of a company incorporated in Member State A to convert itself into a company of Member State B, without losing its legal personality, provided that the conditions laid down by B's law are met, including, as the case may be, the location of the real seat within its territory.<sup>7</sup> Cross-border conversions (and cross-border mergers and

6 Up until the *Polbud* case, ECJ jurisprudence regarding freedom of establishment and its effects on Company Law could be summed up in four fundamental ideas, the first two relating to the incorporation of companies, and the second two to transfers of the registered office and/or the real seat. (i) In the EU, in the absence of a common conflict rule, each Member State decides which connection criterion (the registered office or the real seat) shall determine the application of its own law as well as all other conditions for the valid incorporation of a company under its legal system (ECJ, 27 September 1988, *Daily Mail*, C-81/87, ECLI:EU:C:1988:456; ECJ, 5 November 2002, *Überseering*, C-208/00, ECLI:EU:C:2002:632; ECJ, 16 December 2008, *Cartesio*, C-210/06, ECLI:EU:C:2008:723; ECJ, 12 July 2012, *VALE Építési*, C-378/10, ECLI:EU:C:2012:440). (ii) However, once the company has been incorporated under the law of a Member State, the principle of mutual recognition will apply within the European Economic Area. Therefore, if the law under which the company was first incorporated does not condition such an incorporation to the location of the real seat in that State's territory, said company must be recognised as such even in the Member State in which it has its real seat (ECJ, 9 March 1999, *Centros*, C-212/97, ECLI:EU:C:1999:126; *Überseering*, C-208/00, *cit.*; ECJ, 30 September 2003, *Inspire Art*, C-167/01, ECLI:EU:C:2003:512). (iii) Transferring the real seat to another country without change of *lex societatis* is only possible in compliance with the law of the Member State in which the company was first incorporated. If that State has no objection to the transfer, it may take place, and the State receiving the real seat may not refuse to recognise the company as foreign entity (*Überseering*, C-208/00, *cit.*). (iv) Transferring the real seat to another country involving a change of *lex societatis* is supported by the freedom of establishment. This freedom guarantees that a company incorporated under the law of one Member State may be 're-incorporated' under the law of another Member State in compliance with the latter's requirements (*VALE Építési*, C-378/10, *cit.*). The variation still pending (and now solved by the *Polbud* case, *infra* in the text and in the following note) is what happens when a company incorporated under the law of one Member State wishes to convert to a company in another Member State (i.e. modifying its *lex societatis*), while maintaining its real seat in the first State. See Francisco Garcimartín, "De nuevo sobre el traslado de sede social al extranjero: comentario al caso Polbud", 41 La Ley Mercantil (online version) (2017), 1 *et seqq.*

7 See, recently, ECJ, 25 October 2017, *Polbud*, C-106/16, ECLI:EU:C:2017:804. This judgment of the ECJ, differing from the criterion of Advocate General Kokott, concluded that articles 49 and 54 TFEU are applicable when a company wishes to transfer its registered office from one Member State to another, effectively converting to a company

divisions) are guaranteed by the freedom of establishment enshrined in the TFEU and, consequently, any restriction to that freedom is subject to the proportionality test: it must be suitable for securing the attainment of the objective pursued, it must not go beyond what is necessary to attain that objective and it must not be possible to replace the corresponding restriction with other, less restrictive measures which attain the same result.<sup>8</sup> And we understand that the same proportionality should in principle apply to EU legislators.

In this sense, the Proposal complements the function of the ECJ as a “negative legislator”.<sup>9</sup> Even if cross-border conversions are guaranteed by the TFEU, the lack of rules governing these operations in several Member States and the divergences between the laws of the Member States that do have rules on cross-border conversions are significant obstacles to such conversions in practice.<sup>10</sup> The cross-border nature of these operations requires common rules and procedures that facilitate cross-border conversions within the EU, i.e., ensure the “connectivity” between legal systems.<sup>11</sup>

governed by the law of the destination State, even without an intent to exercise economic activities there (para. 33). For comments on this decision, see, in addition to *Garcimartín* (fn. 6), *Johan Meeusen*, “Freedom of establishment, conflict of laws and the transfer of a company’s registered office: towards full cross-border corporate mobility in the internal market?”, 13(2) *Journal of Private International Law* (2017), 294, *passim*; *Ariel Mucha/Krzysztof Oplustil*, “Redefining the Freedom of Establishment under EU Law as the Freedom to Choose the Applicable Company Law: A Discussion after the Judgment of the Court of Justice (Grand Chamber) of 25 October 2017 in Case C-106/16, *Polbud*”, 15(2) *ECFR* (2018), 270, *passim*; *Stephan Rammeloo*, “Cross-border company migration in the EU: Transfer of registered office (conversion) – the last piece of the puzzle?”, 25(1) *Maastricht Journal of European and Comparative Law* (2018), 87, *passim*; *Gitte Soegaard*, “Cross-border Transfer and Change of Lex Societatis After *Polbud*, C-106/16: Old Companies Do Not Die... They Simply Fade Away to Another Country”, 15(1) *European Company Law Journal* (2018), 21, *passim*; *Pulgar* (fn. 1), 9 *et seq.*; *Paula Del Val*, “El traslado internacional del domicilio sin cambio de sede real”, 52 *Revista de Derecho de Sociedades* (online version) (2018), *passim*.

- 8 This “proportionality test” (also known as the *Gebhard test*) was first laid down for the free movement of goods in ECJ, 20 February 1979, *Rewe-Zentral*, C-120/78, ECLI:EU:C:1979:42 and was then extended to the freedom of establishment in ECJ, 31 March 1993, *Kraus*, C-19/92, ECLI:EU:C:1993:125 and ECJ, 30 November 1995, *Gebhard*, C-55/94, ECLI:EU:C:1995:411.
- 9 For the limits to this ECJ function in the field of cross-borders re-incorporations, see *Carsten Gerner-Beuerle/Federico M. Mucciarelli/Edmund Schuster/Mathias Siems*, “Cross-border re-incorporations in the European Union: the case for comprehensive harmonization”, 18(1) *Journal of Corporate Law Studies* (2018), 1, 34–35.
- 10 See *European Commission*, “Study on the Law Applicable to Companies. Final Report”, June 2016, 215–220.
- 11 At present, there are several mechanisms that allow a company to change its “legal garment” within the EU. On the one hand, the *Societas Europaea* (SE) and the *Societas*

## 2.2. Common Approach

As noted above, the Proposal sets out harmonised rules for three types of company structural modifications: cross-border conversions, mergers and divisions. Furthermore, it takes the same approach to each one: the documents to be prepared and disclosed, the control by the competent authorities and the substantive rules aimed at protecting minority shareholders, creditors or employees are, *mutatis mutandi*, practically identical in all three cases. Perhaps the only significant difference is the absence of a specific rule on abuse of right in the case of cross-border mergers (*infra* 4.5).

For cross-border mergers and divisions, the substantive rules the Proposal sets out are, however, extremely questionable. A cross-border conversion always implies a change of *lex societatis*, i.e. a change of the company's legal structure, for all stakeholders: members or shareholders of the company, creditors and employees.<sup>12</sup> But in the case of a cross-border merger or division, there may be stakeholders for which there is no change of *lex societatis*. In the case of a merger by acquisition, for example, there is no change of *lex societatis* as regards the acquiring company and its stakeholders. And the same may hold true in a partial division as regards the company being divided in relation to the members that do not become members of the new company or liabilities that are not transferred. In these cases, there is a change of the company's economic structure, but not in its legal structure; consequently, it is not at all clear that the same measures of protection should apply as in a cross-border conversion.<sup>13</sup> Should, for example, those members in relation to which there is no change of *lex societatis* have withdrawal or exit rights (*infra* 4.2)? Such rights may be extremely costly for the company and therefore may frustrate the success of the

Cooperativa Europaea (SCE) may transfer their registered office to another Member State, thus changing their *lex societatis*, without the need for winding-up or the creation of a new company (see Art. 8 Council Regulation (EC) No 157/2001 of 8 October 2001 and Art. 7 Council Regulation (EC) No 435/2003 of 22 July 2003). The problem is that, in both cases, the transfer of the registered office must be accompanied by a transfer of the real seat. Another way to accomplish this is by reverse cross-border merger, with a new company set up in the destination Member State. In fact, this is the mechanism used by US companies for re-incorporation in a different State to that in which they were originally incorporated. This procedure, however, may be more cumbersome than a direct cross-border conversion (see *infra* note 22 and the accompanying text).

12 Here, we are using the words “members” and “shareholders” indistinctly, aware that this is not technically correct, as the Proposal applies to different kinds of limited liability companies.

13 See also *Davies/Emmenegger et al.* (fn. 1), 208.

operation. It therefore makes sense to question whether this regime satisfies the proportionality test.<sup>14</sup>

### 2.3. Cross-border Conversions: Concept and Scope

Cross-border conversions<sup>15</sup> are defined as operations whereby a company, without being dissolved, 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 a company of a destination Member State and transfers at least its registered office into the destination Member State whilst retaining its legal personality (Art. 86b of the Proposal). There are two key elements in this definition: first, the maintenance of the legal personality, which is repeatedly expressed both in a negative and in a positive form (“without being dissolved, wound up or going into liquidation” and “retaining its legal personality”).<sup>16</sup> A cross-border conversion entails a change of *lex societatis* without the company losing its legal personality (see Recital 8). And second, that a cross-border conversion is triggered by a transfer of the registered office. To be incorporated under the national law of a Member State, the company has to locate its registered office in that State. Thus, a cross-border conversion presupposes a transfer of the registered office, whereas a transfer of the real seat is not a condition, unless required by the law of the destination Member State (see Recital 2).<sup>17</sup>

14 The Presidency compromise has echoed this concern and amended the approach. It now gives a different treatment for the stakeholders in the company the *lex societatis* of which does not change (see Arts. 126a (1) and 160l(1)).

15 These transactions are also known as “cross-border transformation” or “cross-border transfer of the statutory seat or registered office”. The latter is in fact the expression used by the Spanish Law on Structural Modifications of Commercial Companies which refers to “international transfer of the registered office” (Arts. 92 *et seqq.* LME).

16 In fact, the terms “dissolution”, “liquidation” and “loss of legal personality” are not synonymous, at least insofar as Spanish law is concerned: should any of the causes of dissolution established by law (Art. 363 Corporate Enterprises Act, herein after “LSC”) concur, the company will enter the liquidation stage, in which assets are sold and liabilities are satisfied (Arts. 371 *et seqq.* LSC); according to the predominant view, the disappearance of legal personality occurs only later, after the complete liquidation of all social assets. On these issues, see *Aurora Martínez Flórez/Andrés Recalde*, Los efectos de la cancelación registral en relación con la extinción de las sociedades de capital, in: *Javier García de Enterría* (ed.), *Liber Amicorum Juan Luis Iglesias*, 2014, p. 689, *passim*.

17 In our opinion, this is the only interpretation of the Proposal that is in compliance with the doctrine in the *Polbud* case (see *supra* note 7). We therefore understand that in no case should the anti-abuse clause be used to prevent a change of *lex societatis* effected without a transfer of the real seat, on the grounds that such a situation may be *per se* an “artificial arrangement”. Whatever the meaning of this clause (see *infra* 4.5), it is clear that an artificial arrangement “must, indeed, be aimed at obtaining undue tax advantages

The harmonised framework set out by the Proposal only applies to limited liability companies (included in Annex II of Directive 2017/1132) that carry out an intra-EU cross-border conversion. Extra-EU inbound or outbound conversions are governed by national law. This may lead to paradoxical results in some Member States, where an extra-EU cross-border conversion may be less cumbersome than an intra-EU conversion. Thus, for example, under Spanish Law a company incorporated in Spain may transfer its registered office to a third-country and re-incorporate there without any examination about whether such operation constitutes “*an artificial arrangement aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members*” (Art. 86c(3)) (*infra* 4.5).<sup>18</sup>

#### 2.4. General Conditions

Article 86c of the Proposal lays down two general conditions and a clarification about the scope of the respective applicable laws (the law of the departure Member State and destination Member State). The first condition is controversial from a policy perspective. The Proposal establishes that an EU company is not entitled to carry out a cross-border conversion, merger or division if it is subject to preventive restructuring proceedings because of the likelihood of insolvency or preventive measures to avoid the initiation of those proceedings (Art. 86c(2) (b) and (e)).<sup>19</sup> This prohibition is particularly debatable as regards cross-border mergers and divisions. One effective tool to restructure a company, which is subject to pre-insolvency restructuring proceedings, is to carry out a partial division or a merger. In general terms, changes of legal structure, such as conversions, mergers, divisions and global or partial transfers of assets and liabilities may offer a solution to re-balance the economic situation of a firm. And this holds true irrespective of whether the change of legal structure

or at prejudicing stakeholder interests” (see *Davies/Emmenegger et al.* (fn. 1), 203; see also, *Blanca Vilà/Rafael Arenas/Jorge Miquel/Carlos Górriz/José Antonio Fernández Amor/Xavier Solà/Miguel Gardeñes*, “Comments on the Proposal for a Directive amending Directive (EU) 2017/1132 as regards Cross-Border Conversions, Mergers and Divisions, COM (2018) 241 final”, document released on Monday 10 September 2018, 4 (<<http://blogs.uab.cat/litigacioint11/2018/09/07/some-comments-on-the-commissions-proposal-of-april-2018-on-cross-border-conversions-mergers-and-divisions/comments-on-the-proposal-on-cross-border-conversions-mergers-and-divisions-uab-professors-2/>> last visited: January 2019).

18 Note that the Presidency compromise has changed the approach as regards the “artificial arrangement control” (see *infra* fn. 23).

19 Spanish law only bans the performance of this operation to companies in liquidation or undergoing formal insolvency proceedings (Art. 93(2) LME).



is domestic or cross-border. Thus, instead of an absolute prohibition to carry out those operations, it would have been preferable either to give flexibility to Member States to decide (see Art. 87(3) Directive 2017/1132) or simply allow those operations even if the company is subject to restructuring proceedings but meets the conditions that the rules governing these proceedings may additionally require, e.g., the intervention of an insolvency practitioner. In fact, such an absolute prohibition would probably not satisfy the proportionality test since it does not seem to be the “less restrictive measure that attains the same result”.<sup>20</sup>

The second general condition refers to the “artificial arrangement control”. The Proposal ensures a detailed scrutiny of the legality of the operation by the competent authority in the departure Member State and in the destination Member State. Each authority controls a part of the operation (Art. 86c(4)). The former verifies the part of the procedure that is governed by the law of the departure Member State; in particular: the draft-terms of the cross-border conversion, the reports to the members and employees, the independent expert’s report, the approval of the conversion and the protection of members, creditors and employees, and the issue of the pre-conversion certificate. The authority of the destination Member State controls the part of the procedure governed by the law of the destination Member State; in particular that the proposed converted company complies with the provision of its national law on the incorporation of companies.

The control of abusive behaviours is initially allocated to the authorities of the departure Member State. According to Article 86c(3) of the Proposal, this authority shall not authorise the cross-border conversion where it determines, after an examination of the specific case and having regard to all relevant facts and circumstances, that it constitutes an “artificial arrangement” aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members (see also Art. 86g requiring the independent expert to include in its report all factual elements necessary for the competent authority to carry out the artificial arrangement control).

The legitimacy of this control is debateable and, again, it will probably not satisfy the proportionality test. The Proposal contains a detailed list of specific safeguards aimed at protecting employees, creditors (public and private) and minority members. If all these safeguards are met, there is no legitimate reason to add a further *ex ante* condition requiring the competent authority to verify that the operation does not unduly prejudice those parties. Even if the abuse of

20 The Presidency compromise has also changed the approach on this issue. It now gives the option to Member States not to apply the Directive to companies subject to preventive restructuring proceedings (see Art. 86c(2a)).

law is a general clause in EU law, it would be preferable to keep it as an *ex post* safeguard, i.e. to be apply when an unsatisfied stakeholder challenges the transaction. Furthermore, the practical application of this provision may be extremely cumbersome when the competent authority is not a court, e.g. when it is a public notary or a register.<sup>21</sup> Fortunately, even if this element survives the legislative process, it will likely not have any practical impact. And if it does, it can easily be avoided by carrying out a reverse cross-border merger with a new company set up in the destination Member State, instead of a cross-border conversion (note that in the case of a cross-border merger, there is no artificial arrangement control).<sup>22, 23</sup>

### 2.5. Phases

To analyse the regime applicable to cross-border conversions, it is important to look at each of the four phases of the process as laid out, in order, in the Proposal: (i) the elaboration and disclosure of the preparatory documents; (ii) the approval of the conversion; (iii) the issue of the pre-conversion certificate; and (iv) the registration in the destination Member State.

### 3. First Phase: Documentation

The Proposal requires four main documents. The management or the administrative organ of the company must draw up (i) the draft terms of the cross-border conversion,<sup>24</sup> and two reports, (ii) one for the members of the company

21 As may be the case in Spain; see *Pulgar* (fn. 1), 24.

22 See *Davies/Emmenegger et al.* (fn. 1), 205. On reverse cross-border mergers, see *Erik Werlauff*, “Relocating a Company within the EU”, *European Company Law* 5 (2008), 136, 138. On its disadvantages versus cross-border conversions, see *EU Commission*, “Commission Staff Working Document. Impact Assessment on the Directive on the Cross-Border Transfer of Registered Office”, SEC(2007) 1707 Part I, 39; *Jessica Schmidt*, “Cross-border mergers and divisions, transfers of seat: Is there a need to legislate?”, Study for the JURI committee (Legal Affairs) of the European Parliament (2016), 32–33 (<[http://www.europarl.europa.eu/RegData/etudes/STUD/2016/556960/IPOL\\_STU\(2016\)556960\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2016/556960/IPOL_STU(2016)556960_EN.pdf)> last visited: January 2019).

23 The Presidency compromise has removed this “artificial arrangement control” and it now refers the question to Member States. According to article 86m(8), Member States may provide that the competent authority shall refuse to issue a pre-conversion certificate, if the conversion is set up for abusive or fraudulent purposes.

24 Under Spanish law, the plan must be signed by all administrators, and include a report stating the absence of any signature and the reason for its absence (Art. 95.1). This requirement leads us to conclude that drafting the plan is the exclusive competence of the

and (iii) another for its employees, explaining the legal and economic implications of the cross-border conversion; (iv) it also requires a report by an independent expert, and lays down certain rules dealing with the disclosure of the required documents.<sup>25</sup>

The draft terms of the cross-border conversion must contain the most relevant information about the operation. The Proposal sets out the minimum scope of the information to be provided by such draft terms, for example, the change of company form, the legal form, name and registered office proposed for the converted company, the protection offered to minority shareholders, creditors and employees, and the relevant date for accounting purposes (Art. 86d).<sup>26</sup> In addition to the languages of the departure and destination Member States, the draft terms may be drawn up in English (“a language customary in the sphere of international business and finance”).<sup>27</sup>

The management or administrative organ of the company must also prepare a report to the members that explains and justifies the legal and economic aspects of the cross-border conversion, and in particular its implications for members (Art. 86e). This report must be available not less than *two months* before the general meeting that will vote on the conversion,<sup>28</sup> and will also be disclosed to

administrative organ and, consequently, that it may not be delegated (see *Manuel M. Sánchez Álvarez*, *Traslado a España de sociedad extranjera. Traslado al extranjero de sociedad española. Proyecto de traslado. Informe de los administradores. Depósito del proyecto*, in: Fernando Rodríguez Artigas/Alberto Alonso Ureba/Luis Fernández de la Gándara/Luis A. Velasco San Pedro/Jesús Quijano/Gaudencio Esteban/Rodríguez Artigas (ed.), *Modificaciones estructurales de las sociedades mercantiles*, 2, 2009, p. 51, 77–78). The Proposal does not contain such a requirement, but it seems beyond doubt that it is a non-delegable competence.

- 25 Spanish law requires administrators to prepare only two documents: the draft terms of the cross-border conversion (Art. 95.1 LME) and a single report explaining and giving details of the legal and financial rationale for the transfer plan, and of the consequences for members, creditors and employees (Art. 96 LME). The LME does not require the intervention of an independent expert in operations of this nature.
- 26 The content of the draft terms of the cross-border conversion is, in essence, the same as that required under Spanish law, the sole difference being that the latter does not require the inclusion of information relating to: (i) members enjoying special rights or on holders of securities other than shares representing the company capital; (ii) the date from which the transactions of the company formed and registered in the departure Member State will be treated for accounting purposes as being those of the converted company; (iii) any special advantages granted to members of the administrative, management, supervisory or controlling organs of the converted company (*cfr.* Art. 95 LME).
- 27 The Proposal adds that Member States shall specify which language will prevail in the case of discrepancies, which may refer this question to the terms themselves. The Presidency compromise has not kept this option.
- 28 One month in the Presidency compromise.

the employees, though it shall not be required where all the members of the company have agreed to waive this requirement.<sup>29</sup> Additionally, a second report must be drawn up explaining, in particular, the implications of the conversion for employees (Art. 86f), and made available to them not less than *two months* before the general meeting that will vote on the conversion.<sup>30</sup> This report will also be disclosed to the members.

The fourth document is the report of the independent expert (see Art. 86g, and Art. 86t on their liability<sup>31</sup>). The company must apply to the competent authority, not less than two months before the general meeting, to appoint an expert to examine and assess the draft terms of the conversion and the reports drawn up for members and employees.<sup>32</sup> The expert must draw up a report providing, at least, a detailed assessment of the accuracy of the reports submitted by the company and a description of all factual elements necessary for the competent authority to carry out the artificial arrangement control. As stated above, given the complexity and costs of this analysis, it is debatable whether it satisfies the proportionality test. In any event, micro and small enterprises are exempted from the need of an independent expert report (Art. 86g(6)).<sup>33</sup>

Finally, the Proposal lays down rules for the disclosure of the draft terms of the cross-border conversion and the independent expert report (Art. 86h). Both documents should be publicly available, free of charge, at least *one month* be-

29 Although Spanish law does not mention anything in this regard, it seems that members may not waive the administrators' report, given that, in Spain, it is addressed not only to members but also to creditors and employees, see *Luis J. Cortés/Adoración Pérez Troya*, El informe de los administradores en las modificaciones estructurales, in: Ángel Rojo/Ana B. Campuzano/Luis J. Cortés/Adoración Pérez Troya (ed.), *Las modificaciones Estructurales de las Sociedades Mercantiles*. Estudios, 2015, p. 225, 252.

30 In the case of mergers, the term is reduced, with no apparent justification, to one month (Art. 124a(3)). For a critique of this uneven treatment, see *Vilà/Arenas et al.* (fn. 17), 13. The Presidency compromise has eliminated this inconsistency and established a one month period also in article 86f(3).

31 This article provides that Member States shall lay down rules governing at least the civil liability of the expert, including in respect of any misconduct on their part in the performance of their duties. The Presidency compromise has however deleted this provision.

32 In Spain, the appointment of an independent expert will fall to the Business Register corresponding to the registered office of the company undergoing conversion (*ex Art. 55 LME*, in relation to Art. 34 LME).

33 In contrast to cross-border mergers (Art. 125(4) Directive 2017/1132), the Proposal does not envisage the possibility of members unanimously waiving the report by the independent expert. Such disparity is the result of poor harmonisation of the report content: in the case of mergers, independent experts are only required to issue an opinion on the exchange ratio (Art. 125(3), in relation to Art. 96(2) Directive 2017/1132) and, therefore, their reports are addressed only to members. The Presidency compromise now includes that possibility (see Art. 86g(4)).

fore the date of the general meeting.<sup>34</sup> The disclosure will also include a notice to members, creditors and employees to submit comments concerning the documents. The draft terms shall be disclosed in the Business Register. Member States may allow companies to make these documents available on their website, in which event the most relevant information will still be required to be disclosed in the Business Register.<sup>35</sup>

#### 4. Second Phase: Approval by the General Meeting and Protection of Other Stakeholders

##### 4.1. Introduction

Articles 86i to 86j contain the core substantive rules of the Proposal. These provisions seek to offer a balanced approach to the interests of the different stakeholders in a cross-border conversion: members, creditors and employees. To begin with, there are the interest of the members of the company who approve the cross-border conversion. They are the “owners” of the company and they may have a legitimate interest in changing the *lex societatis*, i.e. the law governing their company, if they wish. A company is *basically* a contract between its members. When they voluntarily become members of the company they accept a particular law as *lex societatis*, i.e., as the law governing their contractual relationships. They can choose that law when they set up the company by incorporating it in a particular country; but they may also have good

34 In practice, this requirement for previous disclosure of the plan and the independent expert report may hinder the adoption of the cross-border conversion agreement at a “universal meeting”, that is, a meeting that has not been formally convened but at which the entire social capital is present or represented and attendees have unanimously agreed to hold the meeting (Art. 178 LSC). On this matter in Spanish law, see *Ricardo Cabanas*, *Las modificaciones estructurales simplificadas*, in: Rojo/Campuzano *et al.* (ed.), *Las modificaciones* (fn. 29), p. 521, 572–573, and *Marina Echebarría Sáez*, *Fase decisoria. Tutela de los intereses de socios y acreedores*, in: Rodríguez Artigas/Alonso Ureba *et al.* (ed.), *Modificaciones estructurales* (fn. 24), p. 85, 95.

35 Spanish law obliges administrators to deposit a copy of the transfer plan at the Business Register corresponding to the company’s registered offices. The deposit and date thereof will be published immediately in the *Boletín Oficial del Registro Mercantil* (Official Mercantile Register Gazette), and the convening notice for the members’ meeting to vote on the transfer may not be issued before such deposit has been made (Art. 95.3 LME). At the time the notice of the call to meeting is published, which must be with at least two months’ advance notice, the transfer plan and the administrators’ report must be made available to members and creditors at the registered office, and both members and creditors will be entitled to one copy of the documents free of charge on request (Art. 98 LME).

reasons to wish a change of that law by reincorporating the company into another country. In principle, if they decide to do this, it will be because the law of the new place of incorporation is preferable in legal and/or economic terms.<sup>36</sup> A company is a relational contract and therefore members should be entitled to change the law governing that contract to better adapt it to, for example, a change of circumstances or market conditions. The change of *lex societatis* may increase the company's competitiveness.<sup>37</sup> The principle of efficiency requires facilitating these operations. The protection of the interest of the main actors in this scenario (i.e. the member of the company) calls for allowing them to change the *lex societatis* without excessive costs. The risk, however, is an opportunistic use of this option, i.e., as a strategic tool to "expropriate" the rights of minority shareholders.

In addition, a company creates a separate patrimony vis-à-vis third parties. A company, as an entity with legal personality, enters into legal relationships with third parties and is liable with its assets against those parties. A transfer of registered office from Member State A to Member State B, with the corresponding change of *lex societatis*, may affect third parties' interest or rights. Thus, for example, it may entail a change of the law governing the capital structure of the company or a change of the jurisdictional rules that may affect creditors' rights, in particular procedural rights. It may also entail a change of the corporate governance regime, which may also affect employees' legal position if they enjoy some kind of participation rights.

Any legal approach to cross-border conversions should weigh and balance all of these interests. On the one hand, it should allow for these operations when the majority of the members of the company wish to reincorporate it in a different country. But, on the other hand, it should minimise the risk of opportunism vis-à-vis minority members or third parties, i.e. to prevent cross-border conversion from being used as a tool to maximise controlling shareholders' interest at the expense of other parties. The general idea is the same as in general

36 Indeed, the possibility of changing the *lex societatis* allows members to set up the corporate government system that is best suited to their needs. This includes such important aspects as the majorities required for the approval of general meeting decisions, administrators' liabilities, the structure of the administrative organ or the balance of power between administrators and members or between majority and minority members. See *Gerner-Beuerle/Mucciarelli et al.* (fn. 9), 5.

37 Marek Szydło, "The Right of Companies to Cross-Border Conversion under the TFEU Rules on Freedom of Establishment", 3 ECFR (2010), 414, 415, points out that "the process of company's cross-border conversion may enable the company to increase its productivity by choosing the system of company law that will be more optimum for a given company from the practical point of view, and will render it possible to increase the shareholders' value."

contract law: the parties may change the law applicable to a contract but without prejudice to third parties' rights.<sup>38</sup> Note, however, that an excessive protection of these parties may give rise to hold-out strategies and prevent efficient changes of *lex societatis*.

Recital 6 of the Proposal echoes these ideas and declares: “*it is appropriate therefore to provide procedural and substantive rules on cross-border conversions which would contribute to the abolition of restrictions on freedom of establishment and provide at the same time adequate and proportionate protection for stakeholders and employees, creditors and minority shareholders*”.<sup>39</sup>

#### 4.2. Members

First of all, the Proposal recognises the right of the members of a company to carry out a cross-border conversion and, therefore to change the *lex societatis*, if they wish. Nevertheless, to prevent opportunism or expropriation strategies between the directors of the company and its members, on the one hand, or between the majority and the minority shareholders, on the other, the Proposal lays down two main safeguards.<sup>40</sup> First, it allocates the competence to approve the operation to the general meeting (Art. 86i).<sup>41</sup> And secondly, it recognises the right to exit the company to minority shareholders, i.e. members of the company who “oppose” that change (Art. 86j).

The approval of the cross-border conversion falls within the powers of the general meeting. A change of *lex societatis* entails the amendment of an essential element of the “company contract” and therefore it should be approved by the members of the company, taking into account the reports prepared by the

38 See Article 3.2 Rome I Regulation: “*The parties may at any time agree to subject the contract to a law other than that which previously governed it, whether as a result of an earlier choice made under this Article or of other provisions of this Regulation. Any change in the law to be applied that is made after the conclusion of the contract shall not prejudice its formal validity under Article 11 or adversely affect the rights of third parties.*”

39 Recital 7 in the Presidency compromise.

40 One evident risk for the minority is that the *lex societatis* in the destination Member State establishes higher percentage stakes in share capital for exercising “minority rights”. Other risks include those deriving from a different configuration of the right to information or of the rules governing administrators’ liabilities. In addition, there is the inconvenience to minority members of having to attend the meeting and exercise their voting rights at offices located abroad. See Echebarría Sáez (fn. 34), 87.

41 In Member States where outbound reincorporations are regulated, the operation must be approved by the general meeting (normally through enhanced majority). For Spain, see Art. 160(g) LSC, and for other legal systems see SEC(2007) 1707 (fn. 22), 223–235.

administrators.<sup>42</sup> Furthermore, the Proposal requires a qualified majority to approve the draft terms of the conversion: not less than 66% but not more than 90% of the votes attached to the shares or to the subscribed capital *represented*; and in any event the voting threshold shall not be higher than that provided in national law for the approval of cross-border mergers (Art. 86i(3)).<sup>43</sup> The term “represented” is ambiguous here. It seems to mean the shares or capital subscribed attending (personally or by proxy) the general meeting.<sup>44</sup>

Approval of the cross-border conversion may be conditioned to an agreement with the employees on their participation rights in the converted company (Art. 86i(2)). This condition protects the interests of members in preventing a cross-border conversion when no agreement with the employees has been reached, in which case the company would be subject to the application of the standard rules for employees’ participation of the destination Member State (*infra* 4.4).

Secondly, the Proposal recognises an exit right for those members that opposed the cross-border conversion.<sup>45</sup> This applies to both those that held voting rights and did not vote for the cross-border conversion and to the members

42 Article 86i(3) does not refer to the approval of the draft terms of the cross-border conversion, but to “the approval of any amendments”, which must be a mistake (“the approval or (?) any amendments”). The Presidency compromise has corrected this typographical error.

43 Note that the Proposal does not establish any threshold for the approval of a cross-border merger. In any case, compliance with both of these cumulative requirements could be impossible, if a Member State, following the provisions of Art. 93(1) subpara. 2 Directive 2017/1132, were to establish a simple majority for the approval of mergers. See *Davies/Emmenegger et al.* (fn. 1), 209, footnotes 60 and 61. In Spain, approval of a cross-border conversion for a public limited company requires, generally speaking, an absolute majority of over fifty percent of the present or proxy share capital. However, a favourable vote of two-thirds majority of the share capital present or represented by proxy at the general meeting shall be required when, at second call, at least twenty-five but less than fifty percent of the subscribed share capital with voting rights is in attendance (Art. 201 LSC). In the case of limited liability companies, the requirement is for a majority of at least two-thirds of the votes associated with the stakes into which the capital is divided (Art. 199(b) LSC).

44 As seen in the note above, this is the rule established in Spain for public limited companies (Art. 201 LSC), whereas for limited liability companies the majority is calculated on the total votes pertaining to the stakes into which the capital is divided (Arts. 198 and 199 LSC). The Presidency compromise now clarifies that “represented” means “represented at the meeting”.

45 According to *Davies/Emmenegger et al.* (fn. 1), 210, “[t]here is almost no reflection on advantages or disadvantages [of the exit right], such as the burdens in terms of costs, time delays, etc.”; hence, in the authors’ opinion, it would be surprising if “these parts of the Proposal were not subject to further discussion”.



holding shares without voting rights (Art. 86j(1)).<sup>46</sup> Such members are entitled to leave the company and receive a cash compensation equivalent to the value of the shares. Note that this may be excessive since passive members also benefit from this exit right: it should be preferable to limit to those who vote against the operation.<sup>47, 48</sup>

The offer of compensation should be included in the draft terms of the cross-border conversion.<sup>49</sup> Once the operation has been approved by the general meeting, the interested parties, entitled to the exit right, have to accept that offer within a period not in excess of one month after the general meeting (Art. 86j(3)).<sup>50</sup> Subsequently, the company (within the legal limits), remaining

46 Under Spanish law, exit rights are granted only to those members voting *against* the cross-border conversion (Art. 99 LME), see *Fernando Martínez Sanz/Achim Puetz*, El derecho de separación de los socios en las modificaciones estructurales, in: Rojo/Cam-puzano *et al.* (ed.), Las modificaciones (fn. 29), p. 309, 320 *et seqq.*

47 The above is reflected in the statement by the Association of German Attorneys (DAV); see DAV, “Stellungnahme zum Vorschlag für eine Richtlinie des Europäischen Parlaments und des Rates zur Änderung der RL 2017/1132/(EU) in Bezug auf grenzüberschreitende Umwandlungen, Verschmelzungen und Spaltungen COM (2018) 241”, 22 Neue Zeitschrift für Gesellschaftsrecht (2018), 857, 866. By contrast, *Davies/Emmenegger et al.* (fn. 1), 210, believe this to be a suitable solution, arguing that requiring a contrary vote “would incentivise shareholders to vote against and might actually block the transaction while shares not represented in the vote will not usually be counted as a vote against”. At all events, it is not altogether clear that exercising exit rights does not presuppose a vote *against* the conversion proposal. At first sight, it may appear sufficient for a member “not to have voted in favour”. However, Art. 86d(1), in establishing the content of the draft terms for cross-border conversions, states that these must contain the (i) details of the offer of cash compensation for the members *opposing* the cross-border conversion in accordance with Article 86j (italics added) (see *Fuentes* (fn. 1), 324 and *Pulgar* (fn. 1), 23).

48 The Presidency compromise follows the approach suggested in the text and limits the exit right to the members who voted against the approval of the cross-border conversion terms.

49 The Proposal states only that such compensation must be adequate (Art. 86j(2)), but, in contrast to mergers (Art. 126a(5)), does not require the independent expert to expressly remark on this adequacy (see however Presidency compromise, Art. 86g(3)). See *Davies/Emmenegger et al.* (fn. 1), 211. In Spanish law, the valuation is left, in principle, to be agreed between the member and the company. However, in the event that no agreement is reached, the value of the shares shall be assessed by an independent expert appointed by the Business Register in the location of the registered office at the request of the company or any shareholder (Art. 353.1 LSC).

50 In Spanish law, the term allowed for exercising exit rights is likewise one month, but in this case it is counted from the disclosure of the agreement or from the date of its notification to dissenting members, in the case of limited liability companies opting for individual notification of the agreement instead of its publication (*cfr.* Art. 99 LME, in relation to Art. 348.2 LSC).

shareholders or third parties should acquire their shares in exchange of such compensation,<sup>51</sup> once the cross-border conversion has taken effects (Art. 86j(2)).

Any member of the company that accepted the offer but considers that the cash compensation has not been adequately set is entitled to demand the recalculation of the compensation before a national court of the departure Member State within one month of the acceptance of the offer (see Art. 86j(5) of the Proposal, and Art. 24(2) Brussels I Regulation, see also ECJ C-560/16, of 7 March 2018<sup>52</sup>).<sup>53</sup> The reference to “national court” should be interpreted broadly as including arbitration courts if applicable, since it is not uncommon in certain Member States that companies include an arbitration clause in their charters or bylaws.<sup>54</sup> The Proposal makes it clear that the approval of the cross-border conversion cannot be challenged solely on the ground that the cash compensation has not been adequately set and therefore the challenge of the cash compensation does not suspend the cross-border conversion process. It may only suspend, where appropriate, the acquisition of the shares.

#### 4.3. Creditors

As explained above, a transfer of the registered office abroad, with the corresponding change of *lex societatis*, may affect the company's creditors.<sup>55</sup> The capital requirements may be different under the new law (assuming these re-

51 There is an erratum in Art. 86j(2) in the English version. The precept states that the members may dispose of their shareholdings, in consideration of adequate cash compensation *paid to* the company, the remaining members or third parties. But, logically, this should be interpreted in the sense that the *shares* “are disposed to” the company, etc. See *Davies/Emmenegger et al.* (fn. 1), 211, footnote 69. The Presidency compromise has corrected this mistake.

52 *E.ON Czech Holding*, ECLI:EU:C:2018:167. See a comment on this ECJ ruling in *Stephan Rammeloo*, “*Forum Societatis*: Jurisdiction Concerning the Reasonableness of Consideration Resulting from a Squeeze-Out Resolution in a Cross-Border Context: CJEU C-560/16 (*E.ON Czech Holding*)”, 15(4) *European Company Law* (2018), 134, *passim*.

53 As pointed out by *Davies/Emmenegger et al.* (fn. 1), 212, the Proposal does not establish that the judgment upholding the challenge should be effective for all creditors who accepted the compensation, “rather, it is at the discretion of Member States to limit the effects of an award to the initial parties to the proceedings and to those who have joined them”.

54 See now article 86j(6) and recital 24 of the Presidency compromise.

55 In effect, the *lex societatis* does not merely rule the relationship between shareholders and administrators, but also contains compulsory rules to protect creditors and other stakeholders. See *Germer-Beuerle/Mucciarelli et al.* (fn. 9), 5–6. See also *Luca Enriques/*

quirements are aimed at protecting them), and the administrators or even members' liability may also be different. But the main consequences are of a procedural nature. The general rule on jurisdiction, i.e. the defendant's domicile, changes (Art. 4(1) Brussels I Regulation), and also the presumption about the location of the debtor's centre of main interests, which may be very relevant for insolvency purposes (Art. 3(1) Insolvency Regulation).

The Proposal lays down certain safeguards to protect creditors' rights and to prevent cross-border conversions from being used as a mechanism to benefit shareholders at the expense of those creditors.<sup>56</sup> First, Member States may require a solvency declaration, i.e. may provide that the managers or administrative organs of the company should make a declaration stating that they are unaware of any reason why the converted company would be unable to meet its liabilities when they fall due (Art. 86k(1)). Managers and members of the administrative organ are personally liable for this declaration under the national law of the departure State (see Recital 17 *in fine*); however, the standard of diligence is partially determined by the Proposal: that declaration is based on "the information available to the management or administrative body at the time of the declaration" and is made "after having made reasonable enquiries".

Furthermore, the draft terms of the cross-border conversion must provide the measures adopted for the protection of creditors (Art. 86d(1)(f)).<sup>57</sup> Creditors who are dissatisfied with these measures are entitled to apply to the competent

*Martin Gelter*, "Regulatory Competition in European Company Law and Creditor Protection", 7 *European Business Organization Law Review* (2006), 417, 422 *et seqq.*

56 The Explanatory Memorandum, p. 19, seems to imply that the Proposal has harmonised *minimum* levels of protection for creditors. If this interpretation is correct, Member States could continue to offer additional guarantees alongside the measures established in the actual Proposal (see also SEC(2007) 1707 (fn. 22), 48 *et seqq.*). Thus, for instance, Spain could maintain creditors' right of rebuttal, currently provided for in Art. 100 LME. However, this approach is questionable insofar as it deprives the Proposal of the benefits of full harmonisation, and the disparity in the treatment of creditors could seriously hinder these operations and compromise the purpose of this Proposal. And, in any event, under the proportionality test (see *supra* fn. 8), it will be extremely difficult for Member States to justify additional measures of creditor's protection. See *Davies/Emmenegger et al.* (fn. 1), 200 and 206 *et seqq.*, and *Vanessa Knapp*, "Cross border mobility: what do we need in practice?", 19 *ERA Forum – Journal of the Academy of European Law* (2018), 63, 65, in which the risks potentially arising from the lack of harmony over this issue are discussed.

57 Art. 86k(3)(b) makes it clear that the adoption of measures to protect creditors is optional, and therefore Art. 86d(1)(f) should be interpreted in the sense that, should the company eventually decide to offer such protection measures, they should figure in the draft terms of the cross-border conversion. On this issue, see -referring to mergers- *Davies/Emmenegger et al.* (fn. 1), 206 and footnote 48.

authority for adequate protection within one month after the disclosure of those terms (Art. 86k(2)).<sup>58</sup> In order to facilitate the assessment of prejudice, the Proposal lays down two rebuttable presumptions (Art. 86k(3)). The creditors shall be presumed not to be prejudiced in either of the following circumstances:<sup>59</sup> (i) if an independent expert report concludes that there was no reasonable likelihood that the rights of creditors would be unduly prejudiced; (ii) or where the company offers a right to payment either against a third party guarantor or against the converted company for the original value of the claim on condition that it may be brought before the same jurisdiction as the original claim and which is of a credit quality at least commensurate with the creditor's original claim immediately after the completion of the conversion. The formulation of the presumptions is not very persuasive: by definition, the liabilities of the company do not change with the cross-border conversion, i.e., creditors have a right of payment against the converted company under the same terms and conditions as what the Proposal calls "the original claim" (see Art. 86s(1) (a): "all the assets and liabilities... shall continue with the converted company").<sup>60</sup> It is true that the jurisdiction where the claim may be brought might change by a transfer of the registered office, though it is very likely that the claim may still be brought before the jurisdiction of the departure Member State under Articles 7 et seq. Brussels I Regulation. Thus, in practice, it will be relatively easy for the company to comply with one of the presumption and therefore with the safeguards laid down by the Proposal.<sup>61</sup>

58 In contrast to Spanish law (*cf.* Art. 100 LME), the Proposal does not limit protection to creditors whose claims antedate the publication of the draft terms of the cross-border conversion. Apparently, this point was debated at length within the Informal Company Law Expert Group acting in an advisory capacity to the Commission in drafting the Company Law Package. At all events, it seems that the Member States themselves will determine the applicability of the creditor protection rules. See *Fuentes* (fn. 1), 325–326.

59 Despite the lack of clarity on this point in the Proposal, it would appear that these presumptions aim to reverse the burden of proof regarding the absence of injury: in general, the company is expected to prove that the cross-border conversion causes no injury to creditors demanding protection measures; nevertheless, when any of the presumptions mentioned in Art. 86k(3) concur, the creditor will be obliged to prove the loss caused by the operation. See, in another sense, *Davies/Emmenegger et al.* (fn. 1), 206–207, who find that the presumptions have precisely the opposite effect: generally speaking, creditors should have to prove the injury, unless any of the assumptions concurred, in which case creditors would not be entitled to additional guarantees on the understanding that no loss results from the operation, with no possibility of proof to the contrary.

60 Article 126 of the Proposal establishes the same rule for cross-border mergers. Note that the second presumption is also absurd as regards the creditors of the acquiring company, since by definition they keep their claim as such and the jurisdiction does not change. The same holds, *mutatis mutandi*, for divisions.

61 The Presidency compromise has notably simplified this provision, but kept its essential elements. Now it requires Member States to ensure that creditors whose claims antedate

The Proposal also clarifies that the provisions on creditors' protection shall be without prejudice to the application of the national laws concerning the satisfaction or securing of payments owed to public bodies.

#### 4.4. Employees

The treatment of employees in a cross-border conversion is a technically complex issue and a politically delicate question. In principle, a mere change of *lex societatis* does not negatively affect employees unless they enjoy participation rights, i.e., unless the company carrying out the cross-border conversion is operating under an employee participation system in the departure Member State. The Proposal, together with the information to be provided to the employees explained above, contains a set of rules to ensure that a cross-border conversion does not prejudice those employees' rights, i.e., in order to prevent the circumvention of the employees' participation rights by means of a cross-border conversion. These rules are inspired by the "before-after regime" applicable to the European Company: when participation rights exist in the company, they should be preserved through its cross-border conversion.

The starting point is simple: the company will have to follow the rules concerning employee participation, if any, of the destination Member State (Art. 86l(1)). Thus, for example, if the company reincorporates from Member State A, where employees do not have participation rights, into Member State B, where they do, the company will be subject to the participation regimen set out by B's law. The exception to that rule applies in the reverse case, i.e., when the company moves from a Member State where employees have participation rights to a Member State where they do not or where they enjoy a lower level of participation rights.<sup>62</sup> Specifically, the Proposal envisages three situations that entail the application of the exception (Art. 86l(2)):

- (i) Where the law of the destination Member State does not provide for at least the same level of employee participation as operated in the company prior to the conversion, measured by reference to the proportion of employee representatives amongst the members of the corresponding organ of the company.

the disclosure of the draft terms of the cross-border conversion are able to institute proceedings against the company in the departure Member State within two years from the date of the conversion (Art. 86k).

62 The terms "participation rights" are defined by a cross-reference to Article 2(k) Directive 2001/86.

- (ii) Where the law of the destination Member State does not provide for employees of establishments of the converted company that are situated in other Member States the same entitlement to exercise participation rights as is enjoyed by those employees employed in the destination Member State. This covers the situation where law of the destination Member States lays down a participation regime but is limited to the employees employed in the establishments located in that Member State.<sup>63</sup>
- (iii) Thirdly, and as a preventive measure, when the company has, in the six months prior to the publication of the draft terms of the conversion, an average number of employees equivalent to four fifths of the threshold set out in the national law of the departure Member State triggering the employee participation rights.<sup>64</sup>

In those cases, the company will have to enter into negotiations with the employees to determine their participation's rights. These negotiations have to start as soon as possible after the draft terms of the conversion are publicly available and the procedure is subject to the rules of Directive 2001/86, with some adaptations (Art. 86l(3) and (4)). The negotiations will result either in an agreement regulating the involvement of employees or, if no agreement is reached within six months, the standard rules of the employees' participation as laid down in Annex of Directive 2001/86/CE (in particular, Part 3(a)) will *mutatis mutandi* apply and, therefore, all aspects of employee participation shall continue to apply, though under the law of the destination Member State. Interestingly, the Proposal seems to rule out the possibility that the agreement will result in excluding participation rights in the converted company: according to Article 86l(6), where the company is operating under an employee participation system, it shall be obliged to take the legal form allowing for the exercise of participation rights under the law of the destination Member State. Furthermore, the company will have to preserve for at least three years in substance the employees' participation rights in case of subsequent operations like domestic or cross-border mergers, divisions or conversions (Art. 86l(7)). Note that the rules on employee participation imply that Member States that currently do not envisage a mechanism of participation rights for domestic companies will be obliged to amend their Company law and include standard rules regulating those rights, at least for companies reincorporating from other Member States.

63 See ECJ, 24 January 2017, *Erzberger*, C-566/15, ECLI:EU:C:2017:562, commented among others by Titiaan Keijzer/Olivier Oost/Marnix van Ginneken, "The ECJ *Erzberger* Case: An Analysis of German Co-Determination and EU Law", 14(6) *European Company Law Journal* (2017), 217, *passim*.

64 The Presidency compromise has also slightly amended these conditions.

#### 4.5. General Clause of Abuse

As pointed out above, on top of these specific safeguards, the Proposal lays down a general clause on abuse. The cross-border conversion will not be authorised where the competent authority determines, after an in-depth examination of the specific case and having regard to all relevant facts and circumstances, that it constitutes an artificial arrangement aimed at obtaining “undue tax advantages”<sup>65</sup> or at unduly prejudicing the legal or contractual rights of employees, creditors or minority shareholders. This in-depth examination should only take place if the competent authority has serious doubts that the conversion is an “artificial arrangement” (*infra* 5).

It seems however difficult to conclude that when those specific safeguards are met, the cross-border conversion may nevertheless constitute an “artificial arrangement” and should not be authorised.<sup>66</sup> Minority shareholders enjoy an

65 As stated by *The Dutch Association of Tax Advisers (NOB)* in a document disclosed on 12 August 2018 (<[https://www.nob.net/sites/default/files/content/article/uploads/nob\\_reaction\\_-\\_directive\\_cross\\_border\\_conversions\\_-\\_engelse\\_versie\\_0.pdf](https://www.nob.net/sites/default/files/content/article/uploads/nob_reaction_-_directive_cross_border_conversions_-_engelse_versie_0.pdf)> last visited: January 2019), the expression “undue tax advantages” (also used without further clarification in the preamble 40) is not explained in the Explanatory Memorandum. This terminology differs from that used both by the ECJ (see case 12 September 2006, *Cadbury Schweppes*, C-196/04, ECLI:EU:C:2006:544, para. 51), and the Anti-Tax Avoidance Directive (see Art. 6(1) Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, hereinafter ATAD). This leads to great legal uncertainty, since determining what is or is not an “undue tax advantage” is ultimately a purely subjective matter, to be left to the Member States’ authorities. See, for an opinion likewise advocating greater clarity on this matter, *Vilà/Arenas et al.* (fn. 17), 8–9.

66 That said, in most cases it may be extraordinarily difficult, if not impossible, to determine *ex ante* the existence of an “artificial arrangement” (see *Segismundo Álvarez Royo-Villanova*, “The Commission’s Company Law Package: Overview and Critical View of The Proposal for Cross Border Transactions”, *European Law Blog*, 7 June 2018, (<<http://europeanlawblog.eu/2018/06/07/the-commissions-company-law-package-overview-and-critical-view-of-the-proposal-for-cross-border-transactions/>> last visited: January 2019); *Jaime Sánchez Santiago*, “Cross-border conversions and ex-ante control of ‘artificial arrangements’: is this an adequate reaction to Polbud?”, *Oxford Business Law Blog*, 20 September 2018, (<<https://www.law.ox.ac.uk/business-law-blog/blog/2018/09/cross-border-conversions-and-ex-ante-control-artificial-arrangements>> last visited: January 2019). The approach taken by ATAD, based on an *ex post* analysis of the operation, seems therefore more sensible. Indeed, as per Art. 6 of this Directive, “[f]or the purposes of calculating the corporate tax liability, a Member State *shall ignore* an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances” (italics added). This effectively counters “artificial

exit right; employees maintain their participation rights; and creditors are not prejudiced by the conversion. Tax law, and public creditors in general, remain outside the scope of the Proposal.<sup>67</sup> Furthermore, the facts and circumstances that the competent authority must take into account to carry the “artificial arrangement test” are mainly of a business-judgment nature: the characteristic of the establishment in the destination Member State, the sector, investment, the net turnover and profit or loss, the number of employees, the composition of the balanced-sheet, the assets and their location, and so on (Art. 86n(1)). None of these elements has anything to do with the *lex societatis*. It is therefore difficult to understand why the majority shareholders may be deprived of their right to change the *lex societatis* as a consequence of an in-depth assessment of, for example, “the net turnover” or the “commercial risks assumed by the converted company in the destination Member State and the departure Member State” (see Art. 86n(1) *in fine*).<sup>68</sup>

### 5. Third Phase: Pre-conversion Certificate

Once the draft terms of the conversion have been approved by the general meeting, the company must obtain a pre-conversion certificate from the competent authority. This authority may be judicial or administrative, depending on the option followed by each Member State.<sup>69</sup> The application to obtain a pre-conversion certificate must be accompanied by the draft terms of the cross-border conversion, the reports of the management or administrative organ to the members and employees, the independent expert report and the resolution of the general meeting approving the conversion (Art. 86m(2)). The

arrangements” without affecting the validity of the operation as such and without preventing its execution. See *Davies/Emmenegger et al.* (fn. 1), 204.

67 Moreover, if the purpose of controlling “artificial arrangements” is understood as being prominently fiscal in nature (as clearly signified on page 11 of the Explanatory Memorandum to the Draft Directive), doubts may arise over whether the Proposal for Directive has a sufficient legal base to be covered by the ordinary legislative procedure set forth in Arts. 50 and 114(1) TFEU, given that, as is widely known, this procedure does not apply to Directives of a fiscal nature, whose approval requires unanimity in the Council (Arts. 114(2) and 115 TFEU). On this issue, see *NOB* (fn. 65), para. 4.

68 But see *supra* fn. 23 on the Presidency compromise.

69 In Spain, the competent authority to issue the pre-conversion certificate is currently the Business Register for the company's registered office (Art. 101 LME: “*In view of the data on file at the Business Register and of the public deed of conversion submitted, the Business Register for the company's registered office shall certify compliance with the acts and formalities to be performed by the company prior to the transfer. As soon as said certificate has been issued, the Register will be closed to further inscriptions*”).



application and the submission of documents may, in principle, be completed on line in its entirety (Art. 86m(3)).

The main purpose of this certificate is to verify the legality of the cross-order conversion as regards the part of the procedure governed by the law of the departure Member State. This control includes the procedural and the substantive conditions required by the national law implementing the future Directive and, in particular, the formal satisfaction of the safeguards regarding employees, creditors and minority shareholders.

The competent authority should decide on the issue of the certificate within one month from the application by the company, and there are three possible outcomes (Art. 86m(7)). First, if the authority has no objection, it will issue the pre-conversion certificate. Conversely, if it concludes that the conversion is unlawful because it does not fall within the scope of the Directive, or because it does not meet all the relevant conditions or formalities, the authority will refuse to issue the certificate. And thirdly, when it has serious concerns that the cross-border conversion constitutes an “artificial arrangement”, it will inform the company that an in-depth examination will be carried out. This examination should conclude with a final decision within two months from the start of the in-depth assessment.<sup>70</sup>

The decision on the pre-conversion certificate is subject to judicial control. According to Article 86o(1) of the Proposal, when the competent authority is not a court,<sup>71</sup> the decision to issue or to refuse to issue the pre-conversion certificate is subject to judicial review in accordance with national law. Furthermore, if the competent authority has issued a certificate, its effectiveness is suspended during the period within which the parties are allowed to challenge its issuance and to obtain, where appropriate, interim measures (Art. 86o(1)). Thus, the cross-border conversion may be suspended if a party that has challenged the issue of the pre-conversion certificate obtains an interim measure in accordance with national law. This however should only apply when the grounds to challenge the cross-border conversion affect its validity, not when they are related to economic remedies such as the adequacy of creditors’ safeguards or the amount to be paid to dissenting shareholders in exchange for their shares.

70 The Presidency compromise has amended this provision to adapt it to its new approach, in particular as regards the artificial arrangement control.

71 As may be the case in Spain (see *supra* fn. 69).

## 6. Fourth Phase: Registration in the Destination Member State

Once the pre-conversion certificate is issued, the company may “leave” the departure Member State. But naturally it has to meet the requirements set out by the law of the Member State of destination to incorporate a company there. For these purposes, and after having received the pre-conversion certificate, the competent authority of the destination Member State must verify that the converted company complies with the provision of its national law on the incorporation of companies, including the results of the negotiations on employee participation, if applicable (Art. 86p).<sup>72</sup> The application and any information and documents required may, in principle, be completed on line (Art. 86p(3)).<sup>73</sup> The competent authority of the destination Member State cannot challenge the accuracy of the information contained in the pre-conversion certificate (Art. 86p(4)).

The Proposal also contains minimum rules on the information that must be entered into both the departure and destination Member States’ registers in relation to the cross-border conversion (Art. 86q(2)). And it also clarifies that when the company has been registered in the destination Member State, such information should be automatically notified to the departure Member State so that the competent authority is able to strike off the company from its company register immediately.

## 7. Consequences

The cross-border conversion, i.e. the transfer of registered office and consequent change of *lex societatis*, takes effect from the date of registration of the converted company in the destination Member State. The Proposal explains the consequences of such conversion in certain detail. First, it specifies that “*the assets and liabilities of the company carrying out the cross-border conversion including all contracts, credits, rights and obligations shall be transferred to and shall continue with the converted company*” (Art. 86s(1)(a)). The same holds true, obviously, as regards contracts of employment (Art. 86s(1)(c)). However, since the company keeps its legal personality, it is not technically correct to say that there is “a transfer” of assets and liabilities; precisely because

72 In Spain, the competent authority to verify compliance with the national legal requirements for incorporating a company may again be the Business Register (Art. 94 LME and Arts. 19 *et seqq.* LSC).

73 *Cfr.* Art. 13 f of the Proposal for a Directive amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law (see *supra* fn. 4), in relation to the incorporation of companies online.

the legal person is retained, nothing is “transferred” to anyone.<sup>74</sup> Second, the members of the company which carry out the cross-border conversion “*shall become members of the converted company, unless they exercise the exit rights referred to in Article 86j(2)*” (Art. 86s(1)(b)). The Proposal is also inaccurate on this point. Since the disposal of their shares by the members who exercised their exit right takes place “*once the cross-border conversion has taken effect*” (see Art. 86j(2)), at that moment they are still members of the company.<sup>75</sup> Finally, also included among the consequences of the conversion, the Proposal establishes a provision, taken from the Regulation of the European Company (Art. 8(13)), according to which the place of the registered office of the converted company in the departure Member State may be relied upon “*until such a time as the company has been struck off from the register in the departure Member State, unless it may be proven that a third party knew, or ought to have known, of the registered office in the destination Member State*” (Art. 86s(1)(d)).<sup>76</sup>

Furthermore, the Proposal also contains certain provisions on any activity of the company between the date of registration in the destination Member State and the date at which the company has been struck off from the register in the departure Member State. It establishes that those activities “*shall be treated as the activity of the converted company*” (Art. 86s(2)), with the nuance mentioned above about the location of the registered office. Additionally, the Proposal contains an enigmatic rule, according to which the converted company “*shall be liable for any losses arising from any differences in national legal sys-*

74 The Presidency compromise has also corrected this provision and replaced the word “transferred” by “continue”.

75 The text of Art. 86j(2) is extraordinarily confusing. The express wording for this precept is as follows: “[dissenting members] *may dispose of their shareholdings, in consideration of adequate cash compensation paid, once the cross-border conversion has taken effect*”. This provision bears two possible interpretations: (i) shareholders may only dispose of their shares once the cross-border conversion has taken effect; (ii) shareholders may dispose of their shares in exchange for compensation that will be payable only after the cross-border conversion has taken effect. According to the second interpretation, the only action that would take place after having concluded the operation is the payment of compensation, but not the disposal of shares, which would have taken place at an earlier time. This is implied in Art. 126a(2) with regard to mergers, and is, furthermore, the rule currently in force under Spanish law, according to which the document formalizing a cross-border conversion “*may not be entered in the Business Registry unless it, or a subsequent instrument, contains the directors’ confirmation that no partner or shareholder has exercised his/her exit rights within the established deadline or that the company, acting on general meeting authorization, has acquired the existing partners’ or shareholders’ stakes or shares, or their confirmation of the capital reduction*” (Art. 349 LSC). The Presidency compromise is much clearer on this issue (see Art. 86j).

76 This provision has been deleted in the Presidency compromise.

tems of the Member States of departure and destination, where any contracting party or counterparty of the company carrying out the conversion had not been informed of the cross-border conversion by that company prior to concluding that contract” (Art. 86s(3)). First, it is difficult to imagine how a counterparty may suffer any loss deriving from the difference between the *lex societatis* of the departure Member State and of the destination Member State. Secondly, general company law and the Proposal itself contain detailed rules on the publicity of the Member State of incorporation/reincorporation of a company, and therefore third parties are or should be informed about those circumstances. This provision would only make sense, if any, if its application is limited to the transitional period, i.e. when a third party may believe that it is entered into a contract with a company incorporated in the departure Member State but it has actually converted into a company of the destination Member State, i.e. until it has been struck off from the Register on the departure Member State.<sup>77</sup> In any event, as said, it is difficult to imagine what “loss” may derive to that counterparty from the differences between the two laws.<sup>78</sup>

Finally, the Proposal lays down a general principle applicable to any modification of the company structure: once it has taken effect, i.e. it has been registered in the destination Member State, it may not be declared null and void (Art. 86u).

## 8. Conclusions

Even if cross-border conversions are encompassed within the freedom of establishment guaranteed by Article 49 TFEU, as has been interpreted by the most recent ECJ case-law, the divergences between the laws of the Member States on these operations has proven to be a significant obstacle to carrying them out in practice. In this regard, the Proposal of Directive on cross-border conversions, mergers and divisions is to be welcomed, as it sets up a common regime that make it easier for companies to carry out cross-border company restructurings.

77 In her recommendations for a new regulation for cross-border conversions, *Knapp* (fn. 56), 74, warns: “It would be helpful to state specifically what the position will be if the company is not immediately removed from the register of companies in its original Member State. It would be sensible for third parties to be able to continue to rely on the registered office in the original Member State unless they knew about (or could not have been unaware of) the registered office in the Member State to which the company has moved.”

78 The Presidency compromise has not kept these provisions.

However, the Proposal still offers many aspects open for improvement:<sup>79</sup>

- (i) Firstly, it should be taken into account that, unlike cross-border conversions, mergers and divisions do not always imply a change of *lex societatis* for all stakeholders, and therefore it does not make sense to apply the same protection measures for members, creditors and employees for all three company restructuring operations.
- (ii) Secondly, the ban on conducting a cross-border conversion, merger or division applied to companies undergoing preventive restructuring proceedings because of the likelihood of insolvency should be reconsidered, given that, in many cases, precisely these types of operations may offer a solution to re-balance the economic situation of a firm.
- (iii) Thirdly, it would be advisable to review the *ex ante* control of abuse. On the one hand, the Proposal already establishes sufficient protection measures for minority members, creditors and employees. On the other hand, a Directive on Company Law does not seem an appropriate instrument for introducing measures to prevent tax evasion. Moreover, it seems pointless to control “artificial arrangements” in cross-border conversion, but not in cross-border mergers, as these two operations may lead to the same result in practice.
- (iv) Fourthly, exit rights should be limited exclusively to members who voted against the agreement for a cross-border conversion, as otherwise, protection would be being given to members adopting a passive attitude and the feasibility of the operation may be placed at risk. Furthermore, greater clarity would be desirable in determining at which moment those members exercising their exit rights should dispose of their shares: before or after the cross-border conversion has taken effect.
- (v) Lastly, clarification should be given on which creditors benefit from the protection measures envisaged in the Proposal. Likewise, the assumptions made regarding absence of injury should be reviewed to give precise details of the scope thereof.

79 As pointed out in the corresponding footnotes, the Presidency compromise has echoed most of these considerations.