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# The European Model Company Act (EMCA) chapter on Groups of companies

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## I. Introduction



### Presentation of the European Model Company Act

- The European Model Company Act (EMCA) is being developed by a group of legal experts from all EU member states on the initiative of Theodor Baums, ILF, House of Finance, Goethe University Frankfurt, and Paul Krüger Andersen from Denmark's University of Aarhus
- Project started in 2007 and is chaired by Professor Paul Kruger Andersen
- Group of academics with one representative from each Member State (with some exceptions and alternates) and experts on special issues
- EMCA Group is independent of business organisations, of Member States and of the European Commission



### Goals of the EMCA

- EMCA is inspired by the similar US experience of the RMBCA which is a resource of company law doctrine and for court decisions
- Designed for Member States (MS) and future MS to incorporate in full, or simply some chapters, or as a source of inspiration on a specific point
- Useful because limited resources available in the Ministry of Justice in many small, and sometimes even larger MS, to deal with company law
- EMCA could become also a benchmark for MS national laws
- Scope is larger than Member States as the EMCA aims to represent the European approach to company law (Eurasia, Latin america...)



### Working methods, scope of EMCA

- EMCA Group meets twice a year for two days in different MS
- Covers public and private companies, includes the *acquis communautaire*, inspired by experiences from the most modern company acts of MS
- Compromise among different sensitivities but mostly liberal approach
- Most chapters to be published by the end of 2013 and subject to a consultation to take into account the views of interested stakeholders
- All information is available on the website : <http://law.au.dk/emca>



### Link to the work of the European Commission

- Company law in the EU has developed through regulatory competition (ECJ) but relies also on approximation of the laws of Member States
- The Commission recognised the interest of EMCA (Consultation 2012)
- EMCA is **not an alternative** to traditional harmonization but rather a source of inspiration and could be turned into a recommendation
- The EMCA could also be a source of targeted inspiration for directives



### Development of the chapter on groups

- Early decision of the EMCA to develop a specific chapter on groups
- Working group composed of Professors Pierre-Henri Conac (Lux.), Isabelle Urbain-Parléani (France) and José Antunes (Portugal)
- Chapter on groups was one of the most difficult to adopt
- Facilitate and enhance the flexibility of the formation, organization and functioning of groups also taking into account a cross-border dimension
- Influence of the *Forum europaeum*, of French (*Rozenblum doctrine*), UK (*wrongful trading*), German law (*right to give instruction*) and Italian (*sell-out*)





### Main points of the chapter of EMCA on groups

- Right of a parent company to give instructions to a subsidiary
- Right to manage the group and its constituent members in the interest of the group subject (recognition of the interest of the group)
- Right to squeeze-out minority shareholders to constitute fully integrated groups
- Right to sell-out to protect minority shareholders
- Wrongful trading to protect creditors



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### **I. The organisation of the group**

#### A The flexibility of the management



### Notion of control

- Definition of control is inspired by IAS 27 *Consolidated Financial Statements and Accounting for Investment in subsidiaries*
- Natural person cannot be a « parent company », only a legal person
- Definition of a wholly-owned subsidiary because of specific rules
- Duty to disclose control by the parent company



### Right to squeeze-out minority shareholders

- Right of a parent company, controlling more than 90 % of the shares and votes of the subsidiary, to demand that other shareholders have their shares sold to the parent company
- Price fixed by an expert appointed by the court with jurisdiction over the place where the registered office of the company is situated



### Right to squeeze-out: reasons and advantages

- Increases the efficiency of the functioning of the group
- Counterparty of the sell-out rights included in the EMCA
- Right to squeeze out recognized in many national laws
- The right to squeeze out minority shareholders in non listed companies is recognized in many national laws (section 70 of the Danish Companies Act, section 327a-327f of the German Corporation Act, art. 49c of Greek Corporation Law, art. 490 of the Portuguese Companies Act).



### **Right of access to information at the level of the subsidiary**

- The board of directors, or equivalent body, and the management of the parent company has the right to obtain the communication of any information from a subsidiary, including in a cross border context, unless such communication would violate the law of the country whose rules apply to the subsidiary or the rights of third parties (eg: banking secrecy)

### **Intra-group transactions**

- Intra-group transactions are not subject to shareholders' approval but to board of directors' approval



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## **B. The right to give instructions**



### Recognition of the right of the parent company to give instructions

- The parent company has the right to give instructions to the organ of management of their subsidiaries, subject to exceptions and conditions
- No requirement of a unilateral declaration, but duty by the subsidiary to disclose that it is subject to instructions of the parent company
- Rebuttable presumption for wholly-owned subsidiaries of being subject to instructions





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- **Exceptions to the right of the parent to give instructions**
- Directors and managers who were not appointed by the parent or by the controlling shareholder, especially following the application of the articles of associations, of a shareholders' agreement or of any law or regulation
- Directors who are defined as “independent directors” according to the applicable Corporate Governance Code (*listed companies*)
- Directors who are employee representatives (codetermination...)



### Conditions of the right of the parent to give instructions

- (1) If the management of a subsidiary, especially as a result of an instruction issued by the parent company, takes a decision which is contrary to the interests of its own company, it shall be not deemed to have acted in breach of their fiduciary duties if :
  - (a) the decision is in the **interest of the group as a whole**, and
  - (b) the management may reasonably assume that the loss/damage/disadvantage will, within a reasonable period, be **balanced** by benefit/gain/advantage and,
  - (c) the loss/damage/disadvantage, referred to in the first sentence hereof, does not include any which would place the **continued existence of the company in jeopardy**



### Conditions of the right of the parent to give instructions

- (2) If the subsidiary is wholly-owned, section (1)(b) does not apply.
  - “(1)(b) the management may reasonably assume that the loss/damage/disadvantage will, within a reasonable period, be balanced by benefit/gain/advantage and,”
- (3) The management of the subsidiary **may refuse to comply** with instructions from the parent company in case the conditions set in paragraph (1) are not satisfied.



### Differences with national Member State law

- No requirement that the group has a balanced and firmly established structure (*Rozenblum*)
- Right (“may”) of the board of directors and management of the subsidiary to refuse to comply in case of illicit instructions
  - Interests of the minority shareholders and creditors are better protected by the right to refuse to apply the instruction (forces an exchange of views)
  - Inspired but more protective than the German approach since the right to refuse to apply an instruction is granted even if the instruction is not a “manifest violation” of the interests of the parent company or of the companies affiliated with it



## **II. The protection of interested parties**

### A The protection of shareholders



### Right of information of the shareholders of the parent

- The relations between the companies of the group, including with companies formerly members of the group, are open to the right of information and to the right to request a special investigation in court
- Explicit right designed to prevent management of the parent company to refuse to answer questions about the situation of the group on the basis that the information would be located at the level of a subsidiary
- Similar provisions can be found in some MS legal orders



### Right of shareholders of the subsidiary to request a special investigation in the parent company (*upstream*)

- The shareholders of a subsidiary can request a special investigation in the parent company
- The right of shareholders to request a special investigation into decisions of the parent company is limited to decisions which have affected the subsidiary



### Corporate opportunity within a group

- When a subsidiary is not wholly-owned, a parent company, including a foreign one, must not itself or through another subsidiary exploit a corporate opportunity unless it has received the approval of the disinterested directors of the subsidiary, and if there are none, of the non-controlling shareholders of the subsidiary





### Right to sell-out

- When a parent company owns directly or indirectly more than 90 % of the shares and of the voting rights, the minority shareholders may request in court that their shares be purchased by the parent company or another person designated by it
- Very **vague provision** but need to take into account the cost and need for liquidity for the parent if sell out can be too easily obtained
  - Provision does not refer to an "important cause" (*Wichtiger Grund*), which leaves a significant freedom to judges to decide
  - Abuse of majority cases could be considered by courts as triggering



## B The protection of creditors



### Wrongful trading

- (1) Whenever a subsidiary company, **which has been managed according to instructions issued by its parent in the interest of the group**, has no reasonable prospect of, by means of its own resources, avoiding a winding-up (*crisis point*), the parent company is obliged without delay to effect a fundamental restructuring of the subsidiary or to initiate its winding-up procedure.
- (2) If the parent acts in **contravention of paragraph 1** or if it has **managed the subsidiary to the detriment of the subsidiary**, it shall be held liable for any unpaid debts of the subsidiary company incurred before the crisis point. In such case, it will be presumed that the parent knew or should have known that the subsidiary company had arrived at a crisis point. The court may assess the extent of the creditors' relevant debts.



### Wrongful trading

- Close to the concept of "Wrongful trading" which originates in the UK (Section 214 Insolvency Act 1986), but requires a link between the insolvency of the subsidiary and the instructions given by the parent
- Close also to proposal of the Forum Europaeum and Reflection Group



## IV. Conclusion



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- EMCA chapter on groups brings back the issue of groups and builds on previous academic work and legislative and court developments in MS
- Recognition of the interest of the group and right to give instructions are the cornerstone of the chapter of EMCA on groups
- European commission could be looking on groups **directly** by the recognition of the interest of the group (Action plan, 2014)
- European commission could also be looking on groups **indirectly** through work on the Single Member Company (Reflection Group)