The Informal Company Law

Expert Group (ICLEG)

Report on the recognition of the interest of the group

October 2016

The Informal Company Law Expert Group (ICLEG) was established by the European Commission (EC) in May 2014 to assist it with expert advice on issues of company law and it held its first meeting on 26 June 2014. The agendas of its meetings are available online at the webpage maintained by the EC[1].

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On 26 January 2015, the EC requested ICLEG to consider the issue of the recognition of group interest. In response to this call one member, **Pierre-Henri Conac**, was charged with producing a report on behalf of the Group. **John Armour** provided specific input in the preparation of this report. After consultation within the Group, this report reflects the advice of ICLEG to the EC as to matters that ICLEG believe merit further consideration.

[1] http://ec.europa.eu/justice/civil/company-law/index_en.htm

Disclaimer: As this paper has been drafted by ICLEG, it solely reflects the views of the Group. It should not in any way be interpreted as representing the views of the European Commission (EC). It should also be noted that the report purports to present a range of ideas that can inspire the EC in its further possible work on group companies. We have not considered whether these ideas are politically feasible and the range of ideas, opinions and recommendations are not necessarily supported by each and every member of the Group, although in general we believe that they are worthy of serious consideration and further consultation with other interested parties. We generally believe that it is important to prepare any legislative initiative by detailed consultation with the affected parties, notably companies, investors, other stakeholders and public authorities, and we recommend that this be done to the greatest extent possible both on the general principles and, once the general principles have been established, on detailed proposals for any action.

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This paper sets out the opinion of the Informal Group of Company Law Experts (ICLEG) as to issues that the Commission may wish to consider relating to the recognition of the interest of the group.

1. Introduction

The Commission's action plan of December 2012 on European company law and corporate governance announced an initiative on « recognition of the concept of « group interest » (p. 14 et seq.).[2] This development is based, inter alia, on the Report of the Reflection Group on the Future of EU Company Law of 2011 which advised that:

> « The EU Commission should consider, subject to evidence that it would be a benefit to take action at the EU level, to adopt a recommendation recognising the interest of the group. »[3]

Member States have different and even conflicting approaches regarding the recognition of the interest of the group. Those differences derive, to a certain extent, from their views on the right of the shareholders to influence the management of a company.

On the one hand, some Member States want to ensure the integrity of the management of each subsidiary so that it is governed exclusively in the interests of that company. The main goal and effect is to protect minority shareholders and creditors of the subsidiary. This approach also reflects the view that shareholders should not micro-manage the company. This should be done by the directors (or members of the supervisory board) and managers (or members of the managing board) of the subsidiary. They are subject to direct or indirect removal by the shareholders, for or without cause, so that shareholders ultimately decide anyway on the main business decisions of the company.

Concomitantly, this group of jurisdictions adopt a *rule*-based approach to the integrity of the assets of subsidiaries relative to the group as a whole. Within this group, there are two different approaches. First, under what we term the 'ex ante' rule-based approach, the rule established in case law in some Member States such as Austria, or Germany in the case of the private limited liability company (*Gesellschaft mit beschränkter Haftung* or GmbH), flatly prohibits parents from inflicting any immediate damage or disadvantage to the subsidiary.

Second, under what we term the 'ex post' rule-based approach, some Member States

[2] Communication From The Commission To The European Parliament, The Council, The European Economic And Social Committee And The Committee Of The Regions, Action Plan: European company law and corporate governance – a modern legal frame work for more engaged shareholders and sustainable companies, Brussels, COM(2012)740/2,

The Action Plan is available at : http://ec.europa.eu/internal_market/company/modern/index_en.htm

[3] *Report of the Reflection Group on the Future of EU Company Law* ('Reflection Group Report') (2011), p. 65.

The report of the Reflection Group is available at:

http:// ec.europa.eu/internal_market/company/modern/.

such as Germany, and others which followed its example, have developed a comprehensive body of rules (*Konzernrecht*) whereby an immediate disadvantage can be inflicted by the parent to the subsidiary provided that it is compensated for the same amount within the financial year.[4] Under the 1965 German Companies Act, the case of a "contractual group", a domination contract (*Beherrschungsvertrag*) is signed by the subsidiary, which is a public limited liability company (A*ktiengesellschaft* or *Kommanditgesellschaft auf Aktien*), with its parent company. The parent company can issue instructions but must compensate the subsidiary's annual loss. Minority shareholders might also have a sell-out right. This approach requires detailed settling-up between the parent and subsidiary at the end of the accounting year. The German Supreme Court (*Bundesgerichtshof*) applies the same rule if the subsidiary, which is part to the domination contract, is a private limited liability company (*Gesellschaft mit beschränkter Haftung* or *GmbH*). In the case of a factual group (*faktischer Konzern*), there is by definition no contract between the subsidiary and the parent company. In such case, German courts also require that all disadvantages be compensated by the end of the fiscal year. In order to control the fulfillment of this obligation, the management board of the subsidiary must establish a dependency report (*Abhängigkeitsbericht*) which is submitted to the supervisory board and to the statutory auditors of the subsidiary. The dependency report lists all relations between the subsidiary and the parent, quantifies the disadvantages inflicted on the subsidiary and the compensations granted to the subsidiary to balance those disadvantages. In case the subsidiary is a private limited liability company with minority shareholders, courts refuse that any damage be inflicted, even if compensated.

On the other hand, other Member States take a *standard*-based approach to the question of integrity of the assets of the subsidiary. The standard generally applied, at least for solvent companies, is that disadvantage to the subsidiary is acceptable provided that it is in the 'interests of the group'. This form of words emphasises a *common* interest of the subsidiary and the parent or other companies in the group. It recognizes that some disadvantage or damage may be inflicted by the parent upon a subsidiary in the name of the interest of the group of which it is part. Being part of the group brings benefits, and therefore some disadvantages should be also tolerated for the benefit of the group. This is the approach adopted by France for instance with the *Rozenblum* decision of the French Supreme Court (*Cour de Cassation*) and the Italian legislative regime on groups. The same holds true for the Netherlands whilst the board of the subsidiary ultimately should ensure that this does not evidently violate the interests of the company (in practice the interests of the creditors).[5] For instance, the Nordic Member States (Denmark and Sweden), as well as the United Kingdom (UK), Ireland, and most recently Estonia (2015) and Spain (2015) also recognise the interest of the group. This is also a logical outcome of the fact that they perceive management as a hierarchy with shareholders on top and have no reservations with shareholders, including parent companies, deciding on management. This explains also why some Member States, which favour a more rigid separation of functions within the company, see "group management" as a problem, whereas Nordic Member States and the UK do not recognize the problem at all.

[4] § 291 et seq. of the German Public Limited Liability Companies Act (*Aktiengesetz* ou *AktG*).
[5] S. Bartman, *Dutch Supreme Court at a Loss over groups*, European Company Law 13, n°4 (2016), 123-128.

These differences as well as rigidities in some Member States render the cross-border functioning of groups based in the European Union more complex, affecting to a certain extent the internal market. This issue, already identified by the Report of the Reflection Group on the Future of EU Company Law of 2011, has led the ICLEG to develop this report.

1.1 Development of the debate on group interest at the EU level

Support for an intervention of the European Union (EU) on groups pre-dates the Reflection Group and can be traced back to the "High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe" (also known as the "Winter Report"). The group established by the Commission in early 2000 decided against the introduction of a comprehensive law on groups of companies but recommended that the EU should consider provisions within the existing range of corporate laws to address particular problems, such as the management of a group (rule allowing group policy, squeeze-out), transparency of groups, protection of creditors (wrongful trading) and minority shareholders' protection (sell-out rights).[6]

The issue was then raised again by the Reflection Group of 2011. As stated by the report of the Reflection Group of 2011 « The international group of companies – not the single company – has become *the* prevailing form of European large-sized enterprises, which business activity is typically organised and conducted through a network of individual subsidiaries located in several States inside and outside Europe ».[7] The specific aim of the Reflection Group in recommending an EU intervention, was not to engage in a theoretical work, but rather to "*enhance the flexibility of the management of groups* especially on a cross-border basis".[8]

In order to achieve this goal, the Reflection Group indicated that:

> "the parent corporation could be vested with a right but also a duty to manage the group and its constituent companies in accordance with the overall interest of the group. Some members of the Reflection Group think that the board of the parent company should have a duty to manage the group only if they choose to."[9]

Members of the Reflection Group supporting the idea of an EU intervention were also divided on other issues since:

> "[s]ome members of the Reflection Group are of the opinion that the recognition of the interest of the group should be limited to wholly-owned subsidiaries. Other members considered that the regime should not apply to listed subsidiaries."

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[6] *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe* ('Winter Group Report'), 2002.

[7] *Report of the Reflection Group on the Future of EU Company Law* ('Reflection Group Report'), See J. Franks, C. Mayer, P. Volpin and H.-F. Wagner, 'The Life Cycle of Family Ownership: International Evidence' 25 *Review of Financial Studies* 1675, 1689 (detailing prevalence of group structure in largest 1,000 firms in, respectively, Germany, France, UK and Italy).

[8] *Reflection Group Report*, 2011, 60.

[9] *Ibid*.

The focus of the Reflection Group was to create a legal framework increasing the flexibility of the cross-border groups management by *providing a "safe harbour" for directors of the subsidiary and the parent company* rather than developing new protections for creditors and minority shareholders as this issue should be left to Member States. The Reflection Group adopted an *enabling law* approach, adopting the view of the parent company, rather than focusing on the protection of creditors and minority shareholders.

1.2 Consultation of 2012 on the Future of European Company Law

As part of the preparation of the 2012 Action Plan, the European Commission led a consultation on the future of European Company law which included a question on whether there would be a need for EU intervention in this field and asked specifically whether "[t]he Commission should recommend the recognition of group interest" and whether "[t]he EU should require groups to provide information on their structure in a consolidated, investor-friendly and easy-to-read document?"[10]

The July 2012 feedback statement noted that:

> "*Over two thirds of respondents expressed support for EU intervention* in the area of groups of companies. Support came in particular from lawyers but also from companies, trade unions and universities. Proponents of EU action supported almost equally measures for better information on the group structure and the recognition of the group interest. Some also recommended other actions in this area, and namely several respondents mentioned the need for rules establishing liability of the parent company for subsidiaries. A small number of respondents also supported a harmonised European framework for corporate groups. Many respondents underlined, however, that any rules on groups should protect the interests of stakeholders involved, namely those of minority shareholders and creditors. Several responses also supported rules on groups of entities other than limited liability companies (such as mutual companies), rules on cash pooling or the need for equal treatment of vertical and horizontal groups. A minority of respondents, in particular business federations, were not in favour of EU measures on groups. Respondents opposed to EU measures in this area considered in particular that there were no significant problems relating to groups that would require EU intervention or that in any case this was not a priority for EU action. Certain respondents also judged that national authorities were better placed to regulate groups."[11]

From a geographical perspective, a closer analysis of the answers shows that a significant number of answers supporting the recognition of the group interest came from Spain, without any clear reason, and from Austria (mostly notaries). In general, there was more support (although not unanimous) for the recognition of the interest of

[10] See question 19 of the EU Consultation Paper on the Future of European Company Law and Corporate Governance as of February 20, 2012.

[11] Question 19. Feedback Statement, Summary of Responses to the Public Consultation on The Future of European Company Law, July 2012. http://ec.europa.eu/internal_market/consultations/docs/2012/companylaw/feedback_statement_en.pdf.

the group in Member States which have rigid rules (Germany, Austria, Hungary, Poland, Slovakia) or uncertain laws (Romania). It seems that some respondents look to the EU as a way to solve national problems. There was also significant support in Italy which has legislation recognizing the interest of the group.

From a sectoral perspective, there was support for the recognition of group interests from the financial sector (e.g. German banking federation, Unicredit), the insurance sector (especially in relation to the fact that the Solvency II directive does not recognize the group support regime and "horizontal groups"),[12] lawyers (especially in Germany), notaries (Council of the Notariats of the European Union and many answers from Austria), accountants (Federation of European Accountants) as well as academics. Business associations were usually not supportive of the recognition of the interest of the group but there were exceptions (Assonime in Italy, BVMW in Germany which represents the *Mittelstand*, Economiesuisse). Some very large companies also expressed their support (Hewlett-Packard and Siemens). However, the largest number of companies either was opposed or had no opinion. It should be noted that some internationally active companies, such as Pirelli, expressed separately a strong support for an EU intervention recognising the interest of the group.[13]

Some Ministries of Justice (12) answered the consultation. Of them, only the German Ministry of Justice fully supported the idea of the recognition of the interest of the group. The Ministry of Justice of Slovakia mentioned in its answer that "[t]o take into account of the interest of group could be acceptable in a case of wholly (100%) owned subsidiary as this is not jeopardizing the interest of minority. »

Many Ministries of Justice opposing an EU intervention originated from Member States which do not consider that there is a problem at the national level (UK, Denmark, Sweden, and Finland). Some opponents to the recognition of the interest of the group at the EU level provided more detailed arguments, through additional contributions attached to their answers, rather than those who were in favour of such recognition.

In particular, the Ministries of Justice which provided additional contributions (Finland, France, Denmark, Sweden and the UK) were against the idea, although the views should be nuanced since their comments seemed to imply that the Ministries of Justice understood « intervention » as possibly meaning a directive and wanted to avoid this approach. For instance, France opposed the creation of a general regime on groups but mentioned the usefulness of the recognition of the interest of the group by national case law. Sweden noted that an intervention in this field would result in endless negotiations with a very unsure outcome. Both answers reflect an understanding that a directive

[12] See. Olivia Erdelyi, Twin Peaks for Europe: State-of-the-Art Financial Supervisory Consolidation, Rethinking the Group Support Regime Under Solvency II, Springer International Publishing, 2016, 262.

[13] See. F. Chiappetta and U. Tombari, Perspectives on Group Corporate Governance and European Company Law, *European Company and Financial Law Review* ECFR ECFR 2012, 261–274.

could be considered.

The answer from the Ministry of Justice of Denmark was more positive and noted that « practitioners have identified a *need to have clearer and harmonised rules on a small number of specific issues such as cash pooling and loans within an international group*. In addition, it would seem appropriate to align the definition of groups in EU company law to the EU accounting legislation to ensure coherence and legal certainty ».

Therefore, it should be taken into account that the question in the consultation was framed in very general terms. As the answer of the Ministry of Justice of Denmark shows, a consultation with a precise text could have led to more informed, and possibly, different and positive (or possibly eventually also negative) answers.

At the same time as the Consultation, the European Parliament provided support for an EU intervention when it adopted a resolution in June 2012 which stated that there was « no need for fully harmonised European corporate legislation on groups, but rather a need for a set of common rules on, inter alia, the protection of subsidiaries and stakeholders and greater transparency as regards legal and ownership structure ».[14]

Since 2012, there have also been calls for an EU intervention, based on the French *Rozenblum* approach, such as the 2015 Proposal of the Forum Europaeum on Company Groups (FECG), "to facilitate the management of cross-border company groups in Europe" (2015), calling for a directive,[15] and the 2015 report of the French Think Tank *Club des Juristes* "Towards Recognition of the Group Interest in the European Union" calling for a Framework recommendation.[16] In 2016, the European Company Law Experts (ECLE) also recommended that the Commission develop an EU "instrument" on Related Party Transactions with a special regime within groups where companies could take into account the interest of other group companies or of a group as a whole.[17]

The ICLEG understand that there is a European Model Companies Act (EMCA) which could become a relevant force for developing rules on groups of companies. The EMCA was drafted by company law experts from several Member States. [18] It is designed as an

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[14] Resolution on the future of European company law (2012/2669(RSP)) Klaus-Heiner Lehne on behalf of the Committee on Legal Affairs, June 2012.

[15] Forum Europaeum on Company Groups, 'Proposal to Facilitate the Management of Cross-Border company Groups in Europe' (2015) 12 *European Company and Financial Law Review* ECFR 2015, 299–306. Two members of the ICLEG (Pierre-Henri Conac and Christoph Teichmann) were members of the FECG.

[16] Club des Juristes (CDJ), 'Towards Recognition of the Group Interest in the European Union?', June 2015. Two members of the ICLEG (Pierre-Henri Conac and Christoph Teichmann) participated to the drafting of the report.

[17] European Company Law Experts, A proposal for reforming group law in the European Union – Comparative Observations on the way forward, 2016.
The article is available on https://europeancompanylawexperts.wordpress.com/

[18] http://law.au.dk/en/research/projects/europeanmodelcompanyactemca/published-draft-chapters/

inspiration for Member States and to promote an EU wide soft harmonisation. The EMCA includes a chapter on groups which essentially applies the *Rozenblum* approach and provides for protections for minority shareholders and creditors. The EMCA was presented at a conference in September 2015 held at the *Wirtschaftsuniversität Wien* (WU) in order to benefit from comments and discussions.[19] The EMCA, including the chapter on groups, will be made public in 2017 free of charge on the internet. [20]

1.3 Recognition of group interest at the international level for financial institutions

The debate on the recognition of group interest is not only taking place at the EU level but also at the international level where the interest of the group has been recognized.

The most recent example is the revision of the Corporate Governance Principles for Banks issued by the Basel Committee on Banking Supervision (BCBS) as of July 8, 2015, which now contain a new principle 5 "Governance of Group Structures" and, inter alia, aim at enhancing the flexibility of the management of multinational groups, especially on a cross-border basis. To that end, the BCBS clarified that potential intra-group conflicts of interests, such as those arising from intra-group transactions, need to be resolved "in appropriate recognition of the interest of the group".[21]

This new best practice recommendation highlights the interest of the group as an important and legitimate aspect to be appropriately considered when balancing conflicting intra-group views (without compromising the legal integrity of individual subsidiaries). The rationale is to enable multinational groups to operate effectively by facilitating efficient intra-group decision-making processes and group-wide strategy execution, even in complex global corporate structures.

A similar set of issues have been taken into consideration in the context of insurance for the recent revision of the International Association of Insurance Supervisors (IAIS) Insurance Core Principle 7 (Corporate Governance) and the discussion of group interest in the October 2014 IAIS Issues Paper on Group Corporate Governance.[22]

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19 See, for a description of the various chapters and the discussions in Vienna, European Company and Financial Law Review (ECFR), de Gruyter, Volume 13, Issue 2 (2016).

20 http://law.au.dk/en/research/projects/europeanmodelcompanyactemca/

21 BCBS, *Guidelines: Corporate Governance Principles for Banks*, July 2015, para 96.

22 See IAIS, *Issues Paper: Approaches to Group Corporate Governance; Impact on Control Functions*, October 2014; IAIS, *Insurance Core Principles*, updated November 2015, 46-69.

2. State of Play

Within the EU, a specific regime for groups is more developed at the Member State level (2.2) than at the EU level (2.1). There is no company law regulation of groups at the EU level although there are provisions linked to this concept. However, the interest of the group has been recently recognized in EU banking legislation. As to Member States, they have adopted different approaches but there is a clear trend towards recognition of the interest of the group.

2.1 State of play at EU level

There is some legislation at the EU level in company law (2.1.1.) and in banking law, which takes into account the reality of the existence and the interest of the group (2.1.2). EU competition also clearly assumes that the group is a single economic entity (2.1.3). However, EU company law does not provide effective tools which could be applied throughout the EU to control the risks for which a parent company can be held liable under either banking law (risk management system for the whole group) or competition law.

2.1.1 Company law

There is no recognition of the interest of the group at the EU level in company law. During the late 1970s and beginning of the 1980s, at a time when there were far fewer Member States (MS) and the Commission pursued an agenda of harmonisation of company law, there was an attempt to elaborate a proposal for a ninth Company law directive, inspired by German law. This attempt was abandoned due to lack of support. However, there have recently been some developments at the EU level that relate to groups.

i) The proposal for a Directive on single-member private limited liability companies (SUP)

The proposal for a Directive of the European Parliament and of the Council on single-member private limited liability companies of 9 April 2014, introducing the *Societas Unius Personae* (SUP) relates to a certain extent to groups, since it deals exclusively with wholly-owned companies.[23] The original idea was to be found in the part of the report of the Reflection Group on groups. [24]

In order to facilitate the cross-border operation of groups of companies, Article 23 of the proposal for a directive introducing the SUP sought to recognize the right of the parent company « to give instructions to the management body », subject to the limitation that they would not be « binding for any director [of the subsidiary] insofar as they violate the articles of association or the applicable national law ».[25] This provision was not equivalent to the recognition of the interest of the group since the scope of instructions from a parent that bind the management body of a subsidiary would still be limited by applicable national law. Therefore, if there were no recognition of the interest of the

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[23] Proposal for a Directive of the European Parliament and of the Council on single-member private limited liability companies ('SUP Directive, Commission Proposal'), Brussels, 9.4.2014 COM(2014) 212 final.

[24] Reflection Group Report, 2011, 66.

[25] SUP Directive, Commission Proposal, Art 23.

group in the relevant Member State, an instruction from the parent that was in the interest of the group, but not in the specific interest of the subsidiary, would not bind the latter.

However, in the general approach adopted in the Council in May 2015, this provision was deleted due to the divergences among the Member States on its meaning and scope.[26]

ii) The Recast European Insolvency Regulation

The Recast European Insolvency Regulation (the 'REIR') has introduced new provisions relating to the coordination of insolvency proceedings that relate to several members of the same group of companies.[27] This is grounded on recognition of the fact that a group of companies can be sold or restructured in a way that benefits group creditors, if the restructuring is done through an integrated and a cross-border approach where the entity-level proceedings are co-ordinated. To this end, the REIR gives Member States' courts power to make orders for "group coordination proceedings", a form of procedural consolidation. These are intended to lead to the production of a group plan, developed by a lead insolvency practitioner and subject to the jurisdiction of a lead court. A court makes a group consolidation order if it considers that such an order:[28]

> "is likely to facilitate the effective administration of the insolvency proceedings relating to the different group members; and that no creditor of any group member is likely to be financially disadvantaged by the inclusion of that member in such proceedings."

The first limb articulates a form of group interest test. The second limb constrains the extent to which the group interest should be pursued: it must not be to the detriment of any creditors. This constraint is fortified by the grant of a veto on participation in any group consolidation to those running insolvency proceedings in respect of group entities.[29] Together, these ensure that the structural priority of creditors of subsidiaries will be respected.

The REIR has no presumption that group consolidation proceedings should be coordinated in the jurisdiction of the parent company. Rather, it is presumed that the proceedings shall be overseen by the court of the place where the group consolidation order is sought.[30]

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[26] See Proposal for a Directive of the European Parliament and of the Council on single-member private limited liability companies, Council General Approach ('SUP Directive, Council General Approach'), Brussels 21 May 2015, http://data.consilium.europa.eu/doc/document/ST-8811-2015-INIT/en/pdf.

[27] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, OJ [2015] L141/19, Arts 56-77.

[28] *Ibid*, Art 63(1).

[29] *Ibid*, Art 65.

[30] Although this can be changed by a two-thirds majority of the participating insolvency practitioners: *ibid,* Art 66.

iii) The Second Company Law Directive

The Second Company Law Directive of 1976 establishes a framework for legal capital in public companies in EU Member States.[31] The Directive is of minimum harmonization. Amongst other things, it prohibits the making of distributions by public companies to their shareholders in excess of either (i) the amount by which (if at all) the value of the company's net assets, as shown in the most recent annual accounts, exceeds the sum of its subscribed capital and undistributable reserves, or (ii) the company's balance sheet profits, if any.[32]

The Second Directive gives only a partial definition of 'distribution', with Article 17(4) providing that, 'the expression "distribution" ... includes in particular the payment of dividends and of interest relating to shares.' In the laws of some Member States, 'distributions' are understood to include not only transactions expressed to be by way of dividend, but also gratuitous or undervalue transactions between a company and its shareholders. Where such transactions are expressed to be effected otherwise than by way of dividend, they may be liable to be recharacterised by a court as a 'disguised distribution'. This imposes a constraint on intra-group transactions.

The extent of the relevant constraint depends on the approach of national law. For example, in both the UK and Germany, a transaction between a public company and its shareholder(s) is liable to be treated as a distribution if, regardless of the label given to it by the parties, the transaction is at a gross undervalue from the company's point of view.[33] However, the consequences of such recharacterisation differ. In Germany, for a transaction entered into by a public company, the simple fact of being a disguised distribution is sufficient to render the transaction unlawful, as all distributions are required to take the form of a dividend.[34] In contrast, for a UK company, or a private German company (GmbH), the transaction is only unlawful insofar as there are insufficient net assets or balance sheet profits to cover such a distribution.[35] In contrast, French law does not recognise the concept of 'disguised distributions'.[36]

In light of this national diversity there is some uncertainty as regards the extent to which, if at all, disguised distributions are reflected in the Second Company Law Directive's scheme: that is, the extent to which they are part of European company law,

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[31] Directive 2012/30/EU [2012] OJ L315/74 ('Second Company Law Directive—Recast'), replacing Second Council Directive 77/91/EEC [1977] OJ L26/1.

[32] *Ibid*, Art 17.

[33] On Germany, see AktG § 57; H. Fleischer, 'Disguised Distributions and Capital Maintenance in European Company Law', in M Lutter (ed.), *Legal Capital in Europe* (Berlin: De Gruyter, 2006), 94, 95; On the UK, see Companies Act 2006 s 829; *Progress Property Co Ltd v Moorgarth Group Ltd* [2010] UKSC 55, [2011] 2 BCLC 332.

[34] AktG § 57(3); P.-H. Conac, L. Enriques and M. Gelter, 'Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy' *European Company and Financial Law Review* ECFR, 2007, 491-528, at 502.

[35] Companies Act 2006 s 845; P. L. Davies, *Gower and Davies' Principles of Modern Company Law*, 9th ed (London: Sweet & Maxwell, 2012), 309-10; GmbHG §30(1).

[36] Fleischer, above n 33, 102-105.

as opposed to those of certain Member States.[37] The definition in Article 17(4) is only partial, and so it is certainly open to argument that its scope is broad enough to encompass disguised distributions. However, the Second Directive does not prohibit the making of distributions otherwise than as authorised dividends. This means that even if Article 17(4) would treat an undervalue transaction between a company and its shareholder as a 'distribution', it would only be prohibited by the Second Directive if the company did not at the time have sufficient net assets or profits to cover the amount of the distribution.

2.1.2 Financial services

The recognition of the existence of an interest of the group is especially strong in the area of financial services. This is due to the fact that financial activities are based on confidence and on the assumption that each subsidiary will benefit from the support of other members of the group, since the confidence in the whole group would otherwise suffer dramatic consequences. In practice, financial groups usually behave as a single economic entity even in a cross-border environment.

i) Group governance and risk management

Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (the Capital Requirements Directive or 'CRD IV') and Regulation 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms (Capital Requirements Regulation or 'CRR') take an integrated view of financial groups, including in relation to corporate governance and risk management. This cross-border view has the potential to create tensions with Member States' company laws, which have a national approach.[38]

CRD IV requires the parent company to be responsible for the organisation and the management of the whole group, with an effective control on subsidiaries, especially from a risk management perspective.[39] Therefore, EU banking regulations recognize the existence of a "banking group interest", as a risk management failure by a subsidiary could inflict damage on the whole group. The financial crisis provides several examples of financial institutions having suffered because of the risky behaviour of a foreign subsidiary or even branch. At the same time, there were also reverse instances of weak foreign parents and strong local subsidiaries, sometimes of systemic importance for host Member States. Some subsidiaries were asked by their parent to provide emergency financial support to prop-up the parent but with little visibility about the real financial situation of the parent, putting them, and their local supervisor, in a difficult situation. Those lessons from the crisis suggest the importance of better coordination in banking groups.

The requirements of CRD IV imply the right of parent's company management to give instructions to subsidiaries in order to ensure the integrated management of the group. However, CRD IV does not recognize the interest of the group or the right to give

[37] See *ibid,* 98-100.

[38] Those rules apply since January 2014.

[39] See Art. 74 and ff. Art. 88 and ff. of the CRD IV.

instructions since they are issues of company law. This has the potential to create serious conflicts with Member States' company laws, especially those which do not recognize the right to give instruction and/or the interest of the group. [40]

Although there are various approaches among Member States Companies Acts regarding the right to give instructions, the EMCA recognizes the right of a parent company to give instructions to the management of a subsidiary (see. below paragraph 2.2.1)

ii) Banking Recovery and Resolution Directive (BRRD)

This tension had to be solved in the case of bank difficulties. Therefore, the interest of the group has been recognized by the Banking Recovery and Resolution Directive (BRRD) of 15 May 2014.[41] The directive allows the provision of « intra group financial support » in a cross-border situation (in another Member State or third country) in the case where one of the parties to the agreement would meet the condition for an early intervention, that is, it would face a rapidly deteriorating financial condition.[42]

Recital 38 of the BRRD explains why an EU intervention was necessary in this field:

> « The provision of financial support from one entity of a cross-border group to another entity of the same group is currently restricted by a number of provisions laid down in national law in some Member States. Those provisions are designed to protect the creditors and shareholders of each entity. Those provisions, however, do not take into account the interdependency of the entities of the same group. It is, therefore, appropriate to set out under which conditions financial support may be transferred among entities of a cross-border group of institutions with a view to ensuring the financial stability of the group as a whole without jeopardising the liquidity or solvency of the group entity providing the support ».

Those provisions which needed to be superseded are national company law provisions which either only take into account the interest of the subsidiary or are not always clear as to the extent to which the interest of the group can be taken into account. Given the various interests at stake, the EU legislator decided to provide clarity for the directors of the subsidiary in order to facilitate cross-border intra-group support and ultimately financial stability in the EU.

According to the BRRD, a group financial support agreement shall, amongst other things, specify the principles for the calculation of the consideration for the provision of financial support.[43] Among these principles, Article 19(7)(b) states that:

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[40] See for instance for Germany, D. Weber-Rey and E. Gissing, *Gruppen-Governance - das Gruppeninteresse als Teil des internen Governance-Systems im Finanzsektor*, AG 2014 Heft 24, 884 – 891.

[41] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending (…), of the European Parliament and of the Council ('BRRD'), OJ [2014] L173/190.

[42] Early intervention implies that the financial institution is 'likely in the near future to infringe the requirements of Regulation (EU) No 575/2013, Directive 2013/36/EU, Title II of Directive 2014/65/EU or any of Articles 3 to 7, 14 to 17, and 24, 25 and 26 of Regulation (EU) No 600/2014' (BRRD, Art 27(1)).

[43] The consideration for the provision of financial support must be set at the time such support is given.

> "each party must be acting in its own best interests which may take account of any direct or any indirect benefit that may accrue to a party as a result of provision of the financial support."[44]

This makes it clear that *a subsidiary may take into account its interest in avoiding the insolvency of the parent* and implicitly recognizes that both interests may be aligned in the interest of the group remaining solvent as a whole.[45] Article 19(7) also requires that any party agreeing to provide financial support must have been 'acting freely' in entering into the agreement, on the basis of 'full disclosure of relevant information' from the recipient of financial support. The agreement must be approved by a joint decision of the consolidating supervisor and the competent authorities of the subsidiaries, and in case of disagreement, the European Banking Authority (EBA) can take a binding decision if a competent authority has referred the matter to it.[46] The shareholders of each concerned company, including wholly-owned subsidiaries, must have authorised the management body to decide whether to provide or receive financial support and can revoke that authority.[47] The management body must report to shareholders each year on the performance of the agreement.[48]

The BRRD also imposes conditions which must be satisfied for a group entity to *provide* group financial support, pursuant to the principles set out in the agreement. Those conditions include a requirement that:

> "the provision of financial support has the objective of preserving or restoring the financial stability of the group as a whole or any of the entities of the group and is in the interests of the group entity providing the support."[49]

This means that (if the other conditions are also satisfied) the subsidiary can act in the interest of the group if it is also its own interest. Since an insolvency of the parent company is likely to affect the subsidiary adversely, the stabilisation of the group can be an indirect benefit to the subsidiary providing support. Other conditions include a requirement that there is a reasonable prospect that the consideration for the financial support will be paid to the subsidiary and that, if support is given in the form of a loan the loan will be reimbursed.[50] Another condition is that the provision of the financial support would not jeopardise the liquidity or solvency of the group entity providing the support.[51] These requirements are being fleshed-out by regulatory and implementing technical standards as well as by EBA Guidelines.[52] These conditions are very similar to the French *Rozenblum* approach and the approach in the Netherlands.[53]

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[44] BRRD, Art 19(7)(b).

[45] Moreover, it is expressly contemplated that such consideration may take into account non-public information known to the subsidiary by virtue of its being part of the group: BRRD, Art 19(7)(d).

[46] BRRD, Art 20.

[47] BRRD, Art 21.

[48] BRRD, Art 21(3).

[49] BRRD, Art 23(1)(b).

[50] BRRD Art. 23(1)(d).

[51] BRRD, Art 23(1)(e).

[52] EBA Guidelines, specifying the conditions for group financial support under Article 23 of Directive

Because of the interests of the local stakeholders, there is an ex-ante right of opposition (*veto right*) and right to restrict the support by the competent supervisory authority of the group entity that intends to provide financial support, if it deems that the conditions for group financial support have not been met.[54] In such case, the consolidating supervisor or the competent authority responsible for the group entity receiving support can request the assistance of EBA which will play a coordination role.[55]

iii) Structural Measures Regulation (Proposed)

In January 2014, the European Commission tabled a proposal for a regulation on structural measures for improving the resilience of EU credit institutions.[56] This is a potentially countervailing current as regards the interests of the group in financial services. The 'structural measures' contemplated pertain to the separation of trading and commercial banking ('core credit') activities.

The Commission's proposal, which is based on the report of Erkki Liikanen,[57] will require Member States' national competent authorities ('NCAs') (or, for the Eurozone's largest banks, the ECB) to review large deposit-taking banks subject to their supervision, with a view to determining whether entity-level structural separation—with ongoing activity restrictions—should be imposed. NCAs must determine whether banks' 'trading activities' constitute a threat to the stability of the bank or to the EU financial system as a whole, using guidance to be supplied by the EBA.[58] If the authorities conclude that some or all of a bank's trading activities do constitute a threat to stability, they will then restrict the bank from carrying on such trading accordingly: this will necessitate 'structural separation' of these activities.

Structural separation may entail requiring the trading activities to be carried on in a separate entity within the group from the core credit activities. In this case, however, the proposal contemplates that the entity must be 'legally, economically and operationally separate'.[59] This includes restrictions on the terms of contracts between the core credit institution and the trading entity with the intention of reducing the extent to which the

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2014/59/EU, EBA/RTS/2015/08, 9 July 2015.

[53] See below Point 2.2.1.

[54] BRDD, Art 25(2).

[55] BRRD, Art 25(4).

[56] European Commission, 'Proposal for a Regulation of the European Parliament and of the Council on Structural Measures Improving the Resilience of EU Credit Institutions' COM (2014) 043 final ('Proposed SMR'). See generally J Armour et al, *Principles of Financial Regulation* (Oxford: OUP, 2016), Ch 23.

[57] High-Level Expert Group on Reforming the Structure of the EU Banking Sector, *Final Report* ('Liikanen Report') (2012).

[58] 'Trading activities' are defined very broadly to cover all activities other than insured deposit-taking, lending, and retail payment services. The NCA review is to focus in particular on three types of trading activity thought to be particularly risky, namely market-making, investing in and sponsoring securitizations, and trading in derivatives (Proposed SMR, Arts 8-9).

[59] Proposed SMR, Art 13(1).

latter may be exposed to the liabilities of the former.[60] Such restrictions would, to the extent they are implemented, pose a constraint on the credit institution's ability to further the interests of the group.

There is a potential conflict between such restrictions and resolution plans, discussed in the previous subsection. To this end, authorities contemplating making an order requiring structural separation at the entity level within a group must take into account the implications for resolution plans.[61]

2.1.3 Competition law

In EU Competition law, the existence of the group is taken into account in order to sanction the parent company for failures at the subsidiary level. The situation is similar to the one in banking law with the implementation of a risk management system (see above 2.1.2 *i*)

The leading case *Akzo Nobel* (ECJ, C-97/08 P of 10th September 2009) may illustrate the problem. *Akzo Nobel* was the parent company of a group of companies. It held directly or indirectly all the shares of the other group members. Some members of the group participated in anti-competitive activities. The European Commission decided to impose a fine on all members of the *Akzo Nobel* group jointly and severally. The parent *Akzo Nobel* claimed that it should not have been included since it had not been proven by the Commission that it had in any way influenced the subsidiaries. The ECJ, however, approved the Commission's approach:

> "It is clear from settled case-law that the conduct of a subsidiary may be imputed to the parent company in particular where, although having a separate legal personality, that subsidiary does not decide independently upon its own conduct on the market, but carries out, in all material respects, the instructions given to it by the parent company (…) (T)he fact that a parent company and its subsidiary constitute a single undertaking within the meaning of Article 81 EC enables the Commission to address a decision imposing fines to the parent company, without having to establish the personal involvement of the latter in the infringement. In the specific case where a parent company has a 100% shareholding in a subsidiary which has infringed the Community competition rules, first, the parent company can exercise a decisive influence over the conduct of the subsidiary (…) and, second, there is a rebuttable presumption that the parent company does in fact exercise a decisive influence over the conduct of its subsidiary (…). In those circumstances, it is sufficient for the Commission to prove that the subsidiary is wholly owned by the parent company in order to presume that the parent exercises a decisive influence over the commercial policy of the subsidiary. The Commission will be able to regard the parent company as jointly and severally liable for the payment of the fine imposed on its subsidiary, unless the parent company, which has the burden of rebutting that presumption, adduces sufficient evidence to show that its subsidiary acts independently on the market (…)."

[60] *Ibid*, Art 13(7).

[61] *Ibid*, Art 19.

Joint and several liability therefore can only be avoided if the group members are strictly separated not only legally but also in economic reality. In practice, however, it may be very difficult for a parent to show that it has not influenced a subsidiary.

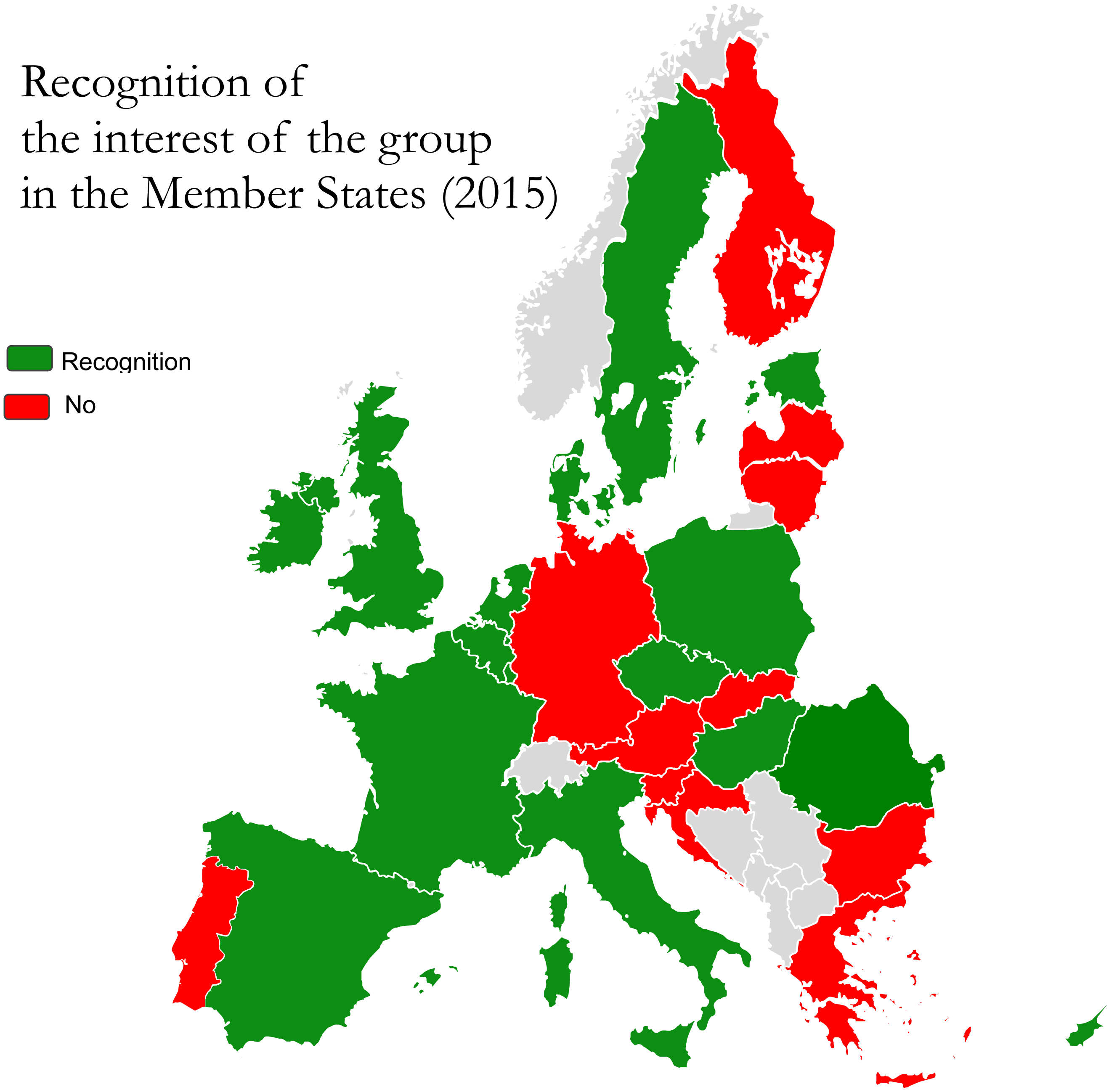
European Union law is therefore inconsistent with regard to groups of companies. There is no single approach; rather there are multiple, sector-dependent approaches. Moreover, it cannot be argued that the EU is moving in a single direction. Rather there is a range of different sectoral trends.

However, while EU legislation assumes in some instances that groups are an economic entity and that the parent is responsible for the subsidiary, it does not offer any company law tool that would enable the establishment of coherent cross-border group management. Cross-border groups therefore are falling between two stools: national company law rules, on the one hand, which start from the assumption that every company is a separate legal entity (and which in some cases do not even entitle the parent to give instructions), and European law rules, on the other hand, which lead to joint and several liability in case of any misconduct committed by one of the group members.

2.2 State of play at national level

Member States have different and even conflicting approaches as to the recognition of the interest of the group in company law. These differences reflect to a large extent the various degrees of preference for the protection of creditors and minority shareholders. Some Member States' company laws are strict and emphasize the protection of creditors and minority shareholders while others tend to favour the flexible management of the group by recognizing the interest of the group. However, these differences should not be overstated.

Figure 1: Recognition of the "interest of the group" in EU Member States, 2015



Note: *This map provides only a general view of the situation in the Member States. Romania includes limited legislative recognition of the interest of the group but has contrary case law. Hungary has in practice a system comparable to the* Rozenblum *doctrine. Finland and Greece do not recognize the interest of the group but there seems to be flexibility in practice as to the management of groups.*

On the one hand, it seems that Member States such as Germany recognize in practice some degree of flexibility in the management of groups and in intra-group transactions such as cash-pooling. On the other hand, no Member State would in practice allow related party transactions which would be highly damaging or severely affect the financial health of the subsidiary. Therefore, *the main difference is whether the directors of a subsidiary can permit some disadvantage to the subsidiary in the pursuit of the interests of the group, without having to compensate the subsidiary for this damage immediately, or within a short time period, and to the full amount.* Some Member States do not take account of the fact that the subsidiary is part of a group. We characterise the laws of Member States that do (not) permit subsidiary directors as (not) "recognising the interest of the group" accordingly. Figure 1 shows how Member States can thus be divided into two categories:

2.2.1 Member States that recognize the interest of the group

A large number of Member States (17) recognize the interest of the group to a certain extent either through case law or legislation.

> Member States which recognize, at least to a certain extent, the interest of the group through case law (or where there is no case law, it is recognized by lawyers and/or academia) are: Belgium, Cyprus (as their company law is inspired by the UK), Denmark, Estonia,[62] France, Ireland, Luxembourg, Malta (as their company law is also inspired by the UK), the Netherlands, Poland, Spain,[63] Sweden and the United Kingdom.
>
> Member States which recognize the interest of the group by virtue of a legislative regime are: the Czech Republic, Hungary and Italy
>
> One Member State recognizes the interest of the group (in the case of intra-group loans) but case law is hostile to the recognition of the interest of the group: Romania.

Although Member States' case law usually developed itself autonomously, the oft-quoted model for the case law recognition of the interest of the group in Europe is the French Supreme Court (*Cour de cassation*) 1985 decision in *Rozenblum*.[64] The French court established in this case that the director of a solvent subsidiary may take into consideration the interest of the group when making a decision that causes an immediate disadvantage to the subsidiary, provided all of the following conditions are satisfied:

> "the financial aid consented by the managers of the company which is part of a group in which they are directly or indirectly interested, should be motivated by

[62] *Riigikohus Tsiviilkoleegium*, n°3-2-1-129-15, Tartu, 24. November 2015.

[63] See, *Tribunal Supremo. Sala de lo Civil Sede, Recurso* n°695/2015, 11 December 2015; and before, in the case of nullification of intra-group guarantees in insolvency, *Juzgado de lo Mercantil*, 8 November 2011 (JUR 2012/335836), and Supreme Court Judgement (Civil, sec.1ª), 8 November 2012 (RJ 2013/901).

[64] See Trib. Corr. Paris, 16 May 1974, Soc. Saint-Frères, D. 1975, p. 37, Rev. soc. 1975, p. 657, n. B. Oppetit, JCP éd. E. 1075, II-11816, p; 381; Court of cassation, Criminal Chamber, 4 February 1985, Rozenblum and Allouche, D. 1985, p. 478, n. D. Ohl, I-639, JCP 1986, II-20585, n. W. Jeandidier, Rev. soc. 1985, p. 648, n. B. Bouloc.

the common economic interest in relation with the global policy of the group, should not be devoid of counterpart and should not provoke imbalance of the mutual obligations, nor exceed the financial capacity of the solicited company".

These conditions are restrictive and rather vague, reflecting the procedural context of the Rozenblum case as concerning the potential application of criminal liability for "abuse of corporate assets" (*abus de biens sociaux*). However, the Rozenblum test also applies in France to directors' civil liability for breach of duty. It also reflects, broadly speaking, the approach adopted in the Netherlands.

Meeting these conditions provides directors with a defence to, or "safe harbour" from, liability for breach of duty.[65] The conditions for the subsidiary company may be expressed as follows:

(i) the company is a member of a group;

(ii) the company's directors act in accordance with what they believe to be the common, or shared, interests of the company and other group members;

(iii) the transaction should not be for a grossly inadequate consideration, from the company's point of view (that is, it should not be 'devoid of counterpart' or 'provoke imbalance of the mutual obligations');

(iv) the transaction should not bring into question the company's ability to pay its debts (it should not 'exceed the financial capacity' of the company).

Of these four criteria, (iv) protects especially the interests of creditors of the subsidiary, and (iii) protects especially the interests of minority shareholders. In the laws of Member States that recognize the interest of the group through case law, the protection of minority shareholders and creditors is effected through general company law and insolvency law provisions such as the right for a shareholder to petition the court if there has been unfair prejudice, which may lead to a court order for the sale of the shares (UK) or a court order for a director to contribute to an insolvent company's assets if there has been wrongful trading (UK).

Member States that have a legislative regime provide for a comprehensive regime for groups which includes specific provisions for the protection of creditors and minority shareholders but also provisions on governance of groups. They usually provide sell-out rights for minority shareholders in certain situations, especially in case of abuse (Italy, Czech Republic). They also recognize the right of parent companies to issue instructions to subsidiaries (also enshrined in the 2012 amendment of Dutch law on private companies, unless the instructions evidently violate the interest of the subsidiary).

The EMCA also recognizes, with some exceptions (e.g. directors and managers who were not appointed by the parent company or by the controlling shareholder; directors who are employee representatives…), the right of a parent company to give instructions to the management of a subsidiary provided those instructions do not violate a *Rozenblum* like test which includes that the transaction(s) would not place the continued existence

[65] For a presentation of the *Rozenblum* case, see Reflection Group Report, 2011, 62.

of the company in jeopardy. The management of the subsidiary may refuse to comply with instructions from the parent company if those conditions are not satisfied.

Member States also imply some degree of transparency for the benefit of stakeholders through disclosure of the existence of the group (Italy, Czech Republic, Hungary) and through, in some cases, the publication of a "dependency report" (Czech Republic).

2.2.2. Member States that do not recognize the interest of the group

Other Member States (11) do not recognize the interest of the group at all or only in particular situations.

> Member States which have a legislative regime are Germany, when the subsidiary is a public limited liability company (*AG*), as well as some Member States which have followed closely the German model: Croatia, Latvia, Portugal and Slovenia.
>
> Member States which do not have a legislative regime but have case law refusing the recognition of the interest of the group are: Austria, Germany (this time for limited liability companies, *GmbH*) and Lithuania.
>
> Member States which do not have a legislative regime and no case law but it is considered that there would be no recognition of the interest of the group (although there might be some flexibility in practice) are: Bulgaria, Finland, Greece and Slovakia.

Broadly speaking, these may be divided into two groups.

Under the German *Konzernrecht*, if there is a "domination contract" (*Vertragskonzern*), the parent company can issue instructions to the subsidiary (*GmbH or AG*) which the latter's board must follow without regard to the subsidiary's separate interests as long as the instruction is justified in the interest of other members of the group. However, the parent must by the end of the relevant fiscal year compensate the subsidiary's annual loss. For the purpose of the protection of minority shareholders, minority shareholders may either sell their shares to the parent or stay in the subsidiary and receive an annual compensation payment. Creditors of the subsidiary can be indemnified if the parent company did not use its right to give instructions with with due care and if compensation can not be received from the subsidiary .[66]

In the case of a group where a parent company exercises control of public limited liability companies and there is no domination contract, German courts qualify this situation as a *de facto* group (*faktischer Konzern*). In such case, there must be a dependency report which indicates what compensation for the damage suffered was provided.

Finally, if the subsidiary is a private limited liability company (GmbH) and is not part of a contractual group, there is a right to give instructions (based on general private limited liability company law) but courts have held that the parent company is not allowed to inflict any damage on the subsidiary subsidiary as long as there are minority shareholders. In case of a wholly-owned subsidiary or the agreement of every shareholder, the infliction of damages is only limited by the so called liability for

[66] German Public Companies Act (*AktG*), § 309.

destruction of economic basic (“*Existenzvernichtungshaftung*”).

2.2.3 Evolution in Member States toward recognition of the interest of the group

It appears that the *Rozenblum* doctrine—or a similar formulation—has reached a status approaching *ius commune* for Member States that recognize the interest of the group. In addition, several Member States have moved in recent years towards the recognition of the interest of the group, through statute or case law (most recently Estonia and Spain by a decision of the Supreme Court of 27 November 2015 and 11 December 2015 respectively), or are considering moving in this direction (a 2014 report in Greece supported the transliteration into Greek law of the *Rozenblum* doctrine) even while adopting some elements of German law. No Member State has moved from *Rozenblum*, or similar, doctrines toward the rigid approach of compensating any losses, although, some elements of the German approach have been usually included (e.g. dependency report, sell-out right).

Despite these differing approaches, opposition might not be so strong especially when the company is wholly-owned. Also as stated by the report of the Reflection Group “the German system, at least relating to factual groups, seems to be closer than it looks to the UK, Nordic and French approach where flexibility is allowed and liability for managing a subsidiary in the interest of the group occurs in practice mostly when the subsidiary is insolvent or close to it ».[67]

Therefore, the opposition seems ultimately to be concentrated on certain types of groups (contractual groups and groups of GmbH in Germany) and in certain countries (Austria, Portugal). Also, the opposition seems to be focused on the tool to protect minority shareholders, although there is a general approach towards a right to sell-out.

2.2.4 Creditor protection

The formulation of the interest of the group set out in the *Rozenblum* doctrine expressly only applies insofar as the actions in question do not call into question the solvency of the subsidiary. This constraint serves to protect the interests of creditors. Where the transaction does call into question the subsidiary’s solvency, then the formulation would not continue to provide a defence to its directors. In order to avoid any encroachment on the rights of creditors, we similarly limit the proposals in this report to cases where the subsidiary is solvent, and the proposed actions do not call this status into question.

However, the determination of a company’s solvency, and the consequences of this for directors’ powers and duties, varies considerably across national laws. For example, in Germany, company directors are required to put their company into insolvency proceedings within three weeks of its becoming overindebted or illiquid, or face personal liability.[68] In contrast, in the UK, the ‘interests of the company’ which directors

[67] Reflection Group Report, 2011, 64.

[68] *Insolvenzordnung* §15a. However, the company is deemed not to be overindebted if, notwithstanding balance sheet or cash flow insolvency, it is ‘highly likely’ the enterprise will be able to continue (*ibid* §19(2)).

must seek to further, become, in the vicinity of insolvency, the interests of the creditors.[69] We understand that, under the aegis of its work on the Capital Markets Union, the European Commission is considering possible reforms to insolvency law. The Report of the Winter Group in 2002 recommended an EU-level harmonizing measure on directors' liabilities in the vicinity of insolvency.[70] Their recommendation was based in part on the observation that the wide degree of variance in Member States laws makes it difficult for creditors to know, and to be confident in, the level of protection they will be offered when lending to a debtor situated in another Member State. This sort of consideration is surely relevant to the CMU's goal of stimulating finance for SMEs.

We note in passing that the problem of inconsistent creditor protection measures has likely been exacerbated by the effects of the CJEU's recent decision in *Kornhaas*.[71] Under the European Insolvency Regulation, insolvency proceedings are generally to be opened in the jurisdiction in which the debtor has its 'centre of main interests'.[72] For a company, this will be the jurisdiction in which the debtor 'conducts the administration of its interests on a regular basis and which is ascertainable by third parties'.[73] This may well be a different jurisdiction from that of the company's registered office. The law of the place of opening proceedings is then applied to govern the insolvency process, including rules prescribing the 'conditions for the opening' of insolvency proceedings and measures laying down the consequences of 'legal acts detrimental to all the creditors'.[74] The Court in *Kornhaas* held that this included a German law measure imposing personal liability on company directors for any payments made by the company after failure to file for insolvency proceedings within three weeks of the company becoming over-indebted, because this dealt with the consequences of failure to open insolvency proceedings, and regulated acts detrimental to all the creditors. As a consequence, many Member State creditor protection measures applying in the vicinity of insolvency would also be classed as 'insolvency law' measures within the ambit of the Regulation. The Court also held, distinguishing earlier case law, that such measures were not relevant to the exercise of the company's freedom of establishment, as they did not apply as a consequence of its establishment in that jurisdiction, but only some time later, following its over-indebtedness.

The result is that directors and creditors of a company incorporated in one Member State ('Member State A') may find that (depending on where its COMI is judged to have been) the rules governing directors' liability in the vicinity of insolvency in another Member State ('Member State B') are applied instead. This may not only confound expectations, but also may lead to inappropriately high (or low) levels of creditor protection. For example, if the laws of Member State A apply creditor protection measures that are categorised as company law, whereas Member State B applies measures categorised as insolvency law, creditors may enjoy two tiers of protection,

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[69] See eg *Roberts v Frohlich* [2011] EWHC 257 (Ch), [2011] 2 BCLC 625.

[70] Winter Group Report, 2002, 68-69.

[71] Case C-594/14, ECLI: EU: C: 2015: 806.

[72] REIR, Art 3(1).

[73] *Ibid.*

[74] *Ibid*, Art 7(2)(m).

through the application of the company law of A and the insolvency law of B. However, if the allocation were reversed, such that A governed creditor protection through insolvency law and B through company law, it seems at least arguable that neither set of measure might apply.

For present purposes, however, we wish to highlight the intersection between measures to coordinate creditor protection, and the recognition of the interests of the group. Any proposal for an EU-level initiative to facilitate recognition of the interests of the group must intersect with creditor protection.[75] Where the substantive creditor protection rules that may apply to subsidiaries are so varied, and subject to such uncertainty, the efficacy of any such intervention is reduced because of uncertainty about its scope of application. Were the Commission to include in its programme a measure—as recommended by the Winter Report—seeking to harmonize directors' creditor-regarding obligations, this would not only avoid the substantive uncertainty over the level of protection to be applied, but also greatly facilitate the recognition of the interests of the group.

[75] Indeed, this point was also made by the Winter Group: Winter Group Report, 2002, 69.

3. Problems

The report of the Reflection Group of 2011 provided several arguments supporting the recognition of the interest of the group at the European level by a recommendation. Other arguments, linked to recent developments in the financial sector, can be added.

The recognition of the interest of the group at the EU level would help to solve those problems:

3.1.1 Lack of clarity for the directors of the subsidiary and of the parent as to the extent to which they can act in the interest of the group in a cross-border situation

3.1.2 Costs of doing business cross-border

3.1.3 Obstacles to the cross-border management of financial institutions

3.1.4 Facilitation of intra-group financing, to reduce the high dependency on bank funding, as required by the Capital Market Union (CMU)

3.1.5 Reduction of legal uncertainties in cross-border cash pooling

The recognition of the interest of the group at the EU level would also provide additional advantages:

3.2.1 Shield the parent company from unjustified claims by creditors of the subsidiary

3.2.2 Improvement in the exercise of freedom of establishment because harmonisation would support the establishment of subsidiaries

3.2.3 An action at the EU level on the recognition of the group interest may pave the way for hard-law change in Member States

3.2.4 An action at the EU level on the recognition of the group interest would be consistent with the development of the Common Consolidated Corporate Tax Base (CCCTB)

3.1 Problems which could be alleviated by an EU intervention

3.1.1 Lack of clarity for the directors of the subsidiary and of the parent as to the extent to which they can act in the interest of the group in a cross-border situation

As stated by the Reflection Group: "A major advantage of the recognition of the interest of the group is that it provides more clarity to the directors of the subsidiary as to which transaction or operations they can approve ».[76]

Directors and managers of the *subsidiary* would benefit because although they know their national company law, the relevant aspects of company laws in those Member States that recognize the interest of the group is often unclear, especially when developed through case law. This might impede an appropriate consideration of group interest at the subsidiary level. An EU intervention, fleshing out what is generally acceptable behaviour within a group, and possibly with a "white list" of acceptable practices and/or a "black list" of unacceptable practices, could yield very useful clarification. Among those examples, it could include transfer pricing guidelines. This approach has been applied successfully in Germany and also in Lithuania. However, in order to be effective, the ICLEG thinks that such a "white-list" should be quite precise.

The benefit would be even larger for the directors and managers of the *parent* company because it may be far from clear to them what is permissible for a subsidiary incorporated in another Member State. A common approach at the EU level would help them to be sure that their instructions or business decisions, as well as typical intra-group transactions, can be implemented by the subsidiaries without triggering a risk of civil or criminal liability for the directors of the subsidiary and themselves, in the case where, eventually because of such instructions, they could be considered shadow or *de facto* directors in the subsidiary jurisdiction. Shadow or *de facto* directors, depending on the Member State, are natural or legal persons whose instructions the directors are accustomed to follow (shadow directors) or who in practice act as directors of a company even though they have not legally been appointed as such (de facto directors).

The benefits of the recognition of the interest of the group would be higher for Small and Medium Size Enterprises (SMEs) engaged in cross-border activity because the managers of the parent company are less likely to be able to bear the cost of legal advice on the company law of other Member States.

Of course, a uniform approach would not achieve complete harmonisation in practice, as a European definition of the interest of the group would still need to be interpreted by national courts. However, an EU intervention would still be of great value if it could provide increased clarity to directors and managers relative to the current position.

3.1.2 Costs of doing business cross-border

As stated by the Reflection Group, the recognition of the interest of the group « would help parent companies located in EU countries recognizing the interest of the group to manage and enter into transactions with their subsidiaries located in other EU countries without having to analyse whether or not the legislation in the other country does or

[76] Reflection Group Report, 2011, 60.

does not recognize the interest of the group. A more uniform rule could therefore reduce the cost for groups doing business in EU cross-border situations since they would have to invest less in knowing and analysing the technicalities of each national law ».[77] The 2015 report of the Club des Juristes supporting a recommendation, also argued that "a standardised solution at the European level would result in simplification and savings ».[78]

A recognition of the interest of the group at the EU level would bring some degree of approximation in Europe as to the interest of the group and what are the best practices. Although approximation of company law is not a goal in itself, it should lead to a reduction in the cost of compliance. For Member States which recognize the interest of the group, an action at the EU level would be useful as it would provide a benchmark, which could influence judges and legislators. This could lead to a soft harmonisation of European company law.

The report of the Reflection Group noted that

> "It will be important to provide factual evidence as to whether the reduction in legal costs and the facilitation of cross-border activity would offset the costs of introducing a new harmonised rule and any uncertainties it might give rise to."[79]

This remark applies more to a directive than to a recommendation which cannot by itself impose a uniform standard. Providing such evidence is not easy to achieve as such costs are sunk into the legal cost of managing companies cross-border. However, a reduction of cost could result also in a reduction in the cost of legal cases involving cross-border intra-group transactions. In general, the more similar the rules, the less the need for costly legal analysis.

This approximation, done by an action at the EU level, could or should not lead to a full harmonisation in those Member States. This is due to the fact that the defence of the interest of the group is raised almost exclusively in insolvency proceedings. It is not possible, nor advisable to have a rigid approach imposed on national courts since each case is fact sensitive and judges need to keep a large degree of discretion. However, a European benchmark would be useful to frame this discretion.

Case study: Parmalat, Italy (2013)[80]

The 2015 report of the Club des Juristes quoted a cross-border case involving a Related Party Transaction (RPT) between a French parent company, Lactalis, and its large Italian listed subsidiary Parmalat.[81] Parmalat had been subject to

[77] Reflection Group Report, 2011, 61.

[78] Club des Juristes, 2015, above n 16, 19.

[79] Reflection Group Report, 2011, 61.

[80] A. Pomelli, Related-Party Transactions and the Intricacies of Ex Post Judicial Review: The Parmalat/Lactalis Case, *European Company and Financial Law Review* ECFR 2016, 73–105.

[81] Club des Juristes, 2015, above n 16, 20.

a takeover by Lactalis in 2011, but was still listed with minority shareholders. This case was the starting point for the report as it was considered to be an example of the problems in the cross-border management of groups that needed to be addressed.

Lactalis requested that Parmalat purchase the Latin American subsidiaries of Lactalis. Minority shareholders of Parmalat argued that the price, around $900 million, was inflated and that the transaction was designed to allow Lactalis to repay the loan used for the takeover, by evading legal limitations on the amount of the dividend it could receive from Parmalat. The transaction was subject to a regulation of the Italian Securities regulator, the Consob, applicable to listed companies in case of large RPTs. The first instance court of Parma found in March 2013 that the advisor establishing the fairness obligation lacked independence, since it was a bank which co-financed the takeover of Parmalat and had a loan outstanding. It also found the RPT Committee of Parmalat negligent as it relied too easily on the opinion of the expert. Because of these procedural violations, the Court appointed an expert to determine whether the price was "fair". The expert held that Parmalat overpaid by around 16%. In May 2013, Lactalis agreed to pay an extra amount to Parmalat to compensate for the difference. The Bologna court of appeals upheld the decision and also decided that the case was moot because of the reimbursement by Lactalis to Parmalat of the alleged overvaluation. In October 2013 Consob found all members of the board of statutory auditors (*collegio sindicale*) guilty of breach of their duty to oversee that the RPT Committee reviewed the process and arguments and that the acquisition was in the corporate interest of Parmalat.[82]

The Club des Juristes noted that Italy recognizes the interest of the group in its Civil Code[83] but that "This decision nonetheless illustrates that even when such recognition does exist, legal uncertainty remains because of the lack of harmonisation at European level."[84] In this case, the legal basis for the decision was the regulation on RPTs by Consob. The violations were procedural leading the court to identify a lack of fairness of the transaction. The Consob regulation played its role to protect the minority shareholders and any European intervention should not interfere with such rules. However, it is clear at the same time that what is considered to be in the interest of the group might not be understood the same way in France and Italy and that some targeted harmonisation would be helpful.

The fact that some Member States do not recognise the interest of the group plays in favour of creditors of a subsidiary at the expense of creditors of the parent (foreign) company. In exceptional circumstances, this divergence could endanger the survival of the group.

[82] Consob decision no. 18678 of 17 October 2013.

[83] Art. 2497 et seq. of the Italian Civil Code.

[84] Club des Juristes, 2015, above n 16, 20.

Case study: Royal Imtech, Netherlands (2015)

Royal Imtech was a Dutch building and engineering services company with a large German subsidiary (which was in charge of building the new Berlin airport). Imtech found itself in difficulties due to several contracts and after accounting irregularities were uncovered in its Polish and German operations. In order to rebuild its solvency, Imtech entered into an agreement with the banks for an amount of €75 million. However, the German subsidiary requested to receive €40 million as part of the €75 million package for fear that otherwise the directors could be subject to liability under German company law if they did not file for insolvency. German company directors are obliged to file for insolvency within three weeks of discovering the firm is insolvent, or they face personal liability.

However, the banks in the Netherlands refused to provide such an amount to the German subsidiary and the agreement collapsed. As a consequence, the German subsidiary filed for insolvency in early August 2015 and the Dutch parent had also to file for insolvency the week later.

The fact that German company law does not recognize the interest of the group suggests that the directors of the German subsidiary decided that they should file for insolvency without waiting, or receive a substantial amount to keep the company solvent, although if the parent had received the 75 million euros loan, the group as a whole might have been saved.

3.1.4 Obstacles to the cross-border management of financial institutions

The situation is more concerning in the financial services industry, which is facing a pull-back toward de-globalization, and sometimes ring-fencing, because of measures by legislators and regulators who want to protect creditors of subsidiaries and financial stability first.[85] This is understandable, especially when a banking subsidiary is systemic for the Member State concerned, since the national taxpayer, in the absence of an EU taxpayer, might foot the bill in the event of an insolvency of the subsidiary. Therefore, there has been a trend since 2008 toward requiring greater board autonomy and independent directors at the subsidiary level.[86] The rationale is that this will help to ensure the separate consideration of the interests of the (systemically important) commercial bank subsidiary from those of the group.

However, if regulatory regimes require a subsidiary board to be staffed with a growing number of independent directors—that is, individuals that are independent from the

[85] 'Ring-fencing' in this context encompasses both host state measures seeking to impose capital requirements on local subsidiaries of international groups, and domestic measures requiring the separation of commercial and investment banking functions into separate entities within a group: see J-H Binder, 'To Ring-Fence or Not, and How? Strategic Questions for Post-Crisis Banking Reform in Europe', working paper, Eberhard-Karls University, December 2014, and section 2.1.2(iii) above.

[86] See eg Independent Commission on Banking (UK), *Final Report* (2011), paras 3.90-92 and 9.2 Recommendation 5; W. Richard Frederick, foreword by Eddy Wymeersch, Focus 13, *Challenges in Group Governance: The Governance of Cross-Border Bank Subsidiaries*, IFC Corporate Governance Knowledge publication, 2014, 64 pages.

group's management--this may further complicate the efforts of group management to ensure managerial compliance with group directives or a group-wide strategy at the subsidiary level. This is a necessary corollary of the ring-fencing policy. However, unnecessary costs may be incurred if there is insufficiently clear guidance for subsidiary directors as to the cases in which it is possible and appropriate to recognise the interest of the group. The UK ring-fencing regime, for example, applies the principle that the subsidiary must be able to take decisions independently of the other members of its group, and may only contract with other group entities on 'arm's length' terms—that is, no less favourable than would be the case in relation to a transaction with a party that was not a member of the group.[87] As was discussed above, the proposed EU Structural Measures Regulation would establish the possibility for similar entity-level separation to be introduced across the EU. However, UK-style independent decision-making and arm's length intragroup transactions involving the commercial bank are the maximum level of separation on a scale, at the other end of which is that the national authorities conclude no separation is required. There are a wide range of positions in between, each of which will necessitate some sort of guidance to banking group members regarding intragroup transactions and the extent to which subsidiaries may legitimately act in the interests of the group.

As discussed in section 2.1.2(i), CRD IV requires the parent company to be responsible for the organisation and the business strategy of the whole group, with an effective control on subsidiaries, especially from a risk management perspective. These requirements can create conflicts with subsidiaries, especially regarding strategic decisions (investment management, procurement, IT) and financing (intra-group cash pooling, upstream or downstream intra-group guarantees) which are at odds with greater board autonomy and independent directors at the subsidiary level. Therefore, it is not surprising that general counsels or chief governance officers of global financial groups have recently raised this issue since the problem is now more acute. They have explicitly supported the recognition of the interest of the group at the EU level to try to limit these conflicts.

For instance, in a recent article, the General Counsel of the Zurich insurance Group argues that:

> "[g]iven the importance of an integrated and consolidated group view, the EU Commission's initiative to improve the recognition of group-interest in the parent-subsidiary relationship is an important step in the right direction. Harmonizing the recognition of the interest of the group within the EU would not only provide helpful and consistent guidance at the corporate level, it would also help mitigate the current tensions between regulatory and corporate law regimes …"[88]

The Chief Governance Officer of Deutsche Bank has also recently called for an EU

[87] See Prudential Regulation Authority (UK), *The Implementation of Ring-Fencing: Prudential Requirements, Intragroup Arrangements and Use of Financial Market Infrastructures*, Consultation Paper CP37/15, November 2015, Draft PRA Rules on Ring-Fenced Bodies, Rules 3 and 12.

[88] Y. Hausmann and E. Bechtold, 'Corporate Governance of Groups in an Era of Regulatory Nationalism — An Analysis with a Focus of Financial Services Regulation' (2015) 12 *European Company and Financial Law Review* 341.

intervention in case the German legislator does not solve the conflict between regulatory and company law.[89]

Considering this background, it is not surprising either that the first European directive recognizing the interest of the group, the BRRD, has been in the area of banking regulation because the stability of the group, which can affect the whole of Europe, must prevail against local interests. Therefore, the European legislator had to strike a balance between the interest of the group, and of the EU, and of the local subsidiaries. Although, a veto right of the local supervisory authority has been recognised, the BRRD is still a major step forward. However, as in the area of risk management, it should be noted that the application of the group support provisions of the BRRD in one Member State would have to be applied by courts within the scope of their company law. Since company law has not been clearly superseded, it cannot be excluded that conflicts might happen in Member States that do not recognize the interest of the group and possibly in the others.

> ***Recommendation 1:*** *The Commission should consult on whether the lack of recognition of the group interest, or the imperfect recognition of such interest, prevents financial institutions from managing their subsidiaries cross-border and/or could hamper the proper functioning of the BRRD provisions on group support.*

3.1.5 Facilitate intra group financing, to reduce the high dependency on bank funding, the aspiration of the Capital Market Union (CMU) programme

As stated in the Green Paper of the Commission on Building a Capital Market Union of 2015, European businesses remain heavily reliant on banks for funding and relatively less so on capital markets.[90] Therefore, the Green Paper of the Commission seeks to improve access to financing for all businesses across Europe and investment projects, in particular start-ups, SMEs and long-term projects; increase and diversify the sources of funding from investors in the EU and all over the world; and make capital markets work more effectively so that the connections between investors and those who need funding are more efficient and effective, both within Member States and cross-border.

The provision of intra-group loans, financial guarantees (both upstream and downstream) are further examples of potential tensions between group management and the subsidiary boards. In the parent-subsidiary context, the views of subsidiaries

[89] See, D. Weber-Rey and E. Gissing, *Gruppen-Governance - das Gruppeninteresse als Teil des internen Governance-Systems im Finanzsektor*, *Die Aktiengesellschaft*, 2014 Heft 24, 889. « *Sollte sich auch der Geseztgeber dieser Auffasung anschliessen oder aber über einen langeren Zeitraum untätig bleiben, wird dadurch – nach Ansicht der Autorinnnen – die Schaffung eines einheitlichen Konzernrechts auf europäischer Ebene begünstigt, möglischerweise dringend notwending machen* » (If the German legislator were to adopt this view or would do not act after a long time period, then, according to the authors, the creation of a group law at the European level, would be attractive, and probably even urgently necessary).

[90] Green Paper Building a Capital Markets Union Brussels, 18.2.2015 COM(2015) 63 final.

and the group (mostly represented by the ultimate parent) are usually aligned. Complications may arise, in particular, when subsidiary boards are asked to approve financial transactions within (and beneficial to) the group. Financial transactions such as the provision of intra-group loans, financial guarantees which may not be perceived by some as equally beneficial to the group and a subsidiary are examples where the group management view (top-down) and the subsidiary's legal entity view (bottom-up) may diverge.

A harmonized understanding of the circumstances in which recognition of group interest should be possible would help EU groups and their subsidiaries to balance these potentially conflicting perspectives and thus help facilitate and promote efficient intra-group financing practices.

Facilitating intra-group transactions would contribute towards the CMU objectives in two ways. First, it would clarify the treatment of internal group transactions for outsiders. This is especially important for those considering providing external finance. General, standardised rules are likely to be relatively important for capital markets, as opposed to banks, because capital market investors in a particular company are typically widely dispersed and face high coordination costs.

Second, facilitating intra-group transactions makes intra-group financing more straightforward to arrange. This contributes to the CMU goal of reducing the reliance of businesses on banks for funding. If there is money available within a group, it should be possible for it to be used in priority to obtaining outside funding if the group so wishes and this does not prejudice the solvency of the company providing the finance.

3.1.6 Reduce legal uncertainties in cross-border cash pooling

As stated in the answer from the Ministry of Justice of Denmark to the Consultation of 2012 on the Future of European Company Law "practitioners have identified a need to have clearer and harmonised rules on a small number of specific issues such as cash pooling and loans within an international group" (see above, section 1.2). Both these issues are closely related since cash pooling arrangements may involve intra-group loans.

Cash pooling involves combining balances in multiple bank accounts, and is commonly used within groups. The main reason for doing so is for the group of companies to obtain a higher rate of interest from the bank on the pooled cash than individual companies would have obtained by using separate accounts. Cash pooling can also, amongst other benefits, reduce back office costs, as cash is centralised.

A brochure published by the law firm CMS in 2013 describes cash pooling as follows:

> "Under a cash pooling arrangement, entities within a corporate group regularly transfer their surplus cash to a single bank account (the 'master account') and, in return, may draw on the funds in that account to satisfy their own cash flow requirements from time to time. The master account is usually held by the parent company or by a 'treasury company' established specifically for this purpose. Depending on the type of cash pooling arrangement, the participating entities may

transfer either their entire cash surplus ('zero balancing'), or cash exceeding a certain surplus level ('target balancing').

In general, all entities participating in the cash pooling arrangement will be liable for any negative balance on the master account, irrespective of the amount they have contributed.

Transfers and draw-downs of funds to and from the master account by the participating companies have the nature of the grant and repayment of intra-group loans.

In addition to physical cash pooling, there is also 'notional' (also known as 'virtual') cash pooling. This does not involve the physical transfer of funds, but rather the set-off of balances of different companies within the group, so that the bank charges interest on the group's net cash balance. This optimises the position of the group as regards interest payments, but does not achieve optimal allocation of liquid funds as between the group members."[91]

Most Member States do not specifically regulate cash pooling. The legal regime is subject to certain company law requirements (such as, agreement by shareholders or directors, and/or capital maintenance requirements) but is mostly regulated by case law. However, there is not always case law, nor does it always provide legal certainty.

Member States that recognize the interest of the group are more flexible as to the conditions required for the validity of a cash-pooling arrangement, especially as to the level of interest paid to the subsidiary participating in the cash pooling. In other Member States, on the contrary, there are specific risks associated with the establishment of a cash pooling arrangement, such as the prohibition on unlawful disguised distribution (hidden dividends). This is the case, for instance, in German and Austrian company laws.

Case study: Austria (2015)

According to companies which are members of the Austrian industrial companies federation (*Industriellenvereinigung Österreich*), the lack of recognition of the group interest creates serious difficulties with the functioning of cross-border cash-pooling. The situation is especially difficult for the managers of Austrian subsidiaries since they face the risk that cash-pooling is treated as a hidden distribution of reserves to their cross-border parent. According to the Austrian industrial companies, this creates considerable obstacles to the cross-border free flow of cash within groups.

These legal uncertainties make it more difficult than it should be to operate a cross-border cash pooling arrangement. An EU intervention could facilitate the cross-border intra-group flow of capital.

[91] CMS, *Cash Pooling*, July 2013, 4.

There could be a consensus among Member States on some elements that could form the basis for an EU standard as to when it would be acceptable for a company which is a wholly-owned subsidiary or companies with minority shareholders to enter into a cash pooling arrangement:

- the need to have a written agreement
- the need for the cash pooling not to create a liquidity or solvency risk for the subsidiary
- the right of the directors and management of the subsidiary to access information in other companies, including the parent company in order to assess the risks
- the subsidiary's right to terminate the cash pooling arrangement if participation in the cash pool is no longer in its interest.

The satisfaction of the conditions would need to be monitored constantly and would cover all series of transactions. However, there would not be a need for documenting in writing the solvency requirement, although this could also be done spontaneously.

Some Member States, for instance Austria, require the subsidiary, not the parent unless it is also a lender, since the lender is usually the subsidiary, to monitor the liquidity and solvency situation of all participants so that they can have a reasonable assurance that the money will be repaid. This is intended to protect the subsidiary's solvency. A similar requirement could be introduced at the EU level although it could also be deemed strict. The intervention of the EU would then be all the more useful because such requirements are difficult to enforce cross-border and from subsidiary to parent. Therefore, an EU cross-border regime on cash-pooling would help subsidiaries manage this requirement in the case that the parent company is established in another Member State.

> ***Recommendation 2:*** *The Commission should consult on whether to develop an EU wide regime on cash-pooling within groups and, if so, the basis on which this should be permitted.*

3.2 Additional advantages which could come from an EU intervention

3.2.1 Shield the parent company against unjustified claims by creditors of the subsidiary

Business associations sometimes fear that allowing subsidiaries to recognise the interest of the group would lead to the imposition of liability on a parent company and to the corporate veil of the subsidiary being pierced. Groups already face situations in which parent companies are subjected to liability for acts of another member of their group in many areas (such as competition law, anti-bribery laws, environmental liability, employment and social responsibility, human rights, etc) in several Member States, whether by statutory law or by case law. Some answers to the consultation of 2012 requested that the EU "should require parent companies to identify and address the risks of violations of internationally recognised human rights by their subsidiary operations by carrying out human rights due diligence".[92] Because of this current environment, business associations fear that recognising the interest of the group at the EU level would make it easier to hold the parent company liable for mistakes by the management of subsidiaries and possibly other acts. This view is incorrect: upstream liability is more likely to follow from jurisdictions that do not recognize the interest of the group. Therefore, the recognition of the interest of the group would and should reduce the risk of parent liability. The recognition of the interest of the group would be advantageous to the parent company since, if it is associated with the right of the parent company to give instructions (this is recognised for private companies in several Member States), it would recognize the right of the parent to influence the management of the subsidiary in certain cases. Therefore, rather than creating a risk that liability could be imposed on the parent company, it would shield it, especially in the Member States where it is not currently clear whether such instructions are legitimate or not. *One possible goal of an EU intervention recognizing the interest of the group would be to make clear that the protection of the parent would be strengthened, not weakened in the circumstances in which the parent is able to give instructions to the subsidiary.*

3.2.2 Improvement in the exercise of freedom of establishment because harmonisation would support the establishment of subsidiaries

As stated also by the Reflection Group:

> "the lack of flexibility in some Member States could also prove, to a certain extent, an obstacle to parent companies from other Member States that are used to this flexibility. It would provide the management of the parent company with more legal certainty and in certain Member States more flexibility when managing a foreign subsidiary and would therefore improve freedom of establishment. A typical transaction that, in some Member States, may be subject to criticism in the absence of recognition of a group interest doctrine is cash pooling or intra-groups loans and an interest of group principle could provide more legal certainty in such cases."[93]

A common definition of what would be generally accepted practice within groups in the EU would certainly help the cross-border management of groups and therefore encourage the establishment of subsidiaries in other Member States.

3.2.3 EU intervention on the recognition of the group interest would be consistent with the development of the Common Consolidated Corporate Tax Base

In 2011, the Commission proposed a directive on a Common Consolidated Corporate Tax Base ('CCCTB').[94] The goal of the proposal was to allow groups doing business in

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[92] See. European Coalition for Corporate Justice, *Regulation of groups of companies and corporate responsibility to respect human rights.*

[93] Reflection Group Report, 2011, 62.

[94] Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), Brussels, COM(2011) 121/4, 2011/0058 (CNS).

several Member States, including through subsidiaries, to be treated as one entity. They would need to apply a single set of rules for calculating how much tax they must pay. The cross-border nature of groups would be recognised by allowing them to offset losses in one Member State against profits in another. They would then be treated for tax purposes as one single entity.

After having faced difficulties, because tax issues require unanimity in the Council, the proposal was relaunched in 2015 by the Commission in relation to the fight against fraud and tax avoidance. In October 2016, the Commission published two proposals of directives.[95] The CCCTB would now be mandatory, at least--according to the Commission--for the type of companies most likely to engage in aggressive tax planning. Those are companies with global revenues exceeding EUR 750 million a year. The common tax base (company's taxable profits) would be shared out between the Member States in which the company is active, according to a formula. There would be an allocation system according to which Member States would receive part of the tax base. Each Member State would tax their share of the profits at their own national rate.

Because the CCCTB would treat entities as pooled for tax purposes, it would create pressure within groups to engage in internal transactions to optimise the group's tax treatment. Harmonisation of the treatment of the interests of the group across Member States would ensure that this optimisation process did not result in distortions due to company law.

[95] Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685 final, Strasbourg, 25.10.2016 and Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2016) 683 final, Strasbourg, 25.10.2016.

4. Solutions

Several approaches could be considered at EU level to improve the flexibility of the management of cross-border groups of companies and provide some approximation of the position on recognition of group interest and the circumstances in which this could be allowed.

As stated in the introduction, the idea of an action at the EU level for all types of companies is not new. Following a proposal of the Winter Report,[96] the 2003 Action Plan of the Commission noted that:

> "Member States should be required to provide for a framework rule for groups that allows those concerned with the management of a company belonging to a group to adopt and implement a co-ordinated group policy, provided that the interests of that company's creditors are effectively protected and that there is a fair balance of burdens and advantages over time for that company's shareholders. The Commission sees the introduction of such a rule as an important step towards improved business efficiency and competitiveness, but stresses that appropriate safeguards have to be carefully designed. A proposal for a framework Directive to this effect will therefore be presented in the medium term."[97]

However, no proposal for a directive was introduced, presumably because of opposition by Member States. Any proposal for an action at the EU level must therefore be carefully framed so as to minimise the chances of opposition.

An action at the EU level recognizing the interest of the group for all companies would encompass both wholly-owned subsidiaries and those with minority shareholders. This would consequently amount to the introduction of a European regime on groups. Views are divided within the ICLEG as to whether it would be desirable to have an action at the EU level recognizing the interest of the group on this basis. In light of this division, the ICLEG's view is that such a broad-ranging measure should be ruled out at this stage. First, this area raises core issues of company law for Member States, which in general do not have a cross-border dimension. Second, the recognition of the interest of the group reflects deep and long-standing preferences on the level of creditors' and minority shareholders' protections. The tools to achieve such level of protection also vary widely. Many Member States, such as Germany and Austria, do not recognize the interest of the group and there is no reason for the EU legislator to change those national preferences unless those Member States would support those changes which does not seem to be the case. Third, there would be political opposition by those Member States that do not recognize the interest of the group, and limited support in those which recognize the

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[96] 'The Group believes there is a case for requiring Member States to provide for a framework rule for groups that allows those concerned with the management of a group company to adopt and implement a co-ordinated group policy, provided that the interests of creditors of each company are effectively protected and that there is a fair balance of burdens and advantages over time for each company's (outside) shareholder' (Winter Group Report, 2002, 97).

[97] Communication From The Commission To The Council and The European Parliament, Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward, Brussels, 21.5.2003 COM (2003) 284 final, p. 19.

interest of the group but do not have specific protections in place as they will be reluctant to change their national preferences.

For these reasons, our preferred formulation is one that is restricted, at least in its ambitions for harmonization, to *wholly-owned subsidiaries.* The fact that wholly-owned subsidiaries allow a different approach than subsidiaries with minority shareholders is widely recognized. It is also applied by Forum Europaeum on Company Groups (FECG) in its Proposal to Facilitate the Management of Cross-Border company Groups in Europe.[98] Such action at the EU level could include a provision allowing a wholly-owned EU subsidiary to recognize the interest of the group along the lines of a uniform formula. It would be possible, without falling foul of the concerns raised above, to include an *option* for Member States to extend the same power to companies that are not wholly-owned, but majority-controlled, subsidiaries.

We set out below three possible basic formulations and two possible extensions.

Option 1

1.1 Member States shall ensure [at least] that the directors of EU companies that are wholly-owned subsidiaries may take account of the interests of other bodies corporate (wherever incorporated) that are members of the same group when they take decisions.

1.2 For the purposes of paragraph 1.1:

> *(a) a company is a wholly-owned subsidiary of another body corporate (wherever incorporated) if its only members are that other body corporate and that other body corporate's wholly-owned subsidiaries or persons acting on behalf of that other body corporate or its other wholly-owned subsidiaries; and*
>
> *(b) 'group' shall have the same meaning as in Directive 2013/34/EU.*

This wording would make clear that a director could take account of the interests of other members of its corporate group when taking decisions. It is permissive – so a director may decide not to take account of such interests if they think it is appropriate. The wording is limited to cases of companies that are wholly-owned subsidiaries, so that there is no question of minority shareholder interests being prejudiced by any such decision. The words in square brackets "[at least]" are intended to make it clear that a Member State can allow directors to take group interests into account in other cases too if they so wish – so the wording is intended to be a minimum harmonization measure, setting a minimum standard where this is permitted (that is, a safe harbour for directors).

A drawback with this wording is that the relationship with other provisions of national law is uncertain. In particular, it is unclear whether, in Member States in which liability may be imposed on directors in the vicinity of insolvency, this formulation would offer

[98] See. Forum Europaeum on Company Groups, 'Proposal to Facilitate the Management of Cross-Border company Groups in Europe' (2015) 12 *European Company and Financial Law Review* ECFR 2015, 299–306

directors any defence against such liability. If the wording were explicitly qualified as regards the subsidiary's solvency, but did not include an autonomous EU definition of 'solvency', then this would do little to enhance certainty, as national law conceptions of solvency, and *a fortiori* liability in the vicinity of insolvency, vary widely.

The Commission is currently considering possible reforms to insolvency law as part of its CMU agenda. One such possible measure would be a harmonization of Member States' rules regarding directors' liability in the vicinity of insolvency. Were such a harmonization to be effected, it would render Option 1 far more feasible. It should be noted, however, that Option 1 does not on its face offer any safe harbour from challenge on the basis that a transaction constitutes a disguised distribution.

Option 2

2.1 Member States shall ensure [at least] that the directors of EU companies that are wholly-owned subsidiaries may take account of the interests of other bodies corporate (wherever incorporated) that are members of the same group when they take a decision if the condition set out in Article 2.2 is satisfied.

2.2 The condition referred to in Article 2.1 is that any actions contemplated by the decision shall not reduce the company's net assets or profits available for distribution below that necessary to justify a distribution under Articles 17(1)-(3) of Directive 2012/30/EU.

2.3 For the purposes of paragraph 2.1:

> *(a) a company is a wholly-owned subsidiary of another body corporate (wherever incorporated) if its only members are that other body corporate and that other body corporate's wholly-owned subsidiaries or persons acting on behalf of that other body corporate or its other wholly-owned subsidiaries; and*
>
> *(b) 'group' shall have the same meaning as in Directive 2013/34/EU.*

This wording introduces an autonomous EU formulation regarding the point at which the interests of creditors should intrude into group affairs. The test is explicitly linked to the Second Directive, because this already applies on an EU-wide basis to public companies, and is intended to protect creditors. Moreover, any alternative formulation would, in relation to public companies run up against questions regarding the extent to which it inter-relates with the Second Directive.

A drawback with this approach is that the legal capital-based restrictions imposed by the Second Directive are now widely thought to be less useful than a solvency test as a mechanism for creditor protection. Legal capital relies for its efficacy on the quality of balance sheet accounting, and is necessarily retrospective in its approach. In contrast, a solvency test that requires directors to certify that they expect the company to remain able to pay its debts for a fixed period is forward-looking, and incorporates all information known to the directors.

In many jurisdictions, wholly-owned subsidiaries are typically not likely to be incorporated as public companies, but rather as private companies. For such companies, there is no necessity to apply the Second Directive framework.

Option 3

2.1 Member States shall ensure [at least] that the directors of EU companies that are wholly-owned subsidiaries may take account of the interests of other bodies corporate (wherever incorporated) that are members of the same group when they take a decision if one of the following conditions are satisfied:

> *(a) if the subsidiary is a public limited company, the condition set out in Article 2.2 is satisfied; or*
>
> *(b) if the subsidiary is a private limited company, the condition set out in Article 2.3 is satisfied.*

2.2 The condition referred to in Article 2.1(a) is that any actions contemplated by the decision shall not reduce the company's net assets or profits available for distribution below that necessary to justify a distribution under Articles 17(1)-(3) of Directive 2012/30/EU.

2.3 The condition referred to in Article 2.1(b) is that, when the decision is taken, each director, having taken reasonable steps to consider the company's situation at the date of the statement and all its liabilities including its contingent or prospective liabilities, has made a written statement not more than [14] days before the date of the decision that he or she has formed the opinion that the company will be able to pay (or otherwise discharge) its debts in full as they fall due for at least 6 months following the date of that statement taking into account the expected effect of the decision.

2.3 For the purposes of paragraph 2.1:

> *(a) a company is a wholly-owned subsidiary of another body corporate (wherever incorporated) if its only members are that other body corporate and that other body corporate's wholly-owned subsidiaries or persons acting on behalf of that other body corporate or its other wholly-owned subsidiaries; and*
>
> *(b) 'group' shall have the same meaning as in Directive 2013/34/EU.*

This formulation introduces a solvency test, based on the formulation used in the SUP proposal,[99] for private company subsidiaries. The written statement could be an option for the Member State or for the company as this could be considered burdensome in practice or unnecessary for solvent groups. The consultation should cover this question.

White-list: could be added to any of Options 1 to 3

In conjunction with any of Options 1 to 3, an action at the EU level could set out a non-exhaustive white list of generally accepted practices as to specific intra-group

[99] The Commission's SUP proposal originally specified a 12 month period (SUP Directive, Commission Proposal, Art 18(3)), but this has been reduced to 6 months in subsequent negotiations (SUP Directive, Council General Approach, Art 18).

transactions, especially when the transaction is not concluded at arm's length, including when the company is close to insolvency. The white list would not deal with the tax treatment of those transactions and would strictly be limited to company law. Such an (indicative) list of best practices could provide guidance for companies as well as courts. It could, for example, cover:

- cash or omnium agreements,
- long term and short term interest free or interest reduced intra group loans
- the management conventions or management fees conventions (« group charges » or « service charges »).

Such an approach has already been successfully developed at the EU level. For instance, the European Securities and Markets Authority (ESMA) published in 2013 a white list on whether investors are acting in concert which has provided clarity to investors.[100]

It would be advisable to ask economic operators what they would consider to be best practices within groups. The 2015 report of the Club des Juristes recommended that:

> « The elaboration of that white list should be the result of the work conducted together with representatives of the economic operators organised in groups. To this end, appendix 2 to this document – which studies the intra-group operations at stake from the point of view of comparative law – could be helpful. ».[101]

Extension to non wholly-owned subsidiaries – could be added to Options 1 to 3

Member States shall allow the directors of a company that is not a wholly-owned subsidiary to take account of the interests of other bodies corporate (wherever incorporated) that are members of the same group when they take decisions at least if the shareholders of the company have passed a resolution amending the company's articles of association to include a provision to this effect.

This would allow the shareholders of a company that is not a wholly-owned subsidiary to permit the directors to take the group interest into account by amending the company's articles to allow this. The percentage vote needed to amend the articles will be a matter for national law and will require more than a simple majority. As the articles are a publicly available document, it will be easy to check whether the directors can do this or not.

It might be thought desirable to further qualify the wording to make clear that the directors would only be free to act on such a decision insofar as this does not result in a transaction for grossly inadequate consideration, or a 'significant imbalance in mutual obligations', along the lines of the *Rozenblum* formula. This would serve to protect the interests of minority shareholders.

[100] ESMA, Public Statement, Information on shareholder cooperation and acting in concert under the Takeover Bids Directive, Date: 12 November 2013 ESMA/2013/1642.

[101] Club des Juristes, 2015, above n 16, 14.

There may be no one-size-fits-all approach. Listed companies, for instance, may require a more elaborated system for Related Party Transactions, as recently proposed by the European Company Law Experts (ECLE).[102] But for the vast majority of subsidiaries which are not listed, a regime designed for listed companies would be far too burdensome. In these cases the Rozenblum formula could offer a more appropriate and flexible approach.

Some Member States already allow directors to take group interests into account without having to change the articles in this way. Presumably such Member States will want to keep this flexibility without the added formality.

Instructions by the parent company

A separate issue is whether to include in an action at the EU level a right for the parent to give instructions to the subsidiary as to the strategy and fundamental decisions in certain cases and as long as the instructions do not make the subsidiary insolvent ? Although, it could be useful, it might trigger opposition in some Member States which are not used to this. An alternative approach, but which would create additional complexity, would be simply to require Member States to allow the articles of association in wholly-owned subsidiaries to allow a parent company to give such instructions provided they do not make the subsidiary insolvent (enshrined in Dutch law for example). An action at the EU level should also provide that issuing instructions would not, of itself, make the parent a shadow director.

Those key provisions, whether or not including the right to give instructions, could be included in Part 1 (general provisions) of directive 2009/102/EC of 16 September 2009 in the area of company law on single-member private limited liability companies which is currently in the process of being modified by the proposal for a directive of the European Parliament and of the Council on single-member private limited liability companies of 9 April 2014, introducing the Societas Unius Personae (SUP).[103] The directive covers all private limited liability companies and also public limited liability companies when the Member State allows them to be single-member companies.

Option for companies rather than for Member States

Some members of the ICLEG consider that the recognition of the group interest and also of the right of the parent company to give instructions to the subsidiary should be a choice left for individual companies rather than Member States themselves.

[102] See report retrievable at https://europeancompanylawexperts.wordpress.com/
[103] SUP Directive, Commission Proposal.

Recommendation 3*: The Commission should consult on whether there should be an action at the EU level allowing wholly-owned subsidiaries to take account of the interests of the group when taking a decision in their own interests where this does not prejudice the solvency of the subsidiary. Such recognition would take the form of a safe harbour and could go along the lines of the "Rozenblum" formula. The consultation should also cover whether this action at the EU level should set out the conditions which must be satisfied for a wholly-owned subsidiary to recognize the group interest or whether these conditions should be left to Member States to determine.*

The consultation should cover whether an action at the EU level should include the right of the parent company to give instructions to the subsidiary and whether this right as well as the recognition of the group interest should be an option for Member States or rather an option for companies themselves.

Recommendation 4*: The Commission should consult on whether there should be an an action at the EU level allowing non wholly-owned subsidiaries to take account of the interests of the group provided that the group applies a conditioned system of good group governance. The consultation should also cover the possible legal framework of good group governance. This could go along the lines of the "Rozenblum" formula, including a coherent group structure, an elaborated group strategy and a protection of the subsidiary against the risk that decisions taken in the interest of the group may incur insolvency of the subsidiary.*

Moreover, the stakeholders should be consulted on possible measures to be considered at EU level for minority protection in non wholly-owned subsidiaries before and after the control has been stablished.

Overview of Recommendations

Recommendation 1: *The Commission should consult on whether the lack of recognition of the group interest, or the imperfect recognition of such interest prevents financial institutions from managing their subsidiaries cross-border and/or could hamper the proper functioning the BRRD provisions on group support.*

Recommendation 2: *The Commission should consult on whether to develop an EU wide regime on cash-pooling within groups and on what legal form such regime could take place.*

Recommendation 3*: The Commission should consult on whether there should be an action at the EU level recognizing the interest of the group for 100 % owned subsidiaries. Such recognition would take the form of a safe harbour and could go along the lines of the "Rozenblum" formula. The consultation should also cover whether this action at the EU level should be an EU harmonised simplified test stating the conditions applicable to the safe harbour recognizing the group interest or the content of the text should be left to Member States.*

The consultation should cover whether an action at the EU level should include the right of the parent company to give instructions to the subsidiary and whether this right as well as the recognition of the group interest should be an option for Member States or rather an option for companies themselves.

Recommendation 4*: The Commission should consult on whether there should be an action at the EU level allowing non wholly-owned subsidiaries to take account of the interests of the group provided that the group applies a conditioned system of good group governance. The consultation should also cover the possible legal framework of good group governance. This could go along the lines of the "Rozenblum" formula, including a coherent group structure, an elaborated group strategy and a protection of the subsidiary against the risk that decisions taken in the interest of the group may incur insolvency of the subsidiary.*

Moreover, the stakeholders should be consulted on possible measures to be considered at EU level for minority protection in non wholly-owned subsidiaries before and after the control has been stablished.