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Harmonization Of Company Law In The European Economic Community

By Hugh J. Ault*

Introduction

The creation of the European Economic Community by the Treaty of Rome¹ has resulted in far-reaching changes in the economic life of the six Member States.² These changes have in turn required modifications in the legal framework within which commercial activities take place. This is particularly true as to the rules in the Member States regarding company organization, operation and validity, which have developed in differing legal frameworks and involve numerous areas of divergent substantive provisions.

The necessity of adapting the existing legal order to the new economic patterns was clearly foreseen by the drafters of the Treaty of Rome. In some fields the Rome Treaty contemplates a wholly new Community law. Article 87, for example, gives law-making competence to the Community institutions to deal with anti-trust matters. In other fields, however, the necessary legal adjustments are to be achieved by changes in the national laws of the Member States.

Article 3(h) of the Treaty includes in the activities of the Community “the approximation of... national laws to the extent required for the Common Market to function in an orderly manner. . . .”³ The method by which this approximation⁴ is to take place is de-

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¹ Treaty of Rome, March 25, 1957, 298 U.N.T.S. 3 (1958). There is no official English translation of the Treaty of Rome. A translation was made in Great Britain by Her Majesty’s Stationery Office and was first published in 1962. 1 CCH Comm. Mkts. Rep. ¶ 151 (1962). This is the most readily available source in the United States and all Treaty references are to it unless otherwise noted. All other translations of foreign material are by the author unless otherwise noted.

² Belgium, France, Germany (Federal Republic), Italy, Luxembourg, the Netherlands.


⁴ Article 3(h) and Article 100 speak of the “approximation” (rapprochement, Angleichung) of municipal legislation. Article 99 deals with “harmonization” of various aspects of national law. Some commentators have seen these differing expressions in the Treaty as representing different grants of power to the Council. The Council is said to have a greater competence in...
developed in more detail in several subsequent sections of the Treaty. The basic authorization for achieving this harmonization is Article 100, which provides that the Community Council of Ministers may issue directives (directive, Richtlinie) to the Member States for the approximation of any legislative or administrative provisions which "directly affect the establishment or operation of the Common Market."5

In addition to the general provisions for harmonization found in Article 100, the Treaty authorizes the Council to undertake a coordination of national laws in certain designated fields. Coordination of company law provisions is dealt with specifically in Article 54(3) (g). This Article empowers the Council to issue directives dealing with "the coordination, to the extent necessary, of the protective provisions (garanties, Schutzbestimmungen) laid down by the Member States, in the interests of shareholders and third parties and applied to companies as defined in Article 58(2), in order to make such provisions equivalent. . . ."6

The projected coordination of company law involves significant problems. The differences in the existing national laws concerning shareholders and third parties dealing with companies are often the result of a more deep-seated divergence on questions of policy. In many situations, protection of one group is only possible at the expense of the other, and where the national lawmakers have resolved these questions differently, progress in coordination is necessarily difficult.

After much delay, the Council, acting on a proposal by the EEC Commission, the executive body of the Community, has recently taken a significant step toward the coordination of company law provisions contemplated in Article 54(3) (g) by issuing the first Direc-

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5 See Gessler, Ziele und Methoden der Harmonisierung des Gesellschaftsrechtes der GmbH in Europa 9, 11 (1962); Monaco, Comparaison et rapprochement des législations dans le marché commun européen, 12 Revue Internationale de Droit Compare [Rev. Int. Dr. Comp.] 61 (1960); Renauld, Aspects de la coordination et du rapprochement des dispositions relatives aux sociétés, [1967] Cahiers de Droit Européen 611. This approach seems over-refined. Linguistic differences in the four official versions of the Treaty make this kind of subtle differentiation at best a questionable undertaking. Hence in this article the terms "approximation," "coordination," and "harmonization" will all be used interchangeably to mean a reduction in the differences in the existing national laws.

6 Author's translation based on the French and German texts. For the original texts, see 1 CCH Comm. Mkt. Rep. ¶ 3301 (1962).
tive in this field. The Directive deals with three areas of company law: disclosure of information, validity of company obligations, and the causes and effects of improper formation. It requires the Member States to make certain adjustments in their national laws in response to the Directive. The new Directive is important both in terms of the substantive company law matters it treats and for the insight it gives into the problems of adapting the national legal systems of the Member States to the increasingly international character of business activities within the Community.

It is the purpose of this article to examine some of the provisions of the new Directive and the changes which the Directive will require in the national company laws. In order to understand the context in which the Directive was issued, the procedures for coordination set up in Article 54(3) (g) will first be analyzed. After a consideration of the Directive and its effects on the national legal systems, the relationship between Article 54(3) (g) and the various proposals for the creation of a form of "European company" will be explored.

I. Article 54(3)(g): Harmonization of Company Law under the Lead of Community Institutions

A. Procedure Under Article 54(3) (g): Action by Directive

It was hoped at first that differences among the company laws of the Member States would gradually disappear as the Community developed. The needs of the new market would generate a "spontaneous coordination" of company law, and resort to the procedures of Article 54(3) (g) would prove unnecessary. Although there has been much activity in the Member States concerning the reform of company law, surprisingly little effort seems to have been made to

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9 Germany and France have both made substantial changes in their company laws recently, and company law reforms are being discussed in Belgium, Italy and the Netherlands. For a survey of the developments see Review of Recent Literature on Corporation Law, 4 COMM. MKT. L. REV. 113-17, 476-79 (1968-67).
coordinate these projects. An early suggestion by a noted commentator that reform of company law by one country independent of the other Member States was a violation of the spirit, if not the letter, of the Treaty of Rome\(^\text{10}\) has not been heeded, and national reform has proceeded unabated. To some extent, the independent national reforms have resulted in a narrowing of previously existing differences in company law. In particular, the new French company law seems to have been influenced by proposals in the draft directive on company law first put forward by the Commission in 1964.\(^\text{11}\) Nonetheless, there is still considerable need for further harmonization of certain company law provisions, and it is here that Article \(54(3)\) becomes important.

Articles \(54(2)\) and \(54(3)\) provide that the Council shall act by means of directives to coordinate company law provisions. Under the directive procedure set up in Article \(189\), the Council determines the “result to be achieved” in the directive while the “form and manner” of implementing the directive is left up to the Member States.\(^\text{12}\) Thus, the new Company Law Directive is addressed to the Member States and requires them to conform their legislation and administrative regulations to the “results” set out in the Directive. The directive procedure is particularly appropriate for the kind of action foreseen under Article \(54(3)\) since it permits, within certain limits, a coordination of existing company legislation without an extensive derogation of national sovereignty.

There is one point concerning the Council’s power to issue directives under Article \(54(3)\) which deserves special attention. Under the terms of the Article, the directives have as their purpose to make “equivalent” (équivalent, gleichwertig) certain company law provisions. The Article does not require that the existing laws be made identical and indeed, this is implicit in the whole process of action by directive.

This aspect of the Article has led some commentators to assert that the Article does not foresee the development of a uniform com-

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\(^{10}\) Bärmann, Ist eine Aktienrechtsreform überhaupt noch zulässig?, [1959] JURISTENZEITUNG 434.


\(^{12}\) For a general discussion of the directive process, see J. Lang, THE COMMON MARKET AND COMMON LAW 10 (1966); J. Oldekkop, DIE RICHTLINIEN DER EWG (34 Studien zum internationalen Wirtschaftsrecht und Atomenergirecht, 1968).
pany law within the Community. In one sense, this position is un-
deniably correct. As regards the scope of Article 54(3)(g), i.e., those
areas of company law which are to be treated, the Article is certainly
limited. On a fair reading, it does not anticipate that all company
legislation will be affected. However, a distinction must be made be-
tween the scope of the Article and the power of the Council to
regulate areas within that scope.

In many areas of company law, the differences among the existing
statutes can be adjusted without resort to a uniform rule. Where
the differences are only matters of degree, e.g., the number of in-
corporators or the minimum amount of capital required, a direc-
tive need only lay down certain basic requirements and leave the
Member States free to act within this framework. Other company
rules, however, involve a choice between mutually exclusive alterna-
tives. A company is or is not bound by ultra vires acts of its offi-
cers; a finding that the company was improperly formed either does
or does not have retroactive effect. In matters like these, the Council
must adopt one rule or the other and require that it be enacted
throughout the Community. Only in this way can "equivalence"
be achieved.

Several of the provisions in the new Directive set out require-
ments which offer the Member States little flexibility in their re-
response. This aspect of the new Directive undoubtedly will be criti-
cized by those who see its specific demands as an unauthorized inva-
sion of national sovereignty, but such specificity in this situation
appears necessary to carry out the objectives of the Treaty. The only
alternative would be to say that in those areas of company law in
which a definite rule is required, the Council is without power
to harmonize the existing law. This unhappy result would clearly
undermine the usefulness of the Article which authorizes action by
the Council "to the extent necessary." The Council thus would
seem justified in using the directive procedure to require the adop-
tion of uniform rules in certain instances in the company law area.

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13 Gessler, supra note 4, at 12-14; Renauld, supra note 4, at 622. See also
14 See text accompanying notes 30-37 infra.
15 The use of directives to require the adoption by the Member States of
uniform rules is well established in other fields and often the directives go
1977 (dealing with the size, shape and location of the stamp which must be
2645 (detailed regulations concerning coloring and conservatives in food-
stuffs); J. Oldekkop, supra note 12, at 87-95.
B. Article 54(3)(g) and Freedom of Establishment

Article 54(3)(g) is placed in that section of the Rome Treaty which deals with the right of establishment, and in order to understand its function, it is useful first to examine some of the Treaty Articles concerned with establishment. Article 52 provides:

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be abolished by progressive stages in the course of the transitional period. Such progressive abolition shall also apply to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to engage in and carry on non-wage-earning activities, to set up and manage undertakings and, in particular, firms and companies (sociétés) within the meaning of Article 58(2), under the conditions laid down for its own nationals by the laws of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

The Commission has interpreted the concept of freedom of establishment very broadly. For example, it has stated that freedom of establishment includes the right to have access to credit and other sources of financing within the country of establishment. Thus, the list of activities set forth in Article 52 is not to be taken as exhaustive.

By its terms, Article 52 is limited in its applicability to "nationals." Article 58, however, extends the right of establishment to companies organized within the Member States. Acting under


17 Treaty of Rome, Article 52 requires the abolition of restrictions on individual nationals of Member States. Article 58 then provides that companies incorporated in one Member State and having their "registered office, central administration or principal place of business within the Community" shall be "treated in the same way as" natural persons who are nationals of Member States. After some early dispute (See Audinet, The Right of Establishment in the European Economic Community, [1959] JOURNAL DU DROIT INTERNATIONAL 983; 2 E. STEIN & T. NICHOLSON, AMERICAN ENTERPRISE IN THE EUROPEAN COMMON MARKET: A LEGAL PROFILE 67 (1960)), it seems clear that the conditions of Article 58 are to be read disjunctively. To prevent companies with only a registered office in the Community from taking advantage of the establishment provisions, the Council in the General Program for the Removal of Restrictions on the Right of Establishment required, in interpreting Article 52, that a company must have a "continuous and effective link with the econ-
Article 54, the Council passed the General Program for the Removal of Restrictions on the Right of Establishment, setting up a timetable for the abolition of these restrictions. The Council has implemented the General Program with a series of directives in various fields requiring the elimination of restrictions on establishment based on nationality.

The early directives did not deal specifically with restrictions on the exercise of establishment rights by companies. In the directive on wholesale trades published in 1964, however, the Council ordered the elimination of certain existing statutory provisions which had been used to control the access of foreign corporations to local markets. The directive stated that "no additional conditions and especially no special permission" could be required from foreign companies which were not also demanded from domestic companies.

The elimination of establishment restrictions based on nationality has increased the means available by which Community-based enterprises may extend their activities into other Member States. In the past, subsidiaries organized under the laws of the receiving state were the vehicles most commonly used to carry on business in another

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20 [1964] E.E.C. J.O. 863. Germany, for example, required that "foreign juridical persons" obtain special permission to do business within the Federal Republic. GEWERBEORDNUNG § 12 (1949). It also repeated the requirement for corporations. AKTENGESETZ § 292 (1949). Both these provisions were modified in accordance with the directive. Law of August 13, 1965, [1965] Bundesgesetzblatt [BGBl.] I, at 849. It is interesting to note that the German Bundestag followed exactly the Treaty and the General Program in defining those companies against whom the restrictions would no longer be applied. The restrictions were eliminated for "foreign juridical persons which are formed under the laws of a Member State of the European Economic Community and have their registered office, central administration or principal place of business within the Community." In line with the General Program, if a foreign juridical person had its registered office but neither its central administration nor principal place of business within the Community, it would have to demonstrate an "effective and continuous connection with the economy of a Member State" to be accorded free establishment rights.
state. The subsidiary form will still be available without limitation, but in addition, with the abolition of restrictions on establishment, operations in the form of branches or agencies in another Member State will also be possible.22 Smaller companies, for whom the expense and inconvenience of setting up a subsidiary in a foreign country was especially burdensome, are being attracted by the new possibility of making unrestricted use of the right to set up foreign branches. There are, of course, numerous factors involved in choosing between a branch or subsidiary form of foreign operation, and tax considerations are often of paramount importance. Nonetheless, it seems clear that the elimination of establishment restrictions will result in an increase in the number of branches and agencies involved in business between Member States.23

This increased use of branches, however, carries with it some legal problems with which Article 54(3)(g) is directly concerned. Under the principles of conflict of laws or “private international law” followed in most of the Member States, the applicable company law, i.e., the company’s “personal” law, is determined generally by reference to the law of the state in which the company has its center of control or siège social (Geschäftssitz).24 This is usually also the state in which it is incorporated.25 As branches become more sig-

22 See M. Lutter, supra note 8, at 11 for an analysis of the business practices.

The determination of where a company actually has its siège social can often be difficult and the tests vary. See id. at 40-46; G. Schlosser, DIE GESELLSCHAFTLICHEN NIEDERlassungen INNERHALB DER EUROPAISCHEN WIRTSCHAFTSGEMEINSCHAFT ALS PROBLEM DES INTERNEN UND DES INTERNATIONALEN PRIVATRECHTS 50-59 (1965).

25 While it may be possible at least in theory for a company to be incorporated in one Member State and have its siège social in another, this situation has been quite uncommon as a practical matter, since a separation of siège social and state of incorporation usually resulted in the company’s failure to be recognized as a legal entity in the other states. See Beitzke, Anerkennung und Sitzverlegung von Gesellschaften und juristischen Personen im EWG-Bereich, 127 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND WIRTSCHAFTSRECHT (Z.H.R.) 1, 13 (1994). This result will be modified on the ratification of the recently signed Convention Relating to the Mutual Recognition of Companies and Legal Persons. 2 CCH COMM. MKT. REP. ¶¶ 6083-6103
significant in business between Community companies, this choice-of-law rule takes on added importance.

For example, suppose a corporation organized in Belgium doing business in a field covered by a directive eliminating restrictions on establishment desires to enter the German market and does so by means of a branch office. The German branch of the Belgian company would enter into contracts and other legal relations with its German customers. However, should a dispute between the parties arise and litigation result, as a matter of conflict of laws, the German courts under the traditional doctrine would apply Belgian law in many matters. Certain protections offered the German third party under German law (e.g., the rule limiting the effect of restrictions on the power of a company representative), might be unavailable. The additional risks in dealing with a foreign corporation under these circumstances might discourage intra-Community business activities and hamper the full utilization of establishment rights.

Article 54(3)(g) foresees a coordination of company law “protective provisions” so that the risks inherent in dealing with an entity subject to the rules of another legal system can be minimized. However, it would seem that a much simpler solution to this particular problem is possible. The danger to legal security created by increased branch operations arises from the fact that the branch’s legal relations are determined in some part by the law of its siège social. Article 52, however, grants to companies only the right to be admitted to the territories of other Member States “under the conditions laid down for [the State’s] own nationals by the law of the country where such establishment is effected . . . .” Thus, there would be nothing to prevent the state of establishment from applying its own laws to the branch of a foreign corporation where such application was necessary to protect the interests of nationals of that state dealing with the foreign corporation.

This approach, however, while promoting legal security from the viewpoint of third parties, overlooks the burdens which overlapping


26 See text accompanying notes 94-101 infra.

27 The Community Court of Justice, in interpreting Articles 52 and 53, has held that a Member State was only prohibited by Article 52 from subjecting foreign nationals to stricter rules regarding establishment than those applied to its own nationals. Costa v. Ente nazionale Energia elettrica impressa già della Edison Volta, [1961-1966 Transfer Binder] CCH Comm. Mktr. Rpt. ¶ 8023 (1964). Thus a non-discriminating rule would not infringe a foreign national’s establishment rights. See Rodière, L’harmonisation des législations européennes dans le cadre de la C.E.E., 1 Rev. Tr. Dr. EUR. 338, 347-48 (1965).
regulatory systems can have on companies carrying on multi-state operations. Companies exercising the right of establishment in several countries could be subject to confusing and contradictory sets of regulations imposed by the various Member States to insure protection of their own nationals dealing with foreign corporations. It was to avoid this undesirable result that the drafters of the Rome Treaty, by Article 54(3)(g), provided for the coordination of certain aspects of company law to solve the problem of legal security without imposing a multiplicity of possibly conflicting regulations on business enterprises. This coordination was limited to "protective provisions" since it is exactly provisions of that type which are important for legal security and, at the same time, involve matters in which a national court would be most likely to apply its own law to foreign companies.

So far the focus of the discussion has been on the protection of third parties dealing with a foreign corporation doing business in branch form in another Member State. Article 54(3)(g), however, also deals with the coordination of protective provisions for the benefit of shareholders, and here the connection with freedom of establishment is somewhat different. The coordination of shareholder protections must be seen from the point of view of the company exercising its establishment rights by forming a subsidiary under the laws of another Member State. Since subsidiaries are generally used only by the larger and more internationally experienced firms, differences in company law in this context do not result in the same threat to legal security as that posed in connection with branch operations. A company setting up a foreign subsidiary is more likely to be aware of any important differences in company law than a third party dealing in the ordinary course of business with the local branch of a foreign company. On the other hand, when a company has several subsidiaries located in different Member States, differences in company law could result in burdensome administrative problems, and thus some coordination would be desirable from the shareholder point of view.

In addition to such administrative problems, there are other reasons for including shareholder protection within the ambit of Article 54(3)(g). First, because of the inseparable connection between the interests of shareholders and the interests of third parties dealing with the company, a coordination of the provisions relating to one group could not be undertaken without consideration of the interests of the other. Secondly, Article 220(3) provides for negotiations by the Member States looking to a convention allowing companies to transfer their seat of operations from one Member State to another.
without dissolution and loss of legal personality.\textsuperscript{28} When such a transfer becomes possible, the shareholders of a company moving its seat from one Member State to another will become subject to the company law of the state of reception, and the protections offered shareholders under that law may be considerably different from those to which they were accustomed. The coordination of shareholder protection would facilitate the transfer of corporate activities once the other problems connected with a transfer of seat have been solved by negotiation. It should be noted, however, that the exercise of establishment rights in the form of a transfer of seat seems somewhat distant in time, and the coordination of shareholder protection must be considered less crucial at this stage in the Community's development than the harmonization of protective provisions for the benefit of third parties.\textsuperscript{29}

In a somewhat larger perspective, there is a final need for coordination of company law provisions related to freedom of establishment. Companies, in exercising their establishment rights by setting up branches or locally incorporated subsidiaries, should not be influenced in their choice of location by differences in the national company laws. Company law provisions would seem to be of relatively little importance in the decision to move into a new market. However, certain matters, such as disclosure requirements, rules dealing with capitalization, and merger provisions can have some effect on the manner in which establishment rights are exercised. In such areas coordination under Article 54(3)(g) can help to ensure that economic forces alone influence the pattern of business development.

C. The Scope of Article 54(3)(g)

The somewhat enigmatic language of Article 54(3)(g) has led to considerable controversy over the intended scope of its application.\textsuperscript{30} The Commission takes the position that the Article has "a very wide scope."\textsuperscript{31} On the other hand, it is apparent that the Article is not intended to cover the whole field of company law, and various arguments have been put forth in support of a restrictive interpretation. The procedures under which the Article operates,\textsuperscript{32} its "legislative

\textsuperscript{28} Under the laws of most of the Member States, it is impossible for a company to transfer its seat to another country without a technical dissolution of the company which often has accompanying tax disadvantages. See generally G. Schlosser, supra note 24, at 115-37.

\textsuperscript{29} See Lutter, supra note 23, at 277.

\textsuperscript{30} See Renauld, supra note 4, at 611-13, for a representative sampling of the literature.

\textsuperscript{31} Internal Market Comm'n Rep., supra note 16 (Answer No. 13).

\textsuperscript{32} See text accompanying note 12 supra.
history, its relation to other Treaty articles, and the existence of diverse company statutes in the United States all have been cited as reasons for limiting the coordination of company law under Article 54(3) (g).

A definitive resolution of the question of the scope of the Article in advance of a decision by the Community Court of Justice is impossible. A few points, however, can be made with some degree of certainty. First, it should be noted that the competence of the Council to issue directives under Article 54(3) (g) is limited to the reduction of differences in national company laws which hamper the extension of a company's activities by means of an establishment in another Member State. Where changes in national company law are felt desirable for reasons unrelated to establishment, e.g., to implement anti-trust policy, Article 54(3) (g) alone cannot serve as the

33 Scholten, Company Law in Europe, 4 COMM. MKT. L. REV. 377, 383-386 (1966-67), analyzes the working papers used during the drafting of the Article and concludes that they point to a narrow interpretation. The author concedes, however, that the Treaty "has its own life after it comes into being." Id. at 386.

34 Under Article 54, directives may be issued by the Council on the basis of a qualified majority of the Representatives after the end of the second stage. On the other hand, under Article 100, the general article authorizing harmonization of legislation in all fields, unanimity is required at all times. This has led some to the conclusion that there could have been no thought by the drafters of the Treaty that Article 54(3) (g) could have any extensive application in the company law area or else the qualified majority approach would not have been adopted. Thus any extensive coordination of company law must be based on Article 100 and not on Article 54(3) (g) alone. Renauld, supra note 4, at 623; Scholten, supra note 33, at 382. It could be argued in reply that because of the very general and open-ended nature of Article 100 and its possible application to all fields of law and regulations, a unanimity requirement was felt necessary. This does not, however, have any limiting implications for an article like 54(3) (g) which is directed only to a single field of law. The whole point may be rendered moot as a practical matter in the light of French objections to relinquishing a veto in the Council. See generally Lambert, The Constitutional Crisis 1965-66, 4 J. COMM. MKT. STUDIES 195 (1965-66).

35 See, e.g., Arnold, Die Angleichung des Gesellschaftsrechtes in der Europäischen Wirtschaftsgemeinschaft [1963] AUSSENWIRTSCHAFTSDIENST DES BERTHES-BERATERS [hereinafter cited as AWD] 221, 222. There are several reasons which make it somewhat misleading to base an argument for limited coordination of company law in the Community on the multiplicity of state corporate statutes in the United States. The common language and legal tradition, the unifying effect of overarching Federal legislation, and the various movements for uniformity culminating in the Model Business Corporation Act, now adopted in substantially similar form in a number of states, all distinguish the American experience from the situation in the Community. See also Leleux, Corporation Law in the United States and in the E.E.C., 5 COMM. MKT. L. REV. 133 (1967-68), for a thorough comparative study.
basis for a directive requiring such changes. Thus, it is clear that directives issued on the basis of Article 54(3)(g) to promote coordination of company law must bear some relation to the problems created by the freedom of establishment granted in Article 52.

Secondly, within the field of freedom of establishment, the primary concern of Article 54(3)(g) is to ensure legal security in intra-Community business transactions. Thus the Article, even within the area of freedom of establishment, does not cover company law in its entirety, but is limited to "protective provisions" for the benefit of third parties and shareholders. This second qualification may appear to be of minor significance since, in a sense, most company law is related in some way or other to the protection of shareholders or third parties. However, certain provisions, such as requirements for disclosure or of minimum capitalization, are much more clearly "protective" in nature than company regulations concerning more general matters such as company structure or management. By using the qualified term "protective provisions" rather than referring simply to "company law," the drafters of the Treaty seem to have focused on company law provisions which are "protective" in the narrower sense.

The debate on the scope of Article 54(3)(g) until recently had been somewhat general since no actual directives had been issued by the Council. In the preamble of the First Company Law Directive of March 9, 1968, however, the Council cited as the treaty authorization for the Directive only Article 54(3)(g). Thus, the Directive raises the problem of the scope of this Article for the first time in a concrete manner. After this initial examination of Article 54(3)(g), a more detailed consideration of the First Company Law Directive, and its treatment of the problems discussed thus far relative to that Article, is now appropriate.

II. The First Company Law Directive

A. Background

The new Company Law Directive has a long history. It was first proposed in draft form by the Commission in February of 1964. In accordance with the procedures set out in Article 54, the draft directive was then referred to the Economic and Social Committee, a consultative body composed of representatives from various occupational and economic groups, which reported on the directive on November 1968.

November 28, 1964. The draft directive was then submitted to the European Parliament which had it under consideration for nearly two years. An extensive memorandum on the draft directive was prepared by the Internal Market Commission under the leadership of Mr. Berkhouwer and the draft directive was discussed in the Parliamentary sessions of May 10 through May 12, 1966. Both the Economic and Social Committee and the Parliament suggested numerous changes in the draft directive and in October of 1966, the Commission submitted a revised draft directive to the Council, which reflected those changes in some degree. The draft directive was then considered by Permanent Representatives within the Council, and the final form of the Directive was approved by the Council on March 9, 1968.

The Directive is primarily concerned with a coordination of certain company law provisions affecting third parties dealing with companies. The Directive involves three substantive areas. First, it sets forth various requirements for the disclosure of information by companies covered by the Directive. Secondly, the Directive coordinates some long-standing differences in the laws of the Member States concerning the power of a company representative to bind his com-

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39 Internal Market Comm'n Rep., supra note 16.
44 Several other directives intended to implement Article 54(3) (g) are currently under consideration by the Commission though they have not been officially published. The second draft directive is said to deal with rules concerning incorporation and capitalization for corporations and limited liability companies. The third draft directive treats the structure of corporate organization. Skaupy, Europäisches Gesellschaftsrecht, 11 DIE AKTENGESELLSCHAFT 13, 17-18 (1966); Review of Recent Literature on Corporation Law, 4 COMM. MKT. L. REV. 113, 121 (1966-67). In addition, several questions are expressly left open in the First Company Law Directive and will be handled in later directives. See text accompanying notes 79-88 infra.
45 The Directive applies to corporations (société anonyme [S.A.], Aktiengesellschaft [AG]), limited liability companies (société à responsabilité limitée [S.A.R.L.], Gesellschaft mit beschränkter Haftung [GmbH]) and certain limited partnerships. The S.A. and AG are similar in most respects to the American corporate form. The S.A.R.L. and GmbH have no direct analogue. They serve the same function as the American "close" corporation. The organization of the limited liability company is much simpler than that of the corporation, and their shares are generally not readily transferable.
pany. Thirdly, the Directive deals with the failure of companies to incorporate properly, especially insofar as improper incorporation has an effect on third parties. In general, the Member States are given eighteen months after notification of the Directive to change their domestic laws and regulations to meet the requirements of the Directive.

The following discussion will relate the preceding analysis of the scope and function of Article 54(3)(g) to some of the company law matters dealt with in the Directive. The changes which the Directive requires in selected existing national legal systems will be considered, as well as the question of whether such changes can be demanded solely on the basis of Article 54(3)(g). It would be redundant to investigate the laws of all six of the Member States on each point. Hence certain national laws which present the most interesting contrasts have been selected for closer examination.46

B. Disclosure of Information

When a national of one country is dealing with a company organized in another country, it is of utmost importance that he be able to find out information about that company quickly and in terms he can understand. This is true, for example, if he is entering into a contract for the sale of goods or is considering a loan to the company. As trade between Member States in the Community accelerates, adequate disclosure of the legal and financial status of companies becomes increasingly important. The present pattern of disclosure consists of rules varying with each Member State as to the information which companies must disclose and the manner in which such disclosure is made. A coordination of disclosure procedures would be an important step toward assuring greater legal security in transactions involving companies organized in different Member States.

In addition, under the present system, an enterprise operating in each Member State could have to file six different reports with six different deadlines, and keep six different sets of books on six different accounting systems to comply with all of the national laws on disclosure. This situation clearly poses serious administrative problems for multi-state companies. The elimination of the diverse disclosure requirements would reduce the administrative burden on enterprises which have establishments in several states.

Finally, disclosure, unlike many provisions of company law, can have an effect on competitive conditions. Those firms which are placed under stricter disclosure requirements by local law could be

46 For a general comparative discussion of the corporate laws of the Member States, see P. Van Ommeslaghe, Le Regime des Societes par Actions et leur Administration en Droit Compare (1960).
at a disadvantage in markets where the rules were less strict. In a highly competitive sector of the economy, differences in disclosure requirements could be of great importance.

For these reasons, a harmonization of disclosure provisions clearly falls within the scope of Article 54(3)(g). A coordination will help to minimize the risks of dealing with a foreign company and at the same time ease the burdens of overlapping regulations with respect to companies exercising their establishment rights in several Member States. However, existing disclosure requirements of the Member States differ radically, and coordination necessarily will be difficult. An examination of the current disclosure requirements of Germany and of Belgium will serve to illustrate some of these problems.

1. The National Law—Germany

The basic instrument for disclosure of legal and financial information about companies in Germany is the Commercial Register (Handelsregister) which is kept by the court of each district. Information which is required to be made public is deposited in the Register. After deposit, the information is published in the official journal (Bundesanzeiger), and in one other paper chosen by the court. Third parties may rely on information contained in the Register, and such information is available to all. The disclosure requirements for the corporation (AG) and for the limited liability company (GmbH) differ, however, and must be considered separately.

a. Corporation

When a corporation is formed, specified documents must be filed in the Commercial Register. These documents include the by-laws of the corporation, the names of the directors and supervisors, the amount of paid-in capital, and the “formation report” (Gründungsbericht), which discloses the relation of the promoters to the new corporation. In addition to the filing of documents, AG Law section 34 requires disclosure of the amounts received for the shares and, if property was received, a statement on the value of the property. Finally, AG Law section 39(2) deals with disclosure of those authorized to bind the corporation.

In addition to this rather extensive disclosure at formation, cor-

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48 Id. §§ 9-10, 15. Special rules apply if the third party knew of facts different from those disclosed in the Register.
Corporations are also required to publish annual reports containing a balance sheet and profit and loss statement. The new AG Law of 1965 sets forth very detailed and comprehensive rules as to the information which must be disclosed in the annual report and the accounting principles which must be used when drawing up the profit and loss statement and balance sheet. Section 151 gives the forms which the financial statements must follow, and sections 153 and 155 set down the principles of valuation which must be used. The basic rules are the cost less depreciation method for capital assets, and lower of cost or market method for inventory. Section 162 requires that the financial statements be examined by qualified auditors before submission to the shareholders.

b. Limited Liability Company

The situation is somewhat different as to the disclosure requirements for the limited liability company. Upon the formation of a limited liability company, sections 8 and 10 of the GmbH Law require the deposit in the Commercial Register at the seat of the limited liability company of a copy of the by-laws, a list of the shareholders and managers, and the initial capital. If shares are issued for property that fact must also be indicated in the Register.

With respect to the annual report, however, only those limited liability companies engaged in the banking business must publish a yearly balance sheet and profit and loss statement. All other

50 AG LAW § 177. It is on the basis of the annual report that the decision as to the payment of dividends is made. Unlike the American practice, in Germany the shareholders and not the management control the payment of dividends. The management draws up a financial statement for the year, which is presented to the shareholders for approval. After approval, the shareholders vote as to whether a portion of the profit, if any, should be paid out in dividends or left in the company. AG LAW § 58.

51 AG LAW §§ 148-62. Corporations whose stock is traded on a stock exchange must also comply with certain additional disclosure requirements set out in the Börsengesetz (Stock Market Law).

52 The new disclosure provisions are considerably stricter and more detailed than the old requirements and were intended to eliminate the practice of an accumulation of "hidden reserves" by the corporation. In the past, management would present financial statements which understated asset values. This would result in less profit for the shareholders to vote as a dividend, and the "hidden reserve" thus created would have in effect been reinvested in the business without the explicit approval of the shareholders. For an analysis of the new votes, see Esser, Gliederungsvorschriften, Bewertung, Gewinnverwendung und Pflichtangaben noch dem Aktiengesetz 1965, 10 Die Aktiengesellschaft 360 (1985).

53 Law of April 20, 1892, [1892] RGBI. 477 [hereinafter cited as GmbH LAW].

54 Id. § 5.

55 Id. § 41.
limited liability companies, no matter how large, are free from this requirement and need make no public disclosure of their financial affairs.

This rule was thought by its proponents to conform to the closed and personal nature of the limited liability company. Limited liability company shares are not easily transferred and are not traded publicly. It was felt that since no appeal was to be made to the public capital market, there should be no requirement of publicity.\(^5\)

Early commentators criticized this policy, noting that third parties had an interest in knowing the financial status of the limited liability company.\(^5\) The exemption of the limited liability company from publicity requirements became increasingly difficult to justify as more large companies took the limited liability form,\(^5\) and there have been many suggestions for change.\(^5\) The corporate law reforms of 1965, however, did little to alter the requirements regarding limited liability company publicity, except in the limited situation covered by AG Law section 329.\(^6\)

2. The National Law—Belgium
a. Corporation

As in Germany, the Belgian Company Code requires a rather extensive disclosure by a corporation (S.A.) upon its formation. The names of the founders, the articles of incorporation, and data


\(^6\) Liebmann, Die Reform der Gesellschaft mit beschränkter Haftung, 15 DEUTSCHE JURISTEN-ZEITUNG 675, 681 (1910); Liebmann, Die Gesellschaft mit beschränkter Haftung in der Praxis, 6 DEUTSCHE JURISTEN-ZEITUNG 327, 329 (1902).

\(^7\) In 1960, fifteen of the 100 largest firms and 294 of the 1,000 largest firms were limited liability companies. [1960] BUNDESTAG DRUCKSACHE ser. IV, at 2320.

\(^8\) Several suggestions for extending publication requirements to the GmbH have been presented to the Bundestag. See [1962] BUNDESTAG DRUCKSACHE ser. IV, at 203; [1960] BUNDESTAG DRUCKSACHE ser. III, at 2278. The problem was also considered extensively by the German bar in 1964. See Die handelsrechtliche Publizität ausserhalb der Aktiengesellschaft, supra note 56. On May 22, 1968, legislation was again proposed which would require disclosure of financial information by larger GmbH’s. BUNDES RAT DRUCKSACHE 269/68.

\(^9\) As part of the regulation of combines (Konzerne), AG Law § 329 requires a GmbH which controls an AG to make public consolidated financial data. In addition, it appears that in practice the new corporate regulations on accounting methods are having some effect on GmbH’s. See PRICE, WATERHOUSE & Co., INFORMATION GUIDE FOR DOING BUSINESS IN GERMANY 14-15 (1967). This does not extend of course to the obligation imposed on corporations to make financial information public.
regarding the cash and non-cash contributions to capital all must be published in the official journal \textit{(Moniteur belge)}.\footnote{\textsc{Code de Commerce} LIV. tit. IX, art. I, §§ 9-10 (J. Servais \& E. Mechelynck ed. 1961) [hereinafter cited as \textsc{Company Code}].} Later amendments—and in particular any modification of the powers of representatives of the company—must also be published.\footnote{Id. § 12.}

Each year the directors of the corporation are required to prepare a profit and loss statement and a balance sheet.\footnote{Id. § 77.} All shareholders are entitled to request a copy of this report before the annual meeting when the report is submitted to them for their approval.\footnote{Id. § 78.} Article 80 of the Company Code stipulates that the balance sheet and profit and loss statement be published in the official journal after they have been submitted to the shareholders. The financial statements of the company must be reviewed by an auditor,\footnote{Id. §§ 65, 77.} but there is no requirement that the auditor have special qualifications or expertise.\footnote{The situation is different if the corporation’s shares are publicly held. Then auditors must be chosen from a group of qualified accountants. \textit{Id.} art. 54. Public issuance of securities is regulated by the \textit{Commission bancaire} which has additional disclosure requirements.}

The accounting standards imposed by the Company Code are exceedingly vague. Article 77 requires only that the balance sheet be divided into assets and liabilities, that on the asset side there be drawn a distinction between liquid and non-liquid assets, and that on the liability side the secured and unsecured liabilities be distinguished. This complete lack of accounting standards did not happen by chance. The legislative history of the Company Code provisions shows a conscious decision against imposing a strict statutory pattern, leaving it to the directors to “declare the situation as they see it.”\footnote{Session of May 9, 1905, \textit{[1905] Annales Parlementaires-Sénat} 317. One Deputy argued that accounting standards did not matter since shareholders never came to meetings anyway and even if they did, they did not read the balance sheets.} Given this vague statutory guidance, the practice has nonetheless developed of a lower of cost or market method for valuation of inventory\footnote{Ministère Public et van Renterghem v. Schelfaut, \textit{[1931] Pasificrisie Belge [Pas. B.]} II. 169 (Cour d’appel de Gand).} and the cost less depreciation method (with some exceptions not pertinent here) for valuation of capital assets.\footnote{J. Van Ryn, \textit{Principes de Droit Commercial} 457 (1954).}

b. Limited Liability Company

On the formation of a \textit{société de personnes à responsabilité limitée}
(S.P.R.L.), the Belgian version of the limited liability company, the names of the shareholders, the names of the managers and their powers, and the initial capital must be published. In addition, unlike the limited liability company in Germany, the Belgian limited liability company must make public an annual balance sheet and profit and loss statement of the same type required of a corporation.

When the adoption of a limited liability company form in Belgium was being considered in the early 1930's, there was much discussion as to whether to follow the German rule exempting the limited liability company from disclosure requirements. When the bill was before the Senate, an amendment was proposed which would have followed the German rule as to the publicity requirements of the limited liability company. The principal argument in favor of the amendment was the same as that made in Germany; namely, that the limited liability company did not look to the public capital market and was basically a personal organization. This position was rejected, however, and the amendment defeated. It was felt by a majority of the legislators that it was "indispensable that those who enter into business relations with such a private company be able to inform themselves over its condition." As a concession to the private nature of the limited liability company, this type of business entity was not required to publish its annual report in the official journal, as was the corporation, but was required only to file it with the local Commercial Court.


The divergence between Belgian and German law on disclosure of information by companies is exemplary of the considerable diversity found in the existing disclosure requirements of the Member States. The basic thrust of the Directive is to increase the amount of disclosure necessary on the part of companies. Article 2(1) of the Directive requires that Member States ensure the mandatory publication of the act constituting the company, the by-laws, the subscribed capital, and the names of individuals having authority to represent the company. In addition, important corporate events such as the appointment of liquidators or a transfer of seat must be disclosed.

The disclosure required by the Directive is to be made by filling in a central or commercial register and by publication in an official

70 Company Code § 7(6).
71 Id. art. 137 makes applicable to the S.P.R.L. the publicity requirements of arts. 77-79.
72 Session of May 12, 1932, [1932] Annales Parlementaires - Senat 1005.
73 Id. at 1006.
74 Company Code § 137.
The publication may be either a copy of the actual material filed in the register or a notation referring to the material. Copies of the documents filed must be available to anyone requesting them, at a nominal cost. In the event of a difference between the information published and the information on deposit, a third party may rely on either source unless he was aware the discrepancy existed. In order to make access to this information as wide as possible, companies must indicate on their letterheads and order forms the location of the registry in which the company files.

Disclosure of this type of general information about the company's status and history involves no great departure from the existing publicity requirements which exists in the German and Belgian law, though the Directive does set up a uniform method of disclosure. Article 2(1)(f) of the Directive, however, requires the publication by companies of an annual balance sheet and profit and loss statement. Here the Directive initiates an important change. In addition to requiring corporations to publish financial data, the Directive requires additionally that limited liability companies also must make financial information public. The application of balance sheet and profit and loss statement disclosure requirements to limited liability companies, however, is deferred until a second directive concerning the coordination of the contents of these financial documents has been issued. The second directive, which is to be forthcoming within two years, will also exempt limited liability companies below a certain size from publicity requirements.

This requirement of the final text of the Directive—that limited liability companies must disclose financial data—will necessitate radical changes in the existing company law of the Member States. It has been a subject of considerable debate since the promulgation of the first draft directive. The first draft directive required publica-

75 First Company Law Directive arts. 3(1), 3(4). The original draft of the Directive left the choice of the means of publication up to the Member States. The Council, however, acting on the advice of the Economic and Social Committee, stipulated the method of publication in the final text of the Directive. This step should simplify the access of third parties to the published information.

76 Id. art. 4. The papers must indicate the legal form of the company. If the company is in liquidation, that fact must also be noted. If, as is the case in some Member States, the capitalization of the company is shown on the letterhead, the amount of paid-in capital must be distinguished from the subscribed capital.

77 Id. art. 2(1)(f).

78 Id.

79 An interesting series of articles appeared in the German publication GMBH-RUNDSCHAU (GMBH R.) shortly after the announcement of the draft directive. The draft directive proposal that Gmbh's disclose financial statements was asserted to exceed the competence of the Commission and to violate
tion of financial data by limited liability companies, but exempted from its publication requirements those companies with balance sheet assets of less than 1,000,000 units of account. This proposal drew sharp reaction from the Dutch commentators in particular, for the special problems it would raise in the Netherlands.

Under Dutch law, the limited liability company form is unknown and businesses are generally organized as corporations if they wish the advantage of limited liability. Since the first draft directive required disclosure for all corporations but exempted limited liability companies under a certain size, small corporations organized under Dutch law would have been at a disadvantage because they would have to make disclosures not demanded of the corresponding legal form in other countries. The second draft of the Directive corrected this problem by providing for a special category of "close" Dutch corporations which would be treated like limited liability companies for the purpose of disclosure, and this approach is followed in the final Directive. The Directive leaves open, however, the question of the size of the limited liability company and the Dutch close corporation which will be exempted from the disclosure requirements. This problem will be covered in the second directive.

The Council decision to extend disclosure requirements to limited liability companies was a sound one. The general need for readily accessible information about foreign companies increases as intra-Community trade develops and new international market opportunities are utilized by smaller companies. An exemption from disclosure for limited liability companies below a certain size will allow the Member States to have diverse disclosure regulations for those companies whose activities are primarily domestic, while requiring a

the German constitutional privilege of privacy. Its adoption, the articles implied, would lead to economic chaos throughout the Market. See 55 GmbH R. 23, 52, 53, 151, 156 (1964). The articles culminated with a telegram to the Council, the Parliament, and the Economic and Social Committee which summarized all the objections to publication for GmbH's and demanded that the provision be stricken from the Directive. Id. at 173. In a more scholarly analysis of the problem, the German Bar Association concluded that some kind of publication of the financial statements of GmbH's was needed, though differences of opinion still exist as to the extent of such publication. See 45 Deutscher Juristentag 69-74.

80 A unit of account is equal to 0.88867088 grams of gold or the value of the United States dollar. [1960] E.E.C. J.O. 1943.

81 E.g., Löwensgteyn, De voorschriften met betrekking tot de openbaarmaking in het ontwerp eerste richtlijn, [1964-65] De NAAMLOZE VENNOOTSCHAP 47. This perhaps explains the negative reaction of the Dutch to proceedings under Article 54(3) (g) generally. See generally Scholten, supra note 33, at 279.

82 First Company Law Directive art. 2(2).

83 See text accompanying note 78 supra.
uniform disclosure on the part of larger limited liability companies with activities of an international character.

A failure by the Council to apply disclosure requirements to larger limited liability companies could have had unfortunate results. As indicated above, limited liability companies in Belgium are already required to make disclosure of financial data. If other limited liability companies were free to avoid disclosure, Belgian companies would be at a disadvantage and there would be pressure to drop publicity even in Belgium. In addition, if limited liability companies were exempt from disclosure, there is a possibility that many businesses would use this legal form to escape the publicity required of the corporation.

The present situation in Germany indicates that this fear of a "flight into the limited liability company" may have some basis in fact. After the enactment of the stricter disclosure requirements for corporations, unofficial sources reported some German corporations turning to the limited liability company form to circumvent the new disclosure procedures. The decision of the Council to announce its approval in principle of disclosure by limited liability companies, while deferring action on the details of the disclosure provisions, will hopefully avoid this sort of problem.

A second matter on which the Directive defers action is the coordination of the contents of balance sheets and profit and loss statements. This coordination presumably will cover the method of presentation in the financial statements as well as the accounting principles on which they are based. An extensive coordination of accounting methods would not seem necessary to ensure adequate disclosure as long as certain basic principles can be made uniform. Most important in this regard would be agreement as to the method of valuation to be used in financial statements. In Germany and Belgium, for example, despite the differences in details of accounting practice, there seems to be general agreement on the use of a cost less depreciation method for the valuation of capital assets, and the lower of cost or market method for inventory. These principles could form the basis for the coordination of financial statement presentation to be undertaken in the future directive.

84 See text accompanying notes 70-74 supra.
86 See text accompanying notes 49-53 supra.
87 "[M]ore than two dozen" large companies have changed from the Aktiengesellschaft form and become GmbH's in order to avoid the stricter disclosure requirements in the new AG Law of 1965. Newsweek, Jan. 24, 1966, at 68. See also Sanders, Die Europäische Aktiengesellschaft, 12 Die AKTIENGESSELLSCHAFT 344, 347 (1967).
88 See text accompanying notes 52, 68-69 supra.
C. Effect of Limitations on the Power of Company Representatives

Companies of necessity act through representatives, but not every act of the representative binds the company. As was the case with disclosure requirements, varying rules have been developed in Member States concerning the ability of third parties to enforce against a company a contract entered into by representatives acting in the name of the company. This diversity threatens the legal security of intra-Community transactions, for it results in the inability of a third party to be certain that his dealings with a representative of a foreign company will result in a binding commitment. Harmonization of the rules on representation under Article 54(3)(g) would reduce the danger of confusion over power of representation and would remove an impediment to greater intra-Community business.

Recent developments with respect to recognition of companies also have made the lack of uniform rules on representation more significant. Acting under Article 220(3), the Member States signed a Convention on February 29, 1968 dealing with the mutual recognition of companies.89 This Convention is awaiting ratification by the national governments. Under the terms of the Convention, Member States are required to recognize companies formed in accordance with the laws of the other Member States. More important for purposes of Article 54(3)(g), the Convention provides that in general the “capacity” of the recognized company will be determined in accordance with the law of the country under which the company was “established”.90 Thus, concerning questions of capacity, and in particular with respect to the effect of limitations on the power of a company representative, the receiving state will not be permitted to apply its own law to foreign corporations after the Convention is ratified.91


90 Recognition Convention § 6090 (art. 6). The determination of legal capacity by reference to the law of the state of “establishment” instead of the traditional siège social approach may be part of a general Continental movement in the direction of an “incorporation” rather than “seat” analysis of corporate problems. See generally Drobnig, Conflict of Laws and the European Economic Community, Am. J. Comp. L. 204, 210-11 (1967); Leleux, supra note 35, at 148-49.

91 Article 7 allows a Member State to deny a foreign company rights and powers which it does not accord to its own companies, but this article would not affect the situation in which the foreign company's representative
Coordination of national law provisions will be essential to reduce the dangers to legal security implicit in the recognition rules set out in the Convention.\^92 A coordination of rules on representation can be based on Article 54(3)(g), since it has the requisite connection with freedom of establishment and legal security. Such a coordination presents certain problems, however, as the following examination of the law in Germany and France will show.

1. The National Law—Germany

Generally, the power of a representative to bind his company may be restricted in two ways. First, there may be an explicit provision in the by-laws or charter of the company limiting the power of a manager or board of directors to enter into certain transactions. Secondly, the Continental version of the *ultra vires* doctrine may operate to limit the power of a representative to bind the company. According to this latter theory of corporate powers, the company is able to act only within the purposes, the *objet social*, for which the company was established. Hence an act by a representative, though within the scope of his authority, does not commit the corporation unless it is encompassed within the *objet social*.\^93

a. Corporation

The German law firmly rejects both these limitations so far as dealings with third parties are concerned. As to the corporation, section 78(1) of the AG Law states that "[t]he Board of Managers (Vorstand) represents the corporation both in and out of court."\^94

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\^92 At least one commentator has suggested that ratification of the Convention should be withheld until a further coordination of company law under Article 54(3)(g) has taken place. Drobnig, *Kritische Bemerkungen zum Vorentwurf eines EWG—Obereinkommens über Anerkennung von Gesellschaften*, 129 Z.H.R. 93, 117 (1966-67).

\^93 See P. van Ommeslaghe, *Le Regime des Societes par Actions et leur Administration en Droit Compare* 475 (1960), for a discussion of the *ultra vires* doctrine in Europe.

\^94 Under German corporate law the day-to-day business of the corporation is handled by the Board of Managers. The Board is appointed by the Supervisory Council (Aufsichtsrat) which is in turn elected by the shareholders and in some cases has representatives of the corporation's employees. See note 154 infra. The Supervisory Council oversees the activities of the Managers and reports to the shareholders. AG Law § 111. Neither institution is exactly analogous to the American Board of Directors, though both have some common elements. For a general discussion of German corporate organization, see Stroble, *Principles of the German Law of Partnerships and Corporations*, in 1 *Doing Business Abroad* 114 (H. Landau ed. 1962).
The powers of the Board must be exercised jointly unless the by-laws provide otherwise. Powers may be delegated in the by-laws to one or several members of the Board and may be exercised in conjunction with a general agent (Prokura).\textsuperscript{95} Section 82(1) provides that the power of representation (Vertretungsbefugnis) of the Board of Managers may not be limited with respect to third parties, though limitations can have effect on the internal relations between the Board and the corporation. Both the commentators\textsuperscript{96} and the courts\textsuperscript{97} have interpreted this broad grant of power to the Board as including a rejection of the doctrine of objet social.

A literally unlimited power of representation, however, would be unworkable as well as unnecessary to fulfill the commercial needs for legal security, and hence some limitations have developed. For example, certain important corporate actions require shareholder or Supervisory Council approval.\textsuperscript{98} In addition, in day-to-day business transactions, if the third party knew or should have known of the limitations on the manager's power, the corporation is not bound.\textsuperscript{99}

b. Limited Liability Company

Similar rules apply to the German limited liability company. Section 35 of the GmbH Law provides that the limited liability company is to be represented in all matters by its managers (Geschäftsführer). They exercise the powers of representation jointly, unless the

\textsuperscript{95} AG Law § 78(2)-(4).

\textsuperscript{96} A. Baumbach & A. Hueck, Aktiengesetz 245 (1968); R. Teichmann & W. Köhler, Aktiengesetz 165 (1950). The Teichmann-Köhler commentary deals with the old AG Law of 1937. As far as representation is concerned, however, the rules in the new AG Law of 1965 correspond exactly to 1937 law. Hence, both case law and commentary on the 1937 statute would seem applicable in interpreting the present AG Law.

\textsuperscript{97} The ultra vires doctrine was specifically rejected in a judgment which held a corporation bound by a contract entered into by its managers to buy shares in another company even though such action exceeded the company's objet social as laid down in the charter. Judgment of Nov. 19, 1926, 115 RGZ 246. The court stated: “The power to represent of the Board of Managers is not limited by the purposes (satzungsmässiger Zweck) of the company. Even when an action of the Board of Managers exceeds the objet social (Gegenstand des Unternehmens), the binding force of such action is not affected.” Id. at 249.

\textsuperscript{98} E.g. AG Law § 52 (contracts involving over one-tenth of the corporation's capital and entered into within two years after formation must be approved by the shareholders); AG Law § 89 (loans to managers require Supervisory Council approval); AG Law § 340 (three-quarters majority shareholder approval must be obtained for merger of the corporation).

\textsuperscript{99} This is partly a judicially-developed doctrine (see Judgment of Nov. 5, 1934, 145 RGZ 311) and is partly based on the requirements of good faith and honesty (Treu und Glauben) of Bürgerliches Gesetzbuch (BGB) art. 242 (1965), which have been applied to all contract situations.
by-laws state otherwise. But section 37(2) stipulates that "[a]gainst third parties, limitations on the powers of the managers to represent the company have no legal effect," and again this broad grant of powers has been interpreted as a rejection of any limitations based on the objet social concept.\textsuperscript{100}

The German statutory pattern thus gives wide protection to third parties dealing with companies. This concern for the rights of third parties can be traced to the Bürgerliches Gesetzbuch of 1896. That Code made an important distinction between Auftrag, or the internal relation between principal and agent, and Vollmacht, the power of the agent to represent and bind his principal in dealing with third parties. Limitations contained in the Auftrag relation did not restrict the Vollmacht of the agent, and had no effect against third parties.\textsuperscript{101} This same idea was incorporated into the company law provisions, which rejected limitations on the power of representatives where third party interests were concerned.

2. The National Law—France

The Law of July 24, 1966,\textsuperscript{102} the first extensive reform of French company law in this century, has made important changes in the law on representation and, though the development of the law on representation in France has taken a considerably different path than in Germany, the final results are not too dissimilar. In order to understand the existing French law, it is necessary to review briefly the history of the present provisions.

a. Corporation—Historical

Article 22 of the Law of July 24, 1867,\textsuperscript{103} the prior basic French corporate statute, provided that the corporation was to be managed by one or more agents (mandataire) who were to be selected from among the shareholders. In contrast to the German law,\textsuperscript{104} there was no reference to the effect of limitations on the power of the mandataire to represent the company. The French courts, when faced with a problem of how to treat these limitations, turned to the

\textsuperscript{100} See Scholz, Kommentar zum GmbH-Gesetz 417 (5th ed. 1960). Though the courts have never ruled on the matter, the principles developed with respect to corporations are thought to apply to limited liability companies.

\textsuperscript{101} BGB §§ 167, 662. Similarly, restrictions on the power to represent of a general commercial agent (Prokura) are not effective against third parties. HGB § 50.


\textsuperscript{103} [1867] Bulletin des Lois 94 (11th Series) [hereinafter cited as Old Company Law].

\textsuperscript{104} See text accompanying notes 94-97 supra.
general principles of mandat\textsuperscript{105} as codified in the Code Civile. Article 1989 of the Code states that an agent (mandataire) can do nothing beyond what is set out in his mandate. Article 1998 provides that the principal is not bound by an act done by the agent outside the scope of the mandate unless he ratifies the act.\textsuperscript{106} Applying these concepts to the corporate context, the French courts concluded that limitations on the powers of corporate representatives were effective against third parties, and that the corporation was not bound by the acts of its representative exceeding the express power granted.\textsuperscript{107}

In addition to enforcing such limitations on the power to represent, the old French law also accepted the principle of ultra vires. The powers of the corporation were to be exercised always within the objet social of the corporation as set out in the charter.\textsuperscript{108} Though

\textsuperscript{105} Roughly translated “agency,” though there are some important differences between the French and American institutions.

\textsuperscript{106} It is interesting to note the historical reasons for the different development of Auftrag and Vollmacht in Germany and mandat in France. In its Roman origins the mandate contract was simply an agreement by one person to perform a service for another without compensation. H. Jolowicz, \textit{Historical Introduction to the Study of Roman Law} 311 (1952). It had nothing to do with the power to represent in the sense of binding the principal in contracts with third parties. In the Middle Ages, the power to represent became combined with the mandate. However, the power to represent extended only as far as the mandate, \textit{i.e.}, only to the extent of the agreement between the parties. This combination of mandate and power to represent was taken into the French Law. Code Civile [C. Civ.] art. 1984 (6\textsuperscript{e} ed. Petits Codes Dalloz 1968). Hence the result that restrictions between principal and agent are effective against third parties. In Germany, however, the internal aspects of the relation, \textit{i.e.}, the mandate or Auftrag, were separated from the power to represent, the Vollmacht, and were regulated independently. As a result, restrictions in the internal aspect of the relation did not limit the power to represent.

\textsuperscript{107} See, \textit{e.g.}, Meyer v. Établissements Maréchal, [1946] \textit{La Semaine Juridique} [Sem. Jur.] II. 2970 (Cour d'appel, Paris) (limitation in by-laws requiring signatures of two directors held effective); Walter v. Moreau, [1891] \textit{Recueil Périodique et Critique} [D.P.] I. 339 (Cass. ch. req.) (mandate principles followed in determining corporation's liability on notes executed by its directors). The harsh result of giving effect to internal limitations was ameliorated somewhat by the doctrine of mandat apparent.

Like the Anglo-American concept of apparent authority, the mandat apparent doctrine allowed the third party to enforce obligations against the corporation, even where actual power to represent was lacking, if the company representative was carrying out a function usual for one in his position. \textit{See}, \textit{e.g.}, Penant v. Balbarie et Haguenauer, [1936] \textit{Recueil Sirey} (S. Jur.) I. 223 (Cass. ch. req.).

The scope and limits of the doctrine, however, were far from clear. \textit{See} P. Van Ommeslaghe, \textit{supra} note 93, at 486; Léauté, \textit{Le mandat apparent dans ses rapports avec las théorie generale de l'apparence}, 45 \textit{Revue Trimestrielle de Droit Civil} 288 (1947).

the potential danger for third parties created by the *objet social* doctrine was somewhat limited by the practice of having a broad statement of purposes in the charter,\(^{109}\) the possibility that a given transaction could be found to be outside the scope of the corporate purpose remained a real one.\(^{110}\)

### b. Limited Liability Company—Historical

The law with respect to the power of representation has developed somewhat differently with respect to the French limited liability company, the *société à responsabilité limitée* (S.A.R.L.). The limited liability company form was first introduced in France in 1925, and was modeled on the German GmbH statute.\(^{111}\) Understandably, the rules on power of representation showed their origin. Article 24 of the Law of March 7, 1925\(^{112}\) provided that the limited liability company was to be managed by one or more agents who were to have full and complete authority to act in the name of the company. The statute did not, however, leave the relation of the third parties to the company to be determined by the *mandat* rules as in the case of the corporation. It provided that “any private agreement limiting the power of managers is without effect as regards third parties.” However, the value of this statute in increasing the protection given third parties was undermined to some extent by the application of the doctrine of *objet social* to the limited liability company by the courts.\(^{113}\)

### c. Current Law

The New Company Law of July 24, 1966 follows the old law quite closely with respect to the power of limited liability company managers. By articles 14 and 49 of the new statute, limitations on the power of managers of a limited liability company “are of no

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\(^{110}\) In Belgium, where the French doctrine is followed, the *Cour de Cassation* held in 1957 that a corporation organized to export goods could not deal as a commission agent in imports since such activity was outside the objects of the corporation. *Société Anonyme Overseas Suppliers Ltd.* v. *Société de Droit Anglais Gilbert Caul and Cy.*, [1957] Pas. B. 1176 (Cass.). Presumably Luxembourg also would follow the French and Belgian decisions.


effect with regard to third parties."\textsuperscript{114} The corporate rules on representation, however, have been changed considerably.

The new law provides alternative methods for the organization of corporate management. The by-laws of the corporation may provide that the corporation is to be managed either by a Board of Directors and a President, somewhat in the American manner, or by a Board of Managers and a Supervisory Council, along the lines of the German corporate structure.\textsuperscript{115} In either case, however, the statute expressly states that limitations on the power of those who according to law represent the corporation may not be invoked against third parties.\textsuperscript{116}

Because of these changes, a third party dealing with a corporation in the ordinary course of business need have no fear, as had been the situation under the prior law, of internal limitations on the powers of Directors or Managers.\textsuperscript{117} However, despite the increased protection given to third parties in the new statute with respect to attempts to limit powers internally, the doctrine of objet social is still retained. The power of representation of both corporations and limited liability companies may still be exercised only "within the limits of the corporate purposes," and a commitment on the part of a company can still be found to be unenforceable on the basis that it does not fall within the objet social of the company.\textsuperscript{118}

3. The Directive Provisions on Representation

A coordination of the rules on representation presents squarely the problem of choosing between the competing claims of third parties and shareholders. In France, the law has developed to protect the shareholder by allowing the company to avoid commitments in certain circumstances. In Germany, the interests of third parties have always been preferred.

The German approach clearly seems best suited to the needs of expanding intra-Community business. The risk that a company representative might enter into an unauthorized transaction should fall on the shareholders rather than the third party since they have chosen him and are in a position, either directly or indirectly, to oversee his activities. This is especially true when the third party is dealing with a company organized in another Member State, for

\textsuperscript{114} New Company Law arts. 14, 49.
\textsuperscript{115} Id. art. 118.
\textsuperscript{116} Id. arts. 98, 124.
\textsuperscript{117} Major corporate actions outside of the ordinary course of business may require shareholder approval. For example, the New Company Law requires shareholder approval for a transfer of all of the company's assets. Id. art. 396.
\textsuperscript{118} Id. arts. 14, 98, 124.
in that case an investigation into the actual authority of the representative could be quite difficult. In fact, the French law has been shown also to be moving in this direction.

As might be expected, the Directive follows the pattern of the German law on representation. Article 9(2) of the Directive provides that limitations imposed on the power of “organs” representing the company by the by-laws or by the internal decisions of the company may never be invoked against third parties even though they have been published. Thus, third parties are protected against any hidden limitations and, in addition, are not required to interpret the scope of limitations which have been made public. The only exception to the general rule is that if the existing company law allows a delegation of powers in the by-laws to one or several persons, the national law may provide that such delegation may be invoked against third parties, as long as it has been disclosed by filing and publication.119 This procedure does not unduly burden third parties since they are required only to make sure that the company representatives with whom they are dealing are named in the documents on deposit in the Commercial Register.

It is interesting to note that Article 9(2) of the Directive states that internal limitations may never be invoked against third parties. As discussed in the examination of German law,120 where a wide power of representation traditionally has been recognized, limitations are nonetheless effective if the third party had knowledge of them. This problem was raised in the debates in the European Parliament,121 and the Parliamentary draft of the directive required that third parties be “in good faith” (de bonne foi) to avoid internal limitations on a representative’s authority.122 The Council, however, omitted this requirement in the final Directive. Presumably it was felt that the test was too difficult to apply. A better solution would have been to put the burden of proof of bad faith on the company, thus protecting third parties in all situations in which they deserve protection, and conforming to the Directive’s approach regarding the solution of the objet social problem.123

With respect to the objet social limitation on company obliga-
The Directive has taken something of a compromise position. Article 9(1) provides:

(1) The company shall be liable to third parties for acts of its organs, even if such acts are not related to the company purpose, unless such acts exceed the powers that have been given or may be given to such organs by law.

The Member States may, however, provide that the company shall not be liable where such acts exceed the company purpose if it can prove that a third party had knowledge of the fact that the act exceeded the company purpose or under the circumstances could have had knowledge thereof; the fact of publication of the by-laws in itself shall not constitute such proof.

Thus, the objet social doctrine still may have some vitality in those countries like France and Belgium in which it is presently accepted, but only in the situation in which the third party reasonably can be supposed to know that the company was acting beyond its scope. The fact that the objet social of the company has been disclosed by publication is not of itself enough to put the third party on notice. The Directive correctly places on the company the burden of showing that a third party could have known that an act exceeded the objet social. Hence, such a person is spared from having to interpret the limitations of the objet social at his own risk.

The Directive will thus require some changes in the existing French law with respect to objet social since the present statutes do not restrict the doctrine as does the Directive. However, the recent French judicial decisions seem to be moving in the direction of upholding limitations on representative power only in situations where the third party had or should have had knowledge of the limitations. Thus, the changes necessitated by the Directive will not be revolutionary.124

The basic goal of the Directive provisions is to insure that third parties dealing with foreign companies will not be exposed to limitations on the power of the company's representative, and this comports with the general objectives of Article 54(3)(g). However, the approach employed by the Directive points up certain interesting and unresolved problems. For example, in Article 9(1), the Directive speaks in terms of the "organs" which represent the company and states that those organs are able to bind the company only to the extent of the power granted them by the national company law. As has been discussed, however, the bodies which represent the company can differ in both composition and function according to the national law. In France, for example, the President may be responsible for the general management of the company while in Germany

the corresponding function is performed by the Board of Managers. In addition, certain powers may be reserved under one national legal system for the shareholders or the Supervisory Council while in another Member State such powers are regularly exercised by the directors. The same difficulty arises with respect to the authority of company officers with less than full power to represent the company. Business needs often require that these officers be able to commit the company within a limited sphere of activities.

The disposition of problems of this type is clearly beyond the scope of the present Directive. To coordinate the basic structure of the various forms of business entities in the Member States would be a large task, involving considerable intrusion into national legal institutions. It is questionable whether such an undertaking could be based on Article 54(3) (g) since this seems to go well beyond coordinating "protective provisions," and the Directive cannot be faulted for failing to deal with problems of this magnitude. On the whole, however, short of such a radical undertaking, the coordination of the rules as to the effect of internal limitations on the power of representatives, together with the provisions for a uniform method of disclosure of information about company representatives, as now required by the Directive, should help to increase legal security in day-to-day business transactions involving companies organized in different Member States.

D. The Causes and Effects of Improper Incorporation

Limitations on the power of a company representative are not the only threat to the rights of a third party dealing with a foreign company. It is also possible that the company was not properly formed and thus never came into existence under the laws of the state of incorporation. In a domestic transaction it is relatively simple to protect against this danger by an investigation of the legal status of the company and a determination of the effects of failure to incorporate properly. As more business is carried on between companies formed in different states, however, the difficulties involved in such an investigation increase. Legal security would be furthered if the grounds for declaration of nullity were coordinated and the effects of such declaration minimized.

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125 See notes 98, 117 supra. For a discussion of this problem in the Netherlands, see Sanders, supra note 87, at 345.

126 The expression "declaration of nullity" (Nichtigerklärung) refers to the procedures under the laws of the Member States whereby a company is annulled and denied further legal existence. See, e.g., AG LAW § 275. It has certain features in common with the Anglo-American quo warranto proceeding though it may be brought by private parties. A declaration of nullity can have varying effects, as the subsequent discussion indicates.
The report of the Internal Market Commission of the Parliament on the first draft directive objected that problems of nullity had no relation to freedom of establishment, and questioned whether coordination in this area could be based on Article 54(3)(g).\textsuperscript{127} However, this approach is not particularly persuasive, for while annulment and its effects may not be as important an area of company law as is publicity, or restrictions on representative power, it still has a clear relation to freedom of establishment. For example, the possibility that a company established in branch or agency form in the territory of another Member State could be found to be improperly incorporated, and hence without legal existence, could bear on the rights of third parties who had business relations with the foreign company. A declaration of nullity having retroactive effect could jeopardize claims against the company and lead to an understandable reluctance to enter into dealings with foreign trading partners. A coordination of the grounds of nullity, and more important, a minimizing of the effects of nullity, would eliminate this problem. In view of the similarity of existing company law provisions, such coordination will not present any serious difficulties.

1. The National Law—France

Like the rules on representative power, the French law on nullity has been altered significantly by the New Company Law of July 24, 1966, and it is helpful first to examine the state of the law prior to the new statute. The old corporate statute listed a number of grounds for a declaration of nullity. Failure to make proper publication of the incorporation papers, defect in the form of the paper when filed, failure to hold necessary organizational meetings, improper appointment of directors, and failure to issue properly the initial stock all could result in a declaration of nullity.\textsuperscript{128} In addition to the specific statutory grounds, the French courts had also developed other grounds for annulment based on the idea of the company as a form of contract among the shareholders.\textsuperscript{129} Since company formation is based on contract principles, all the usual defects (lack of consent of all parties, fraud, duress, etc.) which would invalidate any contract could lead to an annulment of the company.\textsuperscript{130}

While an annulment could not be used by the corporation as a defense to claims by third parties, it could lead in one instance to a subordination of the third party claims. The French courts had held that the personal creditors of a shareholder in an improperly formed

\textsuperscript{127} Internal Market Comm'n Report para. 68.
\textsuperscript{128} Old Company Law, supra note 103, arts. 1-5, 7.
\textsuperscript{129} C. Civ. art. 1832 (67e ed. Petits Codes Dalloz 1968).
\textsuperscript{130} See E. Church, Business Associations Under French Law 217 (1960).
company had the right to bring a proceeding for annulment against the company. If the annulment was obtained, it had retroactive effect and made the company null and void ab initio. The third party who dealt with the corporation was bound by the retroactive declaration of nullity and lost his preferred claim to company assets. After the retroactive annulment, he was reduced to equal status with the personal creditors of the shareholders.

The New Company Law has changed the situation considerably. In the main, the new law reduces the grounds on which nullity will be declared and sets up provisions by which the various defects in incorporation can be cured without a declaration of nullity. Article 369 makes it clear also that the company may not benefit from improper incorporation vis-a-vis the third party acting in good faith. More important, under the new law the retroactive effect of a declaration of nullity, with the corresponding danger to third parties, has been eliminated. Article 368 states that when a corporation has been annulled, it will be liquidated in accordance with the general provisions on liquidation, thus protecting legitimate claims of third parties. This greater protection given to third parties by the new French law was clearly influenced by the provisions of the draft directive relative to the elimination of the retroactive effect of an annulment.

2. The National Law—Germany

In Germany, section 275 of the AG Law sets forth the grounds for a declaration of nullity. The criteria for such a declaration are far less expansive than those of the old French law. The declaration can be obtained when the charter deposited on formation lacks any of the required information or has some error in form. And unlike the French law, both old and new, the German law does not allow the formation of a corporation to be attacked on the basis of general contract principles.

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131 Charpentier v. Müller, [1965] JOUR. SOC. 250 (Cass. ch. civ.).
132 Société de Tréport-Terasse v. Moreau liquidateur de la Société La Nouvelle-Union, [1887] D.P.I. 417 (Cass. ch. civ.). The principle of the retroactive effect of nullity laid down in this case was followed in modern cases. See E. CHUNCHE, supra note 130, at 230.
134 New Company Law, supra note 102, arts. 360-67. Rules governing nullity of contract still apply, however.
136 AG LAW § 275(1).
As well as limiting the grounds for a declaration of nullity, the German law protects third parties from the effects of such a declaration. Section 277(2) of the AG Law specifically provides that the validity of legal transactions (Rechtsgeschäfte) undertaken in the name of the corporation will not be affected by a declaration of nullity. Thus, the third party can assert his claims against the company since a declaration of nullity will in no circumstances have a retroactive effect.

3. The Directive Provisions on Failure to Incorporate Properly and Its Effects

The approach of the final Directive to annulment problems has changed somewhat from that of the draft directive. In the first draft directive the only grounds for a declaration of nullity were an illegal purpose of the corporation or some defect in the procedure under which the corporation was formed. The final Directive spells out the possible grounds for nullity in considerably more detail and expands their scope to a certain extent.

The Directive follows the basic principle of the prior draft directive by providing that in the event of a declaration of nullity, the company shall be liquidated and the declaration of nullity shall not “impair the validity of obligations incurred by or towards the company . . .” Clearly, this provision will prevent those difficulties of retroactive annulment which arose under the old French corporation law, and remains consistent in principle with the provisions of the new French law, which was seen to have been based, in part, on the prior draft directives. In addition, any shareholders who have not paid in all the subscribed capital can be required to make such payments to the extent necessary to satisfy the obligations of the company to third parties.

The Directive would require no significant changes in the existing French and German law apart from a possible reduction in the grounds for a declaration of nullity under French law based on contract principles. One of the Directive sections on nullity, however, presents a problem common to all attempts to coordinate existing company law, which has not yet been considered. Article 11(1)
states that the declaration of nullity must be made by judicial decree; thus only through the action of a judicial body may the company be annulled. This procedure raises the broader question of judicial participation in the coordination of company law.

After the existing national laws and regulations have been altered in response to the Directive, there still remains for the national courts the problem of interpretation and application of the new legal provisions. A fully satisfactory coordination of company law provisions cannot take place by means of directives alone. Only when the courts of the Member States begin to consider decisions rendered by the other national courts on similar problems will the required harmonization in company law provisions be obtained. That this judicial interaction in company law will take place is by no means certain. However, by increasing the similarity of some of the basic company law provisions, the directive procedure of Article 54(3)(g) at least makes it more likely that the courts in one country will look to the decisions of courts in another Member State regarding the company law problems which arise, and this in itself will further the process of harmonization.

III. Article 54(3)(g) and Proposals for a “European” Company

In addition to the work on company law undertaken by the Commission and the Council in connection with Article 54(3)(g), much consideration has been given in the past few years to the creation of a special company form which would be available for businesses in the Community. The idea of a special form of European company is a marked departure from the provisions of the Treaty of Rome dealing with company law, and presents a whole range of new problems. It is beyond the scope of this article to examine in any detail the numerous questions which the suggestions for a European company form have raised. However, it is helpful to consider in general the relation between the various proposals for a European company form and the reasons which prompted them, and the procedures for the coordination of company law under Article 54(3)(g) which have been examined here.

The first suggestion for a European company in the context of the European Economic Community was made in an address delivered by Professor Sanders of Rotterdam in 1959. In March of 1965, the idea was raised again in a Memorandum by the French government to the Council. After noting the slow progress in the coordination

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143 Text of a Memorandum submitted by the French government to the EEC Council, March 1965, 2 CCH COMM. MKT. REP. ¶ 9025 (1965). For a dis-
of company law, the French Memorandum suggested that the governments of the six Member States meet outside the framework of the Community institutions to draft a uniform law which then would be incorporated in a multi-national convention. As part of the convention, each Member State would agree to enact the uniform company law into its own legal system.144

The Commission replied to the French proposal on April 22, 1966 in a Memorandum to the Council supporting the idea of a European company.145 This Memorandum set out in detail the arguments in favor of the establishment of this new type of company organization. As to which form a European company could take, the Commission suggested that such a company might be organized under a convention, supplementing the Treaty of Rome, which would have direct effect in the Member States as a new "European" law existing in association with the domestic laws.

In addition to its Memorandum to the Council, the Commission established an ad hoc working party in December of 1965 under the direction of Professor Sanders to explore further the possibilities for a European company.146 The Sanders group drew up a preliminary draft of a statute under which a European company could be organized,147 leaving open the question whether it should be enacted by the national legislatures as a loi uniforme as the French proposed, or adopted in the form of a convention having direct effect as suggested by the Commission. The draft statute, as well as the Commission Memorandum and the French Memorandum, were considered further by another working party appointed by the Council and also chaired by Professor Sanders, which reported to the Permanent Representatives of the Council in April of 1967.148 It is expected that the discussion of the French proposal, see Foyer, La proposition francaise de creation d'une societe de type europeen, [1965] REVUE DU MARCHE COMMUN 268. One of the effects of the French proposal and clearly an intended one would be to reduce the importance of the "supra-national" Community institutions in the company law area by resort to the more traditional methods of conventions and uniform domestic legislation.

144 2 CCH COMM. MKT. REP. ¶ 9025 (1965).
146 See note 148 infra.
147 P. SANDERS, SOCIETE ANONYME EUROPEENE (1966) [hereinafter cited as DRAFT EUROPEAN COMPANY STATUTE]. This report was printed in a limited number of copies by the Commission. A copy is on file at the Hastings Law Library. For a summary of the Sanders proposal, see Thompson, The Creation of a European Company, 17 INT'L & COMP. L.Q. 183 (1968).
In its memorandum on the desirability of a European company, the Commission outlined the present needs which such an entity could fill. In the first place, such a company form would facilitate the exercise by businesses of their right of establishment in other Member States. The Commission analyzed the extension of economic activity in three areas: (1) recognition of companies; (2) transfer of seat; and (3) establishment of subsidiaries. According to the Commission, company law difficulties in these three areas could be solved by adopting some form of European company. Clearly there would be no question as to the recognition of a European company since it would have its legal basis in a convention ratified by all of the Member States. Further, if a European company form was available, the presently existing company law problems relating to transfer of seat would be eliminated, since there would be no change in the company law applicable to a European company when it moved the location of its activities from one Member State into another. Finally, if a single legal form could be used, it would simplify the setting up of subsidiaries and would facilitate the management of the international operations of larger companies.

In addition to these advantages, the Commission also stressed the function which a European corporation would have in encouraging a greater concentration of industry within the Community. This was the premise behind the original French suggestion and has been the leitmotiv running through all the discussions of the various proposals. A European company form would simplify international mergers by providing a legal framework in which companies organized under different national legal systems could combine. The existing national laws are not adequate for this purpose. Such a form would be neutral with respect to “nationality” and thus could avoid the often vexing problem of choosing which of the existing national laws would be applicable to the company resulting from the mer-

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149 The tax law problems would of course remain. See note 28 supra.
150 See, e.g., Memorandum on Concentration of Enterprises in the Common Market by the Commission of the European Economic Community to the Governments of the Member States, CCH COMM. MKT. REP., Report No. 26 (March 17, 1966); Gessler, Grundfragen der europäischen Handelsgesellschaft, 22 DER BETRIEBBERATER 381 (1967); Sanders, supra note 87, at 345; Scholten, The European Company, 5 COMM. MKT. L. REV. 9 (1967-68); Storm, Statutes of a Societas Europaea, 5 COMM. MKT. L. REV. 265, 269 (1967); Towards the European Company, The Economist, June 15, 1968, at 60.
151 See G. Schlosser, supra note 24, at 153; Conard, Corporate Fusion in the Common Market, 14 Am. J. Comp. L. 573 (1966). Article 220 (3) provides for a negotiation by the Member States on a convention dealing with the problems of mergers between companies organized in different Member States, but little progress has been made.
The European company form could also be used as a holding company vehicle, allowing the pooling of financial interests without an actual merger of one company into another. Finally, the European company form would allow companies organized in different states to form joint subsidiaries, again without the necessity of stipulating that the subsidiary be organized under the laws of one or another of the Member States. In all these areas, the establishment of a European company form would encourage a concentration of economic resources and would enable businesses within the Community to compete more effectively for both capital and customers with large American enterprises.

From the foregoing discussion, it is clear that the reasons behind the proposals for a European company are closely connected with Article 54(3)(g). Both the French and Commission Memoranda point to the lack of progress under Article 54(3)(g) as justification for the adoption of a European company form. This does not mean, however, that the establishment of a European company will eliminate the need for further action under Article 54(3)(g). The European company concept has certain inherent limitations as the following analysis of the question of access to the European company form will show.

The question of the criteria to be used in determining which businesses may organize as European companies has plagued the proponents of the European company idea from its inception. One possibility would be to make access to the European company form as wide as possible, so that formation would be no more difficult than is domestic incorporation. However, if all domestic companies were free to adopt the European company form, it would be possible for them to avoid burdensome regulations in national company laws which were not reflected in the European company statute.

The difficulty in deciding which national company law will apply to the surviving company is a practical impediment to more international mergers. See Sanders, supra note 87, at 345; Storm, supra note 150, at 268.

The access to capital markets has become an increasingly important problem since the American balance of payments regulations (33 Fed. Reg. 49 (1968)) have forced American companies to turn to the Euro-currency market for financing. The Commission has stressed that the increased size of Community businesses which would be made possible by the adoption of a European company would help their position in the competition for Euro-currency financing. Written Question No. 286, E.E.C. J.O. No. C/17, at 17 (Feb. 23, 1968), 2 CCH COMM. MKT. REP. 9224 (1968).

The most important problem in this area concerns the question of labor representation on the governing board of the company. This institution of Mitbestimmung or codetermination is important in Germany and to a limited extent in France but is not known in the other Member States. Germany will require some provision for codetermination in the European company statute.
must be faced in any event, no matter what criteria for access are finally agreed upon. However, the dimensions of the problem are considerably reduced if the access to the European company form is restricted to only a portion of the domestic companies.

One possible method of restriction would be to require that a company show some substantial business activity inside the Community before incorporation as a European company would be allowed. This would be a difficult standard to administer as a practical matter, since some kind of policing would be required to ensure that the requisite intra-community activity was maintained.

This type of "activity" test was rejected by the Sanders working group, whose proposal would limit access to the European company form to organizations having certain minimum capital. For the creation of a new European company through merger, or for a European holding company, a minimum of $1,000,000 capital would be required. A corporation presently organized under the laws of one of the Member States which wished to reincorporate as a European company would be required to have a capital of $500,000. The formation of a European corporation as a wholly or jointly owned subsidiary would require a minimum capital of $250,000. Other proposals have suggested minimum capital requirements ranging from $1,000,000 to $150,000-$200,000.

It becomes immediately apparent from these figures that, under any of the existing proposals, the European company form would be available only to larger enterprises. It was estimated by Professor Sanders that a minimum capital requirement of $250,000 would allow only 10 percent of the existing Community companies to organize as European companies. While the hoped for increase in international mergers would raise this figure, and the use of the European company could promote joint ventures by several smaller companies on a larger scale, nonetheless, the large majority of companies involved in intra-Community trade would still be formed under national company laws even after the establishment of a European company form.

Thus, the basic problem at which the European company proposals are directed is the need for an increase in the size of the economic units in the Community. Though the Commission Memorandum for companies operating in Germany since otherwise the requirements of the domestic law could be avoided. Various solutions to the problem have been suggested. See Sanders, supra note 87, at 347.

155 Draft European Company Statute, supra note 147, art. I-3(1) to (2).
156 Gessler, supra note 150, at 387 (the prospective European company must have at least $1,000,000 capital in its interstate activities); Scholten, supra note 150, at 13 ($150,000-$200,000 as minimum capital).
157 Sanders, supra note 87, at 346.
speaks of the need for a European company in order to solve certain existing company law problems relating to establishment, a closer analysis shows that these matters are adequately handled by already existing legal tools. With respect to recognition of companies, the Convention contemplated by Article 220(3) has already been concluded and awaits only ratification. As to the formation of subsidiaries, another point mentioned in the Commission Memorandum, the Commission itself states that presently "the establishment of subsidiaries raises no insoluble problems under company law..." In addition, Professor Sanders has written that the problems of transfer of seat can be satisfactorily resolved by means of a treaty under Article 220(3). The basic function of a European company form, despite the Commission's discussion of establishment problems, would be to encourage the formation of larger companies within the Community.

IV. Conclusion

In the light of the foregoing analysis of the European company proposals, the continuing importance of Article 54(3)(g) becomes clear. The European company form would enable businesses to combine into larger economic units, but even if all the problems concerning a European company statute can be resolved, much of the intra-Community trade will still be carried on by small and middle-sized firms organized under national company laws. The problems relating to freedom of establishment and legal security created by differences in the existing company laws, seen in the first sections of this article, will still be present, and additional modifications in the national company laws will be needed. The First Company Law Directive is a significant beginning toward the solution of these problems, but much remains to be done in the harmonization of company law. The proposals for a European company, interesting though they may be, should not be seen as offering a panacea for all the company law problems in the Community, and the issuance by the Council of the First Company Law Directive will hopefully bring renewed attention to the role of harmonization of national company laws in the future development of the Community.

158 See text accompanying notes 89-91 supra.
159 Commission Memorandum, supra note 145, at 14.
160 Sanders, supra note 87, at 344.