

# Chapter 4

## ETUC recommendations regarding the Cross-border Mergers Directive: Get real, get employees involved and be consistent

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### 1. Introduction

It took the EU institutions several decades to agree on a cross-border mergers directive. The first attempts were made in the 1980s but failed because of difficulties concerning board structure and employee participation (Brech-Bruun and Lexidale 2013). Regulation of the applicable employees' representation on the company board is normally determined by the company law of the country in which the legal entity is registered. Considering the wide diversity of national traditions on this issue, however, any merger entailing the creation of a new company board in a different jurisdiction from the one applying to the existing companies puts pre-existing mechanisms at risk. But the European Union was not ready for EU harmonisation of such rights.

The adoption of the SE compromise, with its 'before-and-after' principle, in 2001 cleared the impasse. Directive 2001/86 (on the involvement of employees in the SE) foresees a negotiation procedure between management and employees on an information and consultation body, as well as participation rights. Should the negotiations fail, the participation rights in place before the company changed its regime would remain. The Cross-border Mergers Directive was finally published in 2005, offering a similar – but not identical – protection system with regard to employees' participation rights.

In 2015, the Commission announced plans to look at further modernising the rules on cross-border mergers with particular regard to the use of digital technologies (European Commission 2015). While additional tools seem to be needed to further facilitate a cross-border merger, the Commission assumes that the existing provisions on employees' rights are sufficiently protective.

Early on, the Directive was perceived mainly as an instrument for rationalising group structures. Intra-group operations could be facilitated thanks to the merging of existing subsidiaries established in different Member States. Such formal activities do not at first sight entail closures or takeovers of units. This would explain why the provisions related to employees' rights are to be found in a single article.

The reality is more complex. Most mergers leave employees worried about upcoming restructuring and their terms of employment. For example, a cross-border merger can be used in private equity operations, which are now infamous for their extremely negative impact on employment levels. Typically, in a leveraged buyout, the target company is

merged with an acquiring company, which is formed by the investors specifically for this purpose.

Furthermore, companies that wish to transfer their registered office to another Member State are now encouraged to have recourse to a cross-border merger. A company wishing to relocate to another Member State can establish a subsidiary in this country and then merge into this (former) subsidiary. This is a firm trend. Having started life as a tool designed to reduce organisational costs, the Directive is on the way to becoming the main instrument favouring company mobility in the single market. Trade unions across Europe are concerned about such developments, in particular where they lead to letterbox-type practices.

The European Trade Union Confederation (ETUC) believes that increasing company mobility can be beneficial to the European economy to the extent that it responds to justified business needs, which are linked to a genuine organisational logic. But cross-border transfers cannot be treated as an end in themselves by the EU institutions. Indiscriminate mobility will not fulfil promises of renewed growth in the single market.

The ETUC is therefore calling for a global reflection on the revision of the Cross-border Mergers Directive. Cross-border mergers should be facilitated exclusively where there is a genuine business need. Linking the location of the new registration to the location of real economic activity should be a key element of the reform (Section 2). Also, the impact of cross-border mergers on employment must be recognised. This means in particular that rights to information, consultation and board-level participation must be upgraded (Section 3). In a medium-term perspective, employees' rights to information, consultation and board-level participation should be made more consistent and harmonious in all pieces of European company law, including, in particular, in the Cross-border Mergers Directive (Section 4).

## 2. Get real

The so-called fourteenth company law Directive on the transfer of seat from one Member State to another has long been in the Commission's pipeline (for example, European Commission 2003). The issue is highly political. Some Commissioners take a liberal approach to it: EU law should remove any barrier to the re-establishment of a company in another Member State. Other Commissioners have been delaying the publication of such proposal, fearing that they may be accused of promoting '*délocalisation*' in Europe and its accompanying social dumping.

Meanwhile, businesses face legal difficulties if they wish to transfer their activities from one Member State to another. In the absence of EU legislation governing transfer of seat, a company often has to 'die' in its country of origin and to be reborn in the new country of establishment. When a transfer of seat is possible by virtue of two compatible legal systems, conflicts of national laws still arise. Legal complications are frequent and costly.

Large businesses are therefore encouraged to have recourse to the Cross-border Mergers Directive to solve this problem. A new legal entity is incorporated in the Member State of destination. The company in the Member State of origin merges with this ‘artificial’ new entity and the registered seat is fixed in that new Member State. Such operations are further facilitated by a series of initiatives at EU and national levels, designed to promote the creation of subsidiaries (for example, abolition of minimum capital requirement, digital tools for company registration) (Cremers and Wolters 2011).

The ETUC is increasingly concerned about such activities. A cross-border merger can also be misused as a scheme to avoid or minimise legal obligations under a certain national law. A fictional legal entity is established in a ‘convenient’ jurisdiction and the company is subsequently merged into that parent company, while no real economic activity is carried on in that country. Such behaviour is frequently referred to as ‘letterbox-type practices’.

The choice of the location of registration is an important step in the life of a business as it determines the main national legal regime applicable to it. Allowing companies to establish their registered seat in a different Member State from the real place of business leads to regime competition for all the wrong reasons, including, in particular, tax optimisation and circumventing existing worker rights. In certain cases, letterbox-type practices even lead to extreme exploitation of workers and severe losses for national treasuries (ETUC 2016).

Promoting company mobility can be beneficial to the European economy but only to the extent that it responds to justified business needs which are based on genuine organisational reasons. Against this background, the ETUC considers that the ‘real seat’ principle should be a core principle of the Cross-border Mergers Directive. Businesses should be able to benefit from the Directive only to the extent that they can demonstrate that genuine and substantial economic activity is taking place in the Member State of registration of the newly merged company.

### **3. Involve the employees**

Concerning rights of involvement, Article 16 of the Cross-border Mergers Directive seeks to a certain extent to preserve existing rights to participation in the company supervisory or administrative organ. This article applies if the cross-border merger would result in fewer participation rights than previously existed, or if in one of the merging companies more than 500 employees are under a participation regime. A negotiation between employees’ representatives and management is then triggered, along the lines of the provisions of the SE Directive.<sup>1</sup>

The Cross-border Mergers Directive, however, is silent about rights to information and consultation beyond providing that employees receive a copy of the common draft

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1. The Cross-border Mergers Directive is, however, less favourable than the SE Directive. The standard rules, which would apply in the negotiations, can be relied upon where 33 per cent of the entire workforce was under a participation regime before the merger. In the SE Directive, only 25 per cent is required.

terms and the management report on the cross-border merger one month ahead of the shareholders' meeting that is to decide on it. A cross-border merger has considerable consequences for the workforce. It is particularly important that workers are informed and consulted about the proposed merger with a view to properly anticipating and dealing with the changes.

The Directive should provide for a mandatory social impact assessment, as part of a meaningful information and consultation about the proposed merger. The decision to proceed with the merger must not go ahead before the consultation is terminated in both companies. This means that management should inform employees' representatives at an early stage, as soon as a cross-border merger is envisaged. Links between employees' representatives of each company should also be fostered.

Also, while information and consultation in each of the establishments of the newly merged company continue to be governed by national law, global information and consultation at the company level is currently governed by the law of the registered office. This can be problematic in cases where the registered office is not linked to the place of work. Rules on information and consultation at the level of the company must therefore be designed along the same lines as Article 16 of the Directive. Such a rule should ensure that workers do not lose out on a favourable information and consultation regime because of the merger. Most importantly, continuity of the existing works council(s) must be maintained until the new body is ready to start work. The period immediately following a merger is indeed extremely sensitive as restructurings or other decisions affecting employment are most likely to take place then.

Concerning participation rights, Article 16.2 must not be misread as introducing an employment threshold of 500 workers on top of the before-and-after principle contained in the SE Directive. Negotiations on participation rights have to start for companies with more than 500 workers *or* (and not *and*) where workers would be disadvantaged after the cross-border merger. The Directive could benefit from a little clarification in this regard.

The 25 per cent threshold provided for in Article 7.2 (b) of the SE Directive has been raised to 33 per cent in the Cross-border Mergers Directive (Article 16.3.e) for no other reason than to weaken the SE *acquis*. Similarly, the Cross-border Mergers Directive allows management to restrict workers' participation to one-third of the board, a provision that does not exist in the SE Directive. This lack of coherence is problematic as it encourages companies to pick and choose the national law they prefer. It is also hard to justify why workers in a newly merged cross-border company should be treated differently from workers in an SE. The rules triggering negotiations on participation rights, and accompanying fall-back clauses, should be at least the same as those contained in the SE Directive.

Finally, another important issue is what happens when employees' rights have not been respected. In the current text of the Directive, the definition of sanctions is left to the Member States, which leads to a damaging lack of precision in national legislation. The ETUC demands that adequate sanctions are put in place so that there can be no

impunity, especially in case of grave and persistent violations of worker rights. While financial sanctions are important, it is questionable whether fines alone have sufficient dissuasive effect on larger groups of companies. The implementation of decisions by central management with substantial impact on employees must be suspended until a violation has been addressed. It should be possible for such sanctions to have transnational effect so as to prevent companies from avoiding them by relocating to other countries.

#### **4. Be consistent**

As far as worker rights are concerned, the EU company law *acquis* is inconsistent and often contradictory. The Recast European Works Council Directive (Directive 2009/38) usefully guarantees some continuity in case of a change in the legal form of the company (Article 13 last paragraph). Such a principle is not, however, mirrored in company law instruments. Companies not reaching the complex thresholds of the European Works Council Directive are therefore put in a different situation. As far as board-level participation is concerned, the rules in place in the Cross-border Mergers Directive differ from those in the SE Directive. In addition, several proposals for private companies (SPE, SUP) have been issued, each of them undoing the SE *acquis*.

The ETUC is calling for a level playing field on worker rights to board-level representation at EU level. The idea is not to intervene in purely domestic situations, but to propose a sustainable vision for EU company law. Whenever a business wishes to rely on the opportunities offered by European company law, it must at the same time adhere to shared European values. The new framework would become the single reference on information, consultation and board-level representation for all European company law instruments, including specifically the Cross-border Mergers Directive.

Such a horizontal approach to worker rights would guarantee a more secure and clearer legal situation. Above all, it would be good governance. The ETUC strategy to defend this proposal is to demonstrate its positive impact on the long-term interest of EU companies and smart growth in Europe.

#### **5. Conclusion**

From a trade union point of view the experience with the Directive on cross-border mergers demonstrates the need for specific principles that should be included in a revision of this Directive, as well as within European company law in general. These principles are needed to protect employees and other stakeholders from unlimited company mobility and its negative effects.

Firstly, the ‘real seat’ principle is needed to tie the company’s legal obligations to where its real activity – employment and production – is located. Allowing the registered seat to be disconnected from any real activity – which is what ‘incorporation theory’ allows – opens the door to regime shopping and a race to the bottom. Companies should not

be allowed to simply pick and choose their country of registration based on the ability to avoid labour standards and paying taxes. Although the ‘real seat’ principle is ‘out of fashion’ with many company lawyers, policymakers in other areas (insolvency law, tax law) have chosen to include real seat elements in their regulatory systems as a response to company mobility and regime shopping.

Secondly, the Directive on cross-border mergers sorely needs a revision to strengthen provisions with regards to worker information, consultation and participation. At a minimum, the Directive should be brought up to the standards of the SE Directive regarding worker participation. Furthermore, at a minimum, the Directive should contain a provision on the formation of a cross-border works council, along the lines of the SE Directive. Finally, the Directive should contain a provision for the early information and consultation of worker representatives. For these rights to become effective, dissuasive sanctions need to be put in place in case of violation.

Thirdly, the Directive demonstrates the need to be consistent with regard to worker information, consultation and participation across all European company legislation. Here the ETUC has called for a European framework for worker information, consultation and participation, which would apply to all European company legal forms, as well as to company restructuring through European legislation (for example, cross-border mergers and cross-border transfers of registered seat). The European Commission’s current initiative on EU company mobility illustrates the need for such a European framework.

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