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Developments in group law – the current EU debate and its relevance for Ukraine

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why bother about group law?

- Discrepancy between the law and economic reality – exercising influence over dependent companies, one way or another, has been a commonplace – a widespread practice, regardless of the legal regime.
- But if there is a legal vacuum or legal uncertainty, the risks of managing corporate group increases.
  - particularly valid in a cross-border setting
- Key-points:
  - **Flexible management** of corporate group → the need for **safe harbours**:
    - the problem of of **binding instructions** from the parent to the subsidiary
    - the problem of the **group interest**
  - **Transparency** of corporate groups and **information rights**
  - **Minority protection**
  - **Creditor protection**

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Overview

- approaches to corporate groups in legislation and case law of EU MS
- major problems and underlying philosophies of group regulation
  - centralised and coordinated group management
  - protection of corporate constituencies
    - minority shareholders' protection
    - creditor protection
    - disclosure, transparency and information rights
- EU developments and their relevance for Ukraine

Approaches to group law in EU Member States national laws

- comprehensive regulation,
- partial regulation,
- case law recognition of the interest of the group,
- lack of treatment (except what is required by EU directives)

[Comprehensive regulation]

- the **German** model (dating back to the 1965 reform)
  - Focuses on a **contractual group** (*Vertragskonzern*) with **formalised** right of **group management** granted to the parent balanced by special **appraisal** (exit) rights (*Abfundungsrecht*) as well as **indemnification** (compensation) rights (*Ausgleichsanspruch*) for the minority shareholders of the subsidiary
- implemented also in Portugal (1986), Hungary (1988-2012), Czech Republic (1991-2012), and Slovenia (1993), Croatia (1993), Albania (2008), Brazil (1976).
- Austria and Poland, although close in legal tradition to Germany, chose <u>not</u> adopt it.

[Partial regulation]

- Selective regulation addressing **some key questions** of corporate groups without aiming, however, to embrace a comprehensive manner, e.g. Italy (2003)
  - Italian solution acknowledges group interest and provides for special exit rights

[Balancing interest through case-law]

- French approach developed by the courts (**Rozenblum** formula 1985).
  - In Rozenblum the French Cour de **Cassation recognized the interest of the group → the directors of a subsidiary may take into consideration the interest of the group when making a decision that prejudices the subsidiary**, provided several conditions are satisfied.

- This flexible approach is accepted in other MS (e.g. Belgium, Luxembourg, Netherlands, Nordic countries, Czech Republic).

[No regulation of group law]

- No provisions, except for those which are imposed by EU directives.
- This approach is followed e.g. in the UK.
  - However, in the UK, it should be noted that directors of a subsidiary company, in making decisions, are allowed to consider the interests of the group as a whole (as long as it does not threaten the existence of the subsidiary ← rule on wrongful trading).

Efforts at EU level

- **Draft 9th Directive**
  - modelled after the German 1965 law
  - did not find support, abandoned in late 1980s.
- **Forum Europaeum on Group Law (2000)**
  - proposal modelled mostly after German law with some influences from France (Rozenblum) and UK (wrongful trading) as well as some modern solutions (squeeze-out and sell-out rights)
- **HLG (2002)**
  - against the introduction of a comprehensive law on groups
  - Recommendation: EU should consider adopting provisions to address particular problems, such as the **management of a group** (rule allowing group policy, squeeze-out), **transparency** of groups, protection of **creditors** (wrongful trading) and **minority shareholders**' protection (sell-out rights)

Efforts at EU level

- **Reflection Group (2011)**
  - Recommendation: "*The EU Commission should consider, subject to evidence that it would be a benefit to take action at the EU level, to adopt a **recommendation recognizing the interest of the group**.*"

- **SUP** – proposal for a new Directive on Single Member Limited Liability Companies (Societas Unius Personae).
  - Proposal for the recognition of **binding instructions** – eventually abandoned

- **EMCA (2015)**

- **ICLEG (2014-2015)**

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Regulatory philosophies

- **Bottom-up** approach
  - emphasis on the protective role of group law (*Schutzrecht*), **protection of corporate constituencies** such as minority shareholders and creditors
- **Top-down** approach
  - emphasis of the **enabling legislation** – facilitation of flexible and coordinated **group management**

Facilitating coordinated group management

- Acknowledgement of the **interest of the group**
- **Binding instructions** from the parent to the subsidiary level
- Integration of subsidiaries towards wholly-owned companies (**squeeze-out**)

Group interest – national level

- MS which **recognize** the interest of the group:
  - via **case-law**: Belgium, Cyprus, France, Ireland, Luxembourg, Malta, the Netherlands, Poland, Romania, UK, to a certain extent also Denmark, Sweden, Finland, to even lesser extent Spain
  - via **legislation**: Czech Republic, Hungary and Italy
- MS which **don't recognize** the interest of the group:
  - Countries with **legislative regime**: Germany, Croatia, Latvia, Portugal, Slovenia
  - Countries with **case-law refusing group interest**: Austria, Germany (for limited liability companies), Lithuania
  - Countries with **no regulatory framework nor case-law reported**, yet considered sceptical towards recognition of group interest: Bulgaria, Estonia, Greece and Slovakia

Group interest – the French Rozenblum doctrine

- No liability for directors of the subsidiary, provided that following criteria are met:
  1. there must be a **group characterized by capital links** between the companies;
  2. there must be **strong, effective business integration among the companies** within the group;
  3. the financial support from one company to another company must have an **economic *quid pro quo* and may not break the balance of mutual commitments between the concerned companies**;
  4. the support from the subsidiary must **<u>not</u> go beyond its financial capabilities** – it must not put the company's existence in jeopardy).

Group interest – EU level

- Specific and sectoral regulations:
  - The new **Insolvency Regulation (EU) 2015/848**:
    - provisions relating to the group coordination proceedings: group of companies can be sold and restructured at a better price, if the restructuration is done through an integrated and a cross-border approach where the group is considered as a single economic entity
  - Capital Requirements Directive 2013/36/EU (**CRD IV**) and Capital Requirements Regulation 575/2013 (**CRR**):
    - integrated view of financial groups, including CG and RM
    - the CRD IV requires the parent company to be responsible for the organisation and the management of the whole group, incl. effective control over subsidiaries (especially risk management). Failures on the subsidiary level could have adverse impact on the whole group → recognition of the "banking group interest".
  - Banking Resolution and Recovery Directive 2014/59/EU (**BRRD**):
    - possibility of extraordinary transfers from the subsidiary to a distressed parent or other member of the group.

Group interest – <u>EU</u> level

- EMCA – Ch.15, Sec. 16

*(1) If the **management of a subsidiary**, especially as a result of an instruction issued by the parent company, **takes a decision which is contrary to the interests of its own company**, it **shall <u>not</u> be deemed to have acted in breach of their fiduciary duties** if :*

*(a) the decision is **in the interest of the group as a whole**, and*

*(b) the management **may reasonably assume that the loss/damage/disadvantage will, within a reasonable period, be balanced by benefit/gain/advantage** and,* (does not apply to SMC – see infra)

*(c) the loss/damage/disadvantage, referred to in the first sentence hereof, does **<u>not</u>** include any which would place the continued **existence of the company in jeopardy**.*

*(2) **If** the subsidiary is **wholly-owned**, paragraph **(1)(b) does <u>not</u> apply**.*

*(3) The **management of the subsidiary may refuse to comply with instructions** from the parent company in case the **conditions set in paragraph (1) are <u>not</u> satisfied**.*

Group interest – EU level

- ICLEG
  - Position paper outlining various options (not yet public)
  - Considerations:
    - recognition of group interest and the problem of veil piercing and **risk of parent's liability**
    - **facilitation of doing business across borders** (enhancement of **freedom of establishment**)
    - **harmonisation of laws**

Binding instructions

- **SUP** – proposal for a new Directive on Single Member Limited Liability Companies (***Societas Unius Personae***).
  - Relevance for group law: Article 23 of the proposal for a directive: the right of the parent company to **give instructions to the management body which are not binding for any director insofar as they violate the articles of association or the applicable national law**.
  - In the general approach adopted in the Council in May 2015, this provision has been <u>**deleted**</u> **due to the divergences among the Member States on its meaning and scope**.

Binding instructions

- EMCA – Ch.15, Sec. 9

(1) ***A parent company has the right to give instructions to the organ of management of their subsidiaries****, subject to exceptions in subsections (2) and (3). A subsidiary may receive instructions from the management of a foreign parent company.*

(2) Subject to conditions specified in section 16 [group interest]*, the organ of* ***management of a subsidiary shall comply with the instructions*** *issued by its parent.*

(3) The following members of the management of a subsidiary are ***<u>not</u> bound*** *by any instruction:*

(a) ***Directors and managers who were <u>not</u> appointed by the parent company or by the controlling shareholder****, especially following the application of the articles of associations, of a shareholders' agreement or of any law or regulation.*

(b) Directors who are defined as ***"independent directors"*** *according to the applicable Corporate Governance Code.*

(c) Directors who are ***employee representatives****.*

Binding instructions

- EMCA – Ch.15, Sec. 9 (continuation)

*(4) A **non-wholly-owned subsidiary needs to disclose in the Commercial registry whether or not its management is directed by the parent**. Unless a contrary disclosure, a **wholly-owned subsidiary is presumed to be subject to instructions of its parent** company and does not need to make a disclosure in the Commercial registry, except that it is wholly-owned. This disclosure is **for information of third parties and shareholders only**.*

Binding instructions

- What if the directors of the subsidiary follow the instruction which violates Ch.15.,Sec.16(1)? → liability
- What if the directors of the subsidiary do not follow the instructions? – they may be dismissed.

Lowering coordination costs: squeeze-out of minority shareholders

- Goal: facilitation of integration at the subsidiary level (→ 100% subsidiary),
  - lowering costs of complience
  - reduction of formalism
- wide-spread in MS national laws, although often limited to listed companies (Art. 15 TBD)
- Ch.15, Sec. 11 EMCA – threshold 90%

Minority protection – Exit rights

- **Sell-out (reverse squeeze-out)**
  - **Wide-spread in national company laws** (e.g. Poland, Portugal, Hungary, Germany, the Netherlands), although in some jurisdictions limited to listed companies (e.g. France). Thresholds between 90% and 95% of votes or of capital.
  - **EMCA**: Ch.15, Sec. 15 (1): *When a parent company owns directly or indirectly more than 90% of the shares and of the voting rights, the others shareholders may request that their shares be purchased by the parent company*.
- **Appraisal right (dissenters' right)**
  - Germany (§ 305 AktG): triggering event – emergence of a contractual group

Minority protection – Exit rights

- **Exit rights (rights of withdrawal) in case of minority oppression or specified forms thereof**
  - **Italy** (article 2497-*quater* CC: (a) parent company approved change of objective of the subsidiary or changes having adverse impact on the financial situation of the subsidiary; (b) the court found the parent liable for mismanagement of the subsidiary; (c) there has been a change in risk profile in the subsidiary and the subsidiary is a non-listed company
  - **Switzerland** (article 821 OR): exit right for a valid reason (Courts recognize minority oppression in the subsidiary as a valid reason)
  - **EMCA** : Ch.15, Sec. 15 (2): *The shareholders of a subsidiary can request in court that the parent company or another person designated by it purchase their shares*
- **Exit from a listed company via mandatory takeover bid**
  - Article 5 of the Takeover Bids Directive

Minority protection - RPT

- State of play at EU level – no rules
- Revision of the SRD (Commission proposal – April 2014):
  - **1% of the assets**
    - **disclosure**,
    - **fairness report** from an independent third party
    - **exception for recurrent transactions** – upon shareholders' approval for a period not exceeding **12 months**. **Interested** shareholder **excluded from vote**.
  - **5% of the assets** or transaction which can have a **significant impact on profits or turnover**
    - **shareholders' vote**. Interested shareholder **excluded from vote**
    - **advance approval for recurrent transactions** possible for a period of up to **12 months**. Interested shareholder **excluded from vote**
    - **aggregation of transactions in every 12-monts** period (the transaction by which this threshold is exceeded and any subsequent transactions)
  - **Exception for SMC**

Minority protection - RPT

- SRD - Italian presidency compromise (Nov. 2014)
  - **material transactions**
    - subject to **assessment by an independent expert**, but **MS may provide that this report is produced by the independent directors or the administrative or supervisory body** of the company provided that the **related parties and the persons related to them are prevented from having a determining role** in the preparation of the report.
    - **vote by the shareholders or by the administrative or supervisory bodies** of the company according to procedures which prevent a related party from taking advantage of its position and provide adequate protection for the minority shareholders' interests

Minority protection - RPT

- Ukraine
  - **Non-Arm's Length Transactions** (Art. 71-72 JSCA)
    - disclosure
    - approval by the **supervisory board** (<u>interested parties excluded from vote</u>)
  - **Significant transactions** (Art. 70 JSCA)
    - **10-25%** - approval by the **supervisory board**
    - **>25%** - approval by the **GM**
    - **>50%** - approval by **more than 50% of the total number of shareholders**

Minority protection – corporate opportunity

- Ch.15, Sec. 13 EMCA

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

Minority protection – information and investigation rights

- The problem of group transparency and access to information
- **Ch. 15, Sec. 12 EMCA (Right of information and to request a special information)**

The relations between the companies of the group, including with companies formerly members of the group, are open to the right of information and to the right to request a special investigation […]

- **Ch. 15, Sec. 14 EMCA (Right of shareholders to request a special investigation)**

The shareholders of a subsidiary can request a special investigation in the parent company […]

Creditor protection

- **Veil piercing** – remains subject to **national case-law**
- **Wrongful trading** – Ch. 15, Sec. 17 **EMCA**

*(1) Whenever a **subsidiary** company, which has been **managed according to instructions** issued by its parent in the interest of the group, has **no reasonable prospect of**, by means of its own resources, **avoiding a winding-up (crisis point)**, the parent company is obliged without delay to effect a **fundamental restructuring** of the subsidiary **or** to initiate its **winding-up** procedure.*

*(2) **If the parent acts in contravention of paragraph 1 or if it has managed the subsidiary to the detriment of the subsidiary, it shall be held liable for any unpaid debts of the subsidiary company incurred before the crisis point**. In such case, it will be presumed that the parent knew or should have known that the subsidiary company had arrived at a crisis point. The court may assess the extent of the creditors' relevant debts.*

[…]

Some reflections for Ukraine

- Which model to follow?
  - recommended: Rozenblum or EMCA
  - not recommended: comprehensive regulation
- RPT
  - already in place
- Exit rights
  - recommended: sell-out rights
  - worth considering: appraisal rights
- Creditor protection
  - problem with implementation of wrongful trading due to its incompatibility with the self enforcing model of company law

Thank you for your attention!

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