Introducing competition is a key element in the creation of an internal market in the European Union (EU). After all, increased competition should – among other things – make European companies more efficient and therefore more competitive on the world stage and results in lower prices for European consumers. As early as 1959 it was recognized that creating a European business, legally established at the European level, would be a huge boost for the internal market since this would tackle the problem of companies being hampered in their Europe-wide activities by different regulatory frameworks in the different member states (Blanquet, 2002). By the end of the 1960s, tariffs and quotas had been abolished within the – then – European Economic Community. However, this did not mean that the goal of creating an internal market was reached since many other obstacles to trade remained, with technical standards or administrative requirements often constituting non-tariff barriers to trade. The idea of creating European companies was not developed further at this early stage, and it remained just that: an idea.

The Long and Winding Road to the European Company Statute

In 1970, the Commission made a first wide-ranging proposal covering all major aspects of the activities of a European company. However, this proposal soon got stuck in the Council of Ministers, where no consensus on the proposed Regulation could be reached. There were two main problem areas: divergence in company law traditions of the member states and the thorny issue of worker participation. The root of this problem lies in the very different national systems concerning worker participation. These range from the German model of Mittbestimmung where workers are represented on the supervisory board, to the “Anglo-Saxon” system where worker participation is unheard of. After years of negotiations and numerous unsuccessful attempts at drafting an acceptable compromise, the Commission in 1996 decided to set up a high level group of experts under the chairmanship of Etienne Davignon, influential industrialist and former vice-president of the European Commission, to study the issue of worker participation and to come up with a solution to the deadlock that had existed since 1970.

While the reactions to the Davignon-report were generally positive, subsequent efforts by the Luxembourg, UK, Austrian and German EU presidencies all failed to convince Spain, the only country to refuse to join the agreement, that the proposal was not skewed in favor of countries with a tradition of worker participation. It was not until the Nice IGC in 2000 that the deadlock was broken and political agreement on the European Company statute could be reached. Approval by the European Parliament followed so that Council Regulation (EC) 2157/2001 on the Statute for a European company (the ECS regulation)
and Council Directive 2001/86/EC supplementing the Statute for a European company with regards to the involvement of employees (ECS directive) were adopted on October 8, 2001.\(^1\) The ECS regulation entered into force on October 8, 2004, and gave the member states until then to take the necessary actions to comply with it.

Transposition of the European Company Statute into national law had initially been slow, by early 2007, 28 out of 30 countries had successfully done so (Romania and Bulgaria being the exceptions). It is partly because of the sluggish transposition process, that entrepreneurs have also been slow to take advantage of the European Company Statute. However, registration of European Companies (SEs) has recently gathered pace, with some 70 firms registered as SEs by March 2007 and more than 20 others being in the process of changing their registration to this European form.

**But What Does it Do? The European Company Statute in a Nutshell**

The objective is to create a European company (known under its Latin name of *societas Europaea* or SE) with its own legislative framework. This offers companies that want to act or establish themselves beyond their national borders the possibility to be subject to one set of legislation rather than to the (different) legislation of every member state in which it is active. As mentioned before, the European Company Statute is established by two pieces of legislation: a regulation and a directive. The regulation comprises the company law aspects of the creation of an SE, whereas the directive lays down the framework for worker participation.

The regulation identifies four ways in which an SE may be set up:

- by the merger of two or more existing public limited companies from at least two different EU member states;
- by the creation of a holding company promoted by public or private limited companies from at least two different Member States;
- by the formation of a subsidiary by an SE;
- or by the transformation of a limited public company that has had a subsidiary in another member state for at least two years.

One of the major advantages of the SE statute is that companies need not set up a network of subsidiaries any more, each of which would be governed by the specific law of the country in which it was established. This should thus lead to a significant reduction in administrative and legal costs. Furthermore, the single legal structure and the unified management and reporting systems should further add to potential savings. The regulation will facilitate mergers of companies from different member states and will allow corporate groups to expand more easily. Also, relocation costs are reduced

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\(^1\) Recall that the difference between a regulation and a directive is that the former is directly applicable in every Member State whereas the latter still requires implementation in all Member States.
substantially since relocating a registered office will not require an SE to wind up the company in one member state and re-register it in another member state.

The rules governing worker involvement that are laid down in the directive reflect the difficult road to the compromise (Group of Experts, 1997). The directive does not impose a single European model of worker involvement, but instead stresses the importance of negotiations. As soon as possible after a plan for the creation of an SE has been drawn up, a Special Negotiating Body (SNB) consisting of representatives of management and employees has to be established. Here, the rules on employee involvement for that SE are negotiated, and a set of standard principles apply should negotiations fail. Worker involvement covers employee participation as well as employee information and consultation. Worker information and consultation is ensured, since the standard or default rules impose information and consultation mechanisms (although the SNB could – by special majority – decide not to establish any information and/or consultation mechanisms). However, the situation is different in the case of worker participation, given the need to avoid imposing worker participation on companies without a tradition of worker participation before turning into an SE (e.g., in the case of a merger between an English and an Irish firm). The default condition is thus dependent on the situation before the creation of the SE and on how the SE is created. The bottom line is that the worker participation rules that previously existed continue to apply in the case of the creation of an SE by transformation. In all other cases (merger, holding company, subsidiary), the worker participation of the company with the highest level applies.

All in all, it should be noted that the ECS still has some weaknesses. For example, the ECS does not contain any tax arrangements, so that an SE will be taxed like a multinational company according to the relevant national legislation. Furthermore, one of the main reasons why the ECS has proved to be so contentious is the encroachment upon the sensitive area of social protection. As a result, the final compromise leaves many things to be sorted out and regulated at the national level. These multiple layers of regulation, together with the requirement to enter into negotiations with employees on worker information, consultation and participation, make the creation of an SE not as straightforward as it was first imagined by the Commission. However, all in all the benefits of an SE status might well outweigh the costs for many companies. The most important thing is that the legislation is now finally in place. Besides, the Commission has already taken several initiatives to address shortcomings of the ECS legislation and further adjustments and improvements can be expected.

Towards a European Private Company Statute?

In its 2003 Action Plan on Modernizing Company Law and Enhancing Corporate Governance, the Commission foresaw the possibility of establishing a European Private Company Statute (EPC) in the medium term. Over the last few years, pressure to establish such a statute has gathered pace. Indeed, the existing statute for a European Company (SE) does not constitute a viable option for small and medium-sized enterprises (SMEs). The SE statute was designed for public companies and is commonly perceived
as too rigid and too expensive for SMEs. However, as they account for ninety per cent of all companies and two-thirds of jobs of the European economy, SMEs play a vital role in its overall health. The need to develop an EPC has been underlined by BusinessEurope, which has repeatedly emphasized the dynamic effects that could be derived from such a statute. Furthermore, in February 2007, the European Parliament asked the Commission to draw up a statute for an EPC. Heeding these calls, in 2007 the Commission launched a public consultation on the problems facing SMEs when conducting cross-border transactions and on the possible content of an EPC statute. It is widely expected that this consultation will lead to a draft proposal in the first half of 2008.

Sarbanes-Oxley and the Emergence of Corporate Governance Regulation

While one of the achievements of the ECS is the reduction of administrative red tape, businesses fear new challenges and barriers could be coming from an unexpected corner. In the wake of the corporate scandals in the United States (e.g. Enron, Anderson, Worldcom, Adelphia, Health South), tough new corporate governance standards were introduced by the US Congress. Named after the bill’s sponsors, the Sarbanes-Oxley Act (SOX) obliges all firms with US stock market listings or with more than 300 US shareholders to make declarations that a company’s accounts and other financial statements represent its position in a fair way.

The estimated costs of complying with SOX have been increasing steadily with European firms becoming more and more concerned. For example, General Electric spent $30 million to comply with SOX in 2003 (Economist, 2004) and BASF (a German chemical company) also estimates the cost of compliance to be between $30 and $40 million (Howarth, 2005). Some have claimed that the cost of a secondary listing in the United States has started to outweigh the benefits. Indeed, some European companies seem to consider delisting from the New York Stock Exchange. Higher compliance costs are also said to be the main reason why Air China opted for the London Stock Exchange instead of the New York Stock Exchange for its secondary listing in December 2004 (Economist, 2005). In mid-2006 a Mazars survey showed that while 80% of European companies considered SOX as an adequate measure to strengthen their internal control systems, 56% find that the costs derived have not been compensated for by the expected benefits. Although Mazars reported that only 17% of European companies had considered delisting from the US stock exchange, a majority of European companies want to see EU authorities to play a greater role in establishing internal controls.

It seems that the Commission has heeded this call for greater harmonization of internal controls and a reduction in regulatory burden on European companies. In May 2003 the Commission published an Action Plan on “Modernizing Company Law and Enhancing Corporate Governance in the European Union”. The Action Plan defined two key policy objectives, which should inspire any future action taken at EU level:

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• to strengthen shareholders’ rights and protection for employees, creditors and the other parties with which companies deal, while adapting company law and corporate governance rules appropriately for different categories of company;
• to foster the efficiency and competitiveness of business, with special attention to some specific cross-border issues.

The adoption of the 2003 Action Plan has led to several Commission measures in the area of corporate governance over the past years. To aid in the preparation of future legislation, in European Commission in 2005 set up a European Corporate Governance Forum, responsible for strategic direction, and an Advisory group on Corporate Governance and Company Law to provide it with detailed technical advice. Other measures have included the adoption of a directive on shareholders rights, confirmed by the Council in early 2007, and the issuing of recommendations on directors’ pay and disclosure. A 2007 Commission Communication on a simplified business environment in the areas of company law, accounting and auditing promises to assess the continuing relevance of legislation in order to reduce the administrative burden on companies. The Commission plans to submit a legislative proposal on reducing administrative burdens by early 2008.

Summary

It will have become clear that the completion of the internal market is by no means an easy or automatic process. There are still substantial barriers to trade that hamper the creation of a genuine internal market. The ECS, and the future EPC, try to tackle some of these barriers, but the genesis of the ECS shows that there are, broadly speaking, two sets of difficulties. The first category contains factors that immediately derive from the complexity of the European project. These include the divergence in member state preferences and interests (which will likely become more of a problem in an enlarged EU), corporate traditions, and the like. But it also refers to the institutional structure of the EU. Secondly, there is an external element as well. The emergence of corporate governance and the subsequent pressures for regulation were largely imported from the SOX-regulation in the United States. While corporate governance regulation can have a positive impact on improving transparency and market confidence, too much regulation will raise transaction costs and act as an impediment to growth, as the American experience with SOX has illustrated. In this context, the EU’s recent drive to reduce unnecessary administrative burdens and increase transparency should be welcomed, as should its efforts to stimulate growth as a result.

Interesting to note in this respect is the emergence of the European Parliament as an important actor in the legislative process. For example, when agreement had finally been reached on the ECS in the Council in 2000, the Parliament threatened to challenge the legal basis on which the ECS was adopted, claiming that article 95 EC (requiring co-decision) rather than article 308 EC (requiring consultation) should have been the basis. In the end, the Parliament did not follow up on its threat, but this is a good indication of its rising power in the legislative process.
Sources

UNICE (2004) Principles for an EU approach to company law and corporate governance, Ref. 22.6/0/1, 27 July 2004

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