

# THE CROSS-BORDER CONVERSION – A POSSIBLE SOLUTION FOR THE MOBILITY OF COMPANIES IN EUROPEAN UNION

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## **Abstract**

*For decades, the institutions of European Union have strived a varied range of efforts to bring the treaty provisions regarding the freedom of establishment of the companies within the single market into operation. In the view of the Court of Justice of the European Union, developed in several decisions issued from the Centros until the Polbud case, the freedom of establishment for companies includes, inter alia, the right to cross-border conversions, consisting in the possibility of a company having the nationality of a Member State to convert itself into a company governed by the legislation of the other Member State without losing its legal personality. Recently, a very welcomed piece of legislation, the Directive 2019/2121 on cross-border conversions, mergers and divisions - as part of the EU company law package, was adopted in order to stimulate cross-border mobility of the companies, and, in the same time, to provide a coherent framework for the complex cross-border operations (meaning the cross-border conversions, mergers and divisions). The question is if this directive will provide sufficient protection for the multiple stakeholder of the companies.*

**Keywords:** EU Company Law, cross-border conversion; freedom of establishment; cross-border mobility of companies; the case C-106/16 Polbud; the Directive (EU) 2019/2121.

**JEL Classification:** K22, K33

## **1. Introduction**

The general framework of the right of establishment of the companies is provided by the second paragraph of Article 49 of the Treaty on the Functioning of the European Union (TFEU), as follows: “Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.” in conjunction with Article 54 of the TFEU, such as: “Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States. Companies or firms means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.”

According to above mentioned provisions one category of the beneficiaries of the freedom of establishment is the legal persons formed, functioning, and dissolved under the domestic law of every Member States of EU.<sup>2</sup>

Thus, as is stressed in the literature, it is difficult to accomplish the freedom of establishment of companies in practice, due to the lack of harmonisation of the national company laws, and in the absence of the provision regarding the guarantees for the company stakeholders (e.g. employees, creditors, etc.).<sup>3</sup>

The main solution consists in possibility to relocate the companies from one Member States to another, without wind-up and reincorporated<sup>4</sup> these type of business organizations.<sup>5</sup>

Aiming to find a solution in this regard, CJEU has emphasized that a company, having its own

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<sup>2</sup> O.I. Dumitru, A. Stoica, *Business Law. Course Notes*, ASE Publishing House, Bucharest, 2019, p.139.

<sup>3</sup> F.C. Stoica, *Recent developments regarding corporate mobility within EU's internal market*, SSRN paper, 2016, p.5.

<sup>4</sup> O.I. Dumitru, *The European Company, Perspectives after Brexit*, „Juridical Tribune - Tribuna Juridica”, vol.7, issue 2, 2017, p.140; see also C. Lefter, O.I. Dumitru, *Theory and practice concerning the nullity of commercial companies*, in “Accounting and Management Information Systems – 4th International Conference AMIS 2009”, organized by the Faculty of Accounting and Management Information Systems, Academy of Economic Studies, Bucharest, Romania.

<sup>5</sup> F.C. Stoica, Ch. Ene, *Business Law. Business Organizations*, ASE Publishing House, Bucharest, 2016, p. 40 et sub.

legal personality, being independent of its shareholders from the moment of its incorporation,<sup>6</sup> may enjoy of the freedom of establishment based on cross-border operations, like fusion, division and/or conversion.

## 2. The significant decisions issued by the Court of Justice of the European Union regarding conversion of the companies

One of the most important subject of the cases solved by the Court of Justice of the European Union (CJEU) regarding the mobility of the companies inside the EU single market, based on the freedom of establishment.

At the beginning, in several cases such as: Daily Mail, Überseering, Inspire Art, Cadbury Schweppes, Centros, etc., the Court declared for possibility of the home Member State to prohibit the migration of its national companies to another Member State, taking into account that those companies exists only by the virtue of the national legislation.<sup>7</sup> Moreover, the CJEU stated that a Member State may provide several restriction when companies applying the freedom of establishment in the fraudulent or abusive situations.

In the later cases, Cartesio, Vale, Polbud the CJEU extend its analysis of the freedom of establishment to the cross-border conversions.

In Cartesio case, the Court established for the first time the concept of the conversion of a company in the context of the transfer abroad of its seat. In this case, the home State cannot prevent the company to convert into a company governed by the law of host State, to the extent that such a conversion is permitted by the national law of Member State of establishing.

This line of argumentation was developed in Vale case by providing the guidelines for cross-border conversion. The Court stated that in situations where Member State does not have the provisions on cross-border conversions, the rules on conversions must be applied by analogy.

In the most recent case regarding the conversion of the companies, Polbud case, the CJEU decided that the companies have the right for the cross-border conversion even when the company does not intend to obtain an economic activity in the host Member State and as preventing the home Member State to impose restrictions during that process. Moreover, the Court extended the freedom of establishment on the cross-border conversion and stated that the company can convert and thus move its registered seat to another Member State, without transferring its seat in the host Member State.

Taking into account that companies are creatures of the national laws which govern their functioning as well as the connecting factors required for obtaining and maintaining the company's legal status, the CJ EU stated that the host Member State determines the connecting factors (the registered office, the central administration and the principal place of business) required for cross-border conversions, which it is located within its territory.<sup>8</sup>

The host Member State is empowered to define what national rules should be applied to cross-border conversions and what connecting factor should be transferred to its territory for obtaining the status of a domestic company under its jurisdiction. This area enjoys immunity from the provisions on the freedom of establishment and companies have to comply with it.<sup>9</sup>

Therefore, the home Member State loses the absolute power over that company and cannot prevent it from migration to another jurisdiction.<sup>10</sup>

<sup>6</sup> C. Lefter, O.I. Dumitru, *Theoretical and Practical Aspects Regarding the Nullity of Commercial Company*, „Revista de Economie teoretică și aplicată”, no. 11, 2009, p. 34.

<sup>7</sup> C. Lefter, O.I. Dumitru, *Dissolution of the Commercial Companies due to the Passing of Time Established as a Duration of the Company*, in *Theoretical and Practical Aspects*, „Revista de Economie teoretică și aplicată”, no.11 (564), 2011, p. 51.

<sup>8</sup> Case 81/87 *Daily Mail* (n. 25), paras 19-21; Case C-106/16 *Polbud* (n. 3), para 34.

<sup>9</sup> I. Basova, *Cross-border conversion in the European Union after the Polbud case*, „Nordin Journal of European Law”, 2018 (1), pp.70-72.

<sup>10</sup> V. Korom, P. Metzinger, *Freedom of Establishment for Companies: the European Court of Justice Confirms and Refines its Daily Mail Decision in the Cartesio Case C-210/06*, „European Company and Financial Law Review” no. 6/2009 (125), pp. 154-155.

However, the decisions of the CJEU have only a limited scope to the interpretation of the EU law.<sup>11</sup>

The Court has been drawing the attention to the lack of secondary legislation on cross-border conversions and the need for their regulation at the EU level.<sup>12</sup>

### 3. The main provisions of the Directive 2019/2121 regarding cross-border conversions, mergers and divisions<sup>13</sup>

It is obviously that the absence of the EU secondary legislation on cross-border conversions distorts the functioning of the Single Market despite the case law of the CJEU.<sup>14</sup> Some Member States prohibit the exit step in cross-border conversions, whilst in others it is unclear exactly how such operations are regulated in law, or dealt with in practice.

Since the subject of this paper is the cross-border conversion, the further analysis will focus only on the provisions governing this particular cross-border operation.

Cross-border conversion, meaning the operation whereby a company, without being dissolved or wound up or going into liquidation, converts the legal form under which it is registered in a departure Member State into a legal form of the destination Member State and transfers at least its registered office to the destination Member State, while retaining its legal personality, is governed by the provision of the Article 1, paragraph (5) of the Directive (EU) 2019/2121.

According to this article, the substantive and procedural rules on cross-border conversion are included in the Chapter I of Title II of the amended directive and encompass the following main issues:

- the obligation for the MS to enable cross-border conversion and conditions relating to cross border conversion (Art. 86c),
- the draft of terms and reports that must be drawn up by the company and the duties of an independent expert which precede cross- border conversion (Art. 86d, 86e and 86f),
- rules on disclosure of relevant documents to all stakeholders (Art. 86h 86g),
- the procedure of the cross-border conversion approval by the general meeting of company involved (Art. 86i),
- the protection of the rights of company stakeholders, such as: shareholders, creditors and employees (Art. 86j, 86k, 86l),
- the in-depth assessment of Members State' competent authorities regarding: the characteristics of the establishment in the destination Member State, the intent, the sector, the investment, the net turnover and profit or loss, number of employees, the composition of the balance sheet, the tax residence, the assets and their location, the habitual place of work of the employees and of specific groups of employees, the place where social contributions are due and the commercial risks assumed by the converted company in the destination Member State and the departure Member State'.
- pre-conversion certificate (Art. 86m). The decision to issue or not issue a certificate *is subject to judicial review in accordance with national law* (Art 86o) If there are *serious concerns* that the restructuring constitutes an artificial arrangement (Art 86m(7)(c), national authority will conduct an in-depth assessment before deciding whether to issue certificate, drawing on report prepared by independent experts (Art. 86g),

<sup>11</sup> V. J. Knapp, *Cross border mobility: what do we need in practice?*, „ERA Forum” (2018) 19, p.64; see also M. Szydło, *Cross-border conversion of companies under freedom of establishment: Polbud and beyond*, „Common Market Law Review”, Vol. 55, No. 5, 2018, pp. 15-49.

<sup>12</sup> D. Akšamović, L. Šimunović, I. Kuna, *Cross -border movement of companies: The new EU rules on cross border conversion*, „EU and Comparative Law Issues and Challenges Series”, Issue 3/2019, p. 962.

<sup>13</sup> Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 Amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions Official Journal of the European Union L 321, 12.12.2019.

<sup>14</sup> C. Gerner-Beuerle, F. Mucciarelli, E. Schuster, M. Siems, *Cross-border Reincorporations in the European Union: The Case for Comprehensive Harmonisation*, „Journal of Corporate Law Studies”, vol. 18(1)/2018, p. 20-25.

- the effects of cross-border conversion (Art. 86r and 86s),

In summary, these rules aim to offer an harmonized European legal framework on procedure for cross-border conversions and, in the same time, a protection of the interests of multiple stakeholders of the company.

#### 4. Conclusion

Despite the fact that freedom of establishment has been provided by the treaties many years ago, and it has been developed by CJUE since then, it has been proved in practice that the companies needs a specific procedure to follow in order to pursue that freedom and to change their place of operation from one Member State to another.

Therefore, the solution was to adopt the EU company law package mainly in order to create common standards of procedures for cross-border operations in the EU and to offer adequate protection to company stakeholders.

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