



FACULTY OF LAW  
Lund University

Kai Vainola

Protection of Creditors under the 10<sup>th</sup>  
Company Law Directive on Cross-Border  
Mergers – an Impediment to the Freedom of  
Establishment?

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## TABLE OF CONTENTS

SUMMARY .....	3
1. INTRODUCTION .....	4
1.1. Introduction to the subject .....	4
1.2. Hypothesis and research questions .....	5
1.3. Research method, materials and previous research .....	6
1.4. Delimitations .....	7
1.5. Outline .....	7
2. CROSS-BORDER MERGER AS A METHOD OF EXERCISING THE FREEDOM OF ESTABLISHMENT .....	9
2.1. Corporate restructuring benefitting from the freedom of establishment .....	9
2.2. Extending the scope of freedom of establishment to cross-border mergers.....	11
2.2.1 Cross-border mergers as a means for increasing competitiveness .....	11
2.2.2. <i>SEVIC</i> broadening the scope of the freedom of establishment .....	12
3. LACK OF HARMONISATION HINDERING THE FREEDOM OF ESTABLISHMENT .....	16
3.1. The effect of cross-border mergers on the creditors of the merging companies .....	16
3.2. Protection of creditors under 10 <sup>th</sup> Company Law Directive.....	17
3.2.1. The underlying principle .....	17
3.2.2. Differences in creditor protection offered by Member States under the 10 <sup>th</sup> Company Law Directive.....	20
3.3. Different systems of creditor protection hindering the freedom of establishment .....	24
4. ARTICLE 4(2) OF THE 10 <sup>TH</sup> COMPANY LAW DIRECTIVE RESTRICTING THE FREEDOM OF ESTABLISHMENT .....	27
4.1. The interpretation of article 4(2) of the 10 <sup>th</sup> Company Law Directive.....	27
4.1.1. The compliance of article 4(2) with the freedom of establishment.....	27
4.1.2. The interpretation of article 4(2) by the Member States .....	29
4.2. Difference in treatment constituting a restriction on the freedom of establishment .....	31
4.2.1. Higher level of creditor protection as a directly discriminatory restriction .....	31
4.2.2. Possible justifications for the restriction .....	33
CONCLUSION .....	37
TABLE OF CASES.....	40
TABLE OF LEGISLATION .....	41
BIBLIOGRAPHY .....	41
OTHER SOURCES.....	43

## SUMMARY

In 2005, the CJEU established in the *SEVIC* case that cross-border mergers fell within the scope of the freedom of establishment. In 2005, the 10<sup>th</sup> Company Law Directive on cross-border mergers, aiming at facilitating the cross-border merger process was also adopted. The rapid increase in cross-border merger transactions after its implementation indicates that the directive as a whole has achieved its goal and has facilitated the cross-border merger process. However, there have been concerns whether the provisions regulating the protection of creditors contribute to the general goal of the directive and to the freedom of establishment. This thesis argues that it does not. Instead, the protection of creditors under the 10<sup>th</sup> Company Law Directive constitutes an impediment to the freedom of establishment.

The 10<sup>th</sup> Company Law Directive does not aim at harmonising national provisions regulating the protection of creditors in cross-border mergers. Instead, it leaves it up for the Member States to regulate this area. Member States have adopted different creditor protection systems regarding its commencement, duration and consequences. The lack of harmonisation gives rise to uncertainties and delays which hinder the cross-border merger process. Creditors are more likely to oppose to the merger, and owners of the companies are faced with difficulties which can reversely affect their decision to merge. Thus, the creditor protection systems should be harmonised in order for it to contribute to the exercise of the freedom of establishment.

Article 4(2) of the 10<sup>th</sup> Company Law Directive gives the Member States the opportunity to take into consideration the cross-border nature of the merger when adopting national provisions regulating the protection of creditors. Member States such as Estonia, Germany and Slovenia have interpreted this as providing grounds for the adoption of national measures offering higher level of protection to creditors in cross-border mergers than in domestic mergers. This, however, constitutes a restriction on the freedom of establishment. Since it provides for difference in treatment, it constitutes a directly discriminatory measure which cannot be justified. Therefore, art 4(2) of the directive gives rise to Member States adopting national measures which are restricting the freedom of establishment.

# 1. INTRODUCTION

## 1.1. Introduction to the subject

Already in March 2000, the strategic goal of the European Union to become the most competitive global economy by 2010 was set.<sup>1</sup> The competitiveness of the Union can only be achieved through the competitiveness of the companies established in the EU and active on the EU market. The EU companies, in turn, can increase their competitiveness through methods of corporate restructuring, including domestic and cross-border mergers. A merger between a subsidiary and its parent company or between several subsidiaries of one parent can give rise to reduction of organisational costs. At the same time, a merger between a company and its competitor or supplier can result in efficiency gains through achieving economies of scale and scope.

The 3<sup>rd</sup> Company Law Directive<sup>2</sup> on domestic mergers of public limited liability companies was adopted in 1978. However, it was not until 26 October 2005 that the 10<sup>th</sup> Company Law Directive<sup>3</sup> on cross-border mergers was finally adopted. Less than two months after that, but before its transposition date, the CJEU rendered a judgement in the *SEVIC*<sup>4</sup> case where it extended the traditional interpretation of the scope of the freedom of establishment and stated that cross-border mergers fell within its scope.

With the *SEVIC* judgement conferring the protection of the fundamental freedom of establishment upon cross-border merger process, the 10<sup>th</sup> Company Law Directive as secondary legislation should promote the exercise of the freedom of establishment, and shall not contain provisions which could constitute restrictions thereof. A clear indication of the 10<sup>th</sup> Company Law Directive facilitating the overall cross-border merger process can be deduced from statistics demonstrating the rapid increase of the cross-border merger activity in the internal market. The amount of cross-border mergers conducted per year increased from 132 in the year

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<sup>1</sup> Presidency Conclusions, Lisbon European Council 23-24 March 2000 SN 100/1/00 REV 1, para 5

<sup>2</sup> Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies [1978] L295/36 (3<sup>rd</sup> Company Law Directive).

<sup>3</sup> European Parliament and Council Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies [2005] OJ L310/1 (10<sup>th</sup> Company Law Directive).

However, the Commission had adopted a proposal for a Tenth Council Directive on cross-border mergers of public limited companies already in 1984, but the latter was not approved. Commission, 'Proposal for a Tenth Council Directive based on Article 54 (3) (g) of the Treaty concerning cross-border mergers of public limited companies' OJ (1985) C 23/11.

<sup>4</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805.

2008<sup>5</sup> to 361 in the year 2012.<sup>6</sup> However, the growth of cross-border trade also presents challenges for the existing company law framework. For this reason, the Internal Market and Services Directorate General of the Commission launched a public consultation on the future of European company law in 2012.<sup>7</sup> In the feedback of the consultation, cross-border mergers process was the most frequently mentioned regime in need of improved harmonisation, and more than a half of the responses indicated the need to enhance the protection of creditors.<sup>8</sup> Thus, there are indications that the current regulation of creditor protection under the 10<sup>th</sup> Company Law Directive is deficient and could possibly constitute an impediment to the cross-border merger process and, consequently, to the freedom of establishment.

The thesis aims at providing an in-depth analysis of what could be the possible reason for the feedback raising concerns regarding the current creditor protection regulation under the 10<sup>th</sup> Company Law Directive. The thesis concentrates on arts 4(1)(b) and 4(2) of the 10<sup>th</sup> Company Law Directive which, *inter alia*, regulate the creditor protection regime in cross-border mergers. The named provisions do not aim at harmonising the creditor protection system in the Member States<sup>9</sup> as a result of the implementation of the 10<sup>th</sup> Company Law Directive. Instead, they provide for the application of national legislation regarding creditor protection in domestic mergers also to cross-border merger process. However, the 3<sup>rd</sup> Company Law Directive on domestic mergers and the Directive on Domestic Mergers<sup>10</sup> repealing the former leave it up for the Member States to regulate the protection of creditors in domestic mergers. Additionally, art 4(2) of the 10<sup>th</sup> Company Law Directive gives the Member States the right to adopt ‘special provisions’<sup>11</sup> for protecting the creditors of the companies involved in cross-border mergers.

## 1.2. Hypothesis and research questions

The underlying hypothesis for the thesis is that the current regulation of creditor protection under the 10<sup>th</sup> Company Law Directive on cross-border mergers constitutes an impediment to

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<sup>5</sup> 10<sup>th</sup> Company Law Directive had to be implemented by the Member States by 15 December 2007. 10<sup>th</sup> Company Law Directive, art 19.

<sup>6</sup> Study on the Application of the Cross-Border Mergers Directive (2013) 5  
<[http://ec.europa.eu/internal\\_market/company/docs/mergers/131007\\_study-cross-border-merger-directive\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/mergers/131007_study-cross-border-merger-directive_en.pdf)> accessed 12 April 2015.

<sup>7</sup> Commission, ‘Summary of Responses to the Public Consultation on the Future of European Company Law’ (Feedback Statement) (2012) 2.  
<[http://ec.europa.eu/internal\\_market/consultations/docs/2012/companylaw/feedback\\_statement\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2012/companylaw/feedback_statement_en.pdf)> accessed 13 April 2015

<sup>8</sup> Ibid, 4-5.

<sup>9</sup> The term Member States in the thesis refers to the Member States of the EEA.

<sup>10</sup> European Parliament and Council Directive 2011/35/EU of 5 April 2011 concerning mergers of public limited liability companies [2011] OJ L110/1 (Directive on Domestic Mergers).

<sup>11</sup> 10<sup>th</sup> Company Law Directive art 4(2) gives the Member States the right to take into account the cross-border nature of the merger when adopting national provisions regulating creditor protection in cross-border mergers.

the freedom of establishment. There are two research questions to be answered in order to defend the established hypothesis:

- 1) Does the lack of harmonisation of creditor protection systems in the Member States provided by the 10<sup>th</sup> Company Law Directive hinder the freedom of establishment?
- 2) Does art 4(2) of the 10<sup>th</sup> Company Law Directive give rise to the Member States to adopt measures restricting the freedom of establishment?

### **1.3. Research method, materials and previous research**

The thesis is built upon qualitative and comparative analysis. The analysis in the thesis is supported mainly by articles from different authoritative journals, relevant textbooks and the Commission's proposals and communication. The thesis also contains references to the case law of the CJEU, with the main emphasis on the *SEVIC* judgement along with the opinion delivered by AG Tizzano. A study on the implementation of the 10<sup>th</sup> Company Law Directive<sup>12</sup> conducted at the Commission's request has been used for gathering the necessary statistical data and information about the implementation process in different Member States, and for providing an overview of the concerns raised by legal practitioners. For the comparative analysis, mainly the national legislations adopted in Estonia, the Netherlands, Spain, Germany and Slovenia are used.

There is previous research conducted which relates to the topic of this thesis. For example the study on the implementation of the 10<sup>th</sup> Company Law Directive conducted by one of the leading Scandinavian law firms in collaboration with various law firms established in the Member States, and also a master thesis on creditor protection and how it is influenced by cross-border mergers written by K.E. Karamesini<sup>13</sup>. The study deals with the possible problems arising from the non-harmonisation from a practitioner's point of view, and can and is used as an authoritative source in that regard. The master thesis by Karamesini provides a more descriptive analysis of the creditor protection regulations in different member states and the possible issues arising from the non-harmonisation. However, neither of them elaborate on the question of how and whether the non-harmonisation can be seen as hindering the freedom of establishment and both ignore the possible issue of article 4(2) of the 10<sup>th</sup> Company Law Directive providing grounds for the adoption of discriminatory national measures. This thesis

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<sup>12</sup> Study on the Application of the Cross-Border Mergers Directive (2013) <[http://ec.europa.eu/internal\\_market/company/docs/mergers/131007\\_study-cross-border-merger-directive\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/mergers/131007_study-cross-border-merger-directive_en.pdf)> accessed 12 April 2015.

<sup>13</sup> K.E. Karamesini, 'Creditor Protection. And how it is influenced by a cross-border merger' (Master thesis, University of Amsterdam 2011).

aims to take into account the previous research, but to provide a more comprehensive and in-depth analysis on the issue of the current creditor protection regulation under the 10<sup>th</sup> Company Law Directive impeding the freedom of establishment, by tying together the interpretation of the scope of the freedom of establishment, the issue of non-harmonisation, and the question of whether art 4(2) of the directive can be seen as grounds for adopting discriminatory national measures which has not been discussed in the previous research.

#### **1.4. Delimitations**

The aim of the thesis is to point out and analyse the two possible aspects of the current creditor protection regulation under art 4 of the 10<sup>th</sup> Company Law Directive which could be considered impediments to the freedom of establishment – the lack of harmonisation and art 4(2) which allows Member States to adopt national legislation while ‘taking into account the cross-border nature of the merger’. When analysing how the interpretation of the scope of the freedom of establishment has developed, the question of the application of real seat and incorporation theory will not be thoroughly discussed as its full consideration goes beyond the scope of this thesis. Also, the thesis does not aim to provide an exhaustive list nor a thorough economic analysis of the reasons why cross-border mergers are conducted and the possible problems arising from cross-border mergers. When providing examples of the creditor protection systems adopted by Member States, the national laws of Estonia, the Netherlands and Spain are used in order to demonstrate the differences and possible clashes between national legislations, instead of providing a descriptive overview of the national legislations of all the Member States.

#### **1.5. Outline**

The thesis is divided into four chapters, the first one being the introduction which is followed by three substantive chapters. The second chapter gives an overview of how the interpretation of the scope of the freedom of establishment has developed. It will culminate in analysing the importance of cross-border mergers to increasing the competitiveness of the internal market, and how the CJEU has extended the scope of the freedom of establishment to include cross-border mergers. The next two chapters will follow the research questions established. The third chapter analyses the lack of harmonisation required by the 10<sup>th</sup> Company Law Directive regarding the creditor protection systems and how it hinders the freedom of establishment. More precisely, it concentrates on why the protection of creditors in cross-border mergers is even a relevant issue, how it is regulated by the 10<sup>th</sup> Company Law Directive, how different Member States have regulated the area, and what the possible issues are deriving from the difference between national provisions applicable to creditor protection in cross-border mergers. The

fourth chapter concentrates on article 4(2) of the 10<sup>th</sup> Company Law Directive which allows Member States to take into account the cross-border nature of the merger. It deals with how the article has been interpreted, which national measures have been adopted under it, and whether they constitute a restriction on the freedom of establishment.

## **2. CROSS-BORDER MERGER AS A METHOD OF EXERCISING THE FREEDOM OF ESTABLISHMENT**

### **2.1. Corporate restructuring benefitting from the freedom of establishment**

The European Union, already from its foundation as the European Economic Community by the Treaty of Rome<sup>14</sup>, has had one of its principal objectives the establishment of the common (internal) market and the elimination of barriers that are capable of dividing the market. It has been recognised from the start that an essential feature for establishing the internal market without barriers is enabling undertakings to operate and structure their businesses freely throughout the European Union.<sup>15</sup> The same objectives can be found from the primary legislation of the Union. Article 3(3) TEU stipulates the task to establish an internal market, and to work for the sustainable development of the Union based on economic growth and highly competitive market economy. In order to achieve the establishment of the internal market, according to art 26 TFEU, the Union shall aim at establishing or ensuring an area without barriers and obstacles to the free movement. Article 120 TFEU adds that the Union shall act in accordance with the principle of an open market economy and favour an efficient allocation of resources.

One of the fundamental freedoms, aimed at ensuring the proper functioning of the internal market provided in arts 49 and 54 TFEU is the freedom of establishment. Articles 49 and 54 TFEU include the right to set up and manage companies (primary establishment), and the right to set up agencies, branches or subsidiaries (secondary establishment) in other Member States. The more traditional interpretation of the right of establishment in another Member State included mostly the establishment through formation or acquisition of a subsidiary or a branch in another Member State. Thus, the freedom was interpreted as the right of secondary establishment in relation to the already existing company in the state of primary establishment.<sup>16</sup> However, for the proper functioning of the internal market, it is not enough to ensure free access to the territory of individual Member States through the right of secondary establishments, by allowing companies to establish subsidiaries, branches and agencies.<sup>17</sup> Similarly, arts 49 and 54 TFEU do not provide only for the right to set up primary establishments in other Member

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<sup>14</sup> Treaty Establishing the European Economic Community of March 25 1957, 298 U.N.T.S. 11 (Treaty of Rome).

<sup>15</sup> Jonathan Rickford, 'Current Developments in European Law on the Restructuring of Companies: An Introduction' (2004) 15 *European Business Law Review* 1225, 1225.

<sup>16</sup> Thomas Rønfeldt, Erik Werlauff, 'Merger as a Method of Establishment: on Cross-border Mergers, Transfer of Domicile and Divisions, Directly Applicable under the EC Treaty's Freedom of Establishment' (2006) 3 *European Company Law* 125, 126.

<sup>17</sup> *Ibid*, 125, 127.

States, but also to manage them. Thus, the freedom of establishment should include the right of the owners to reorganise and restructure (ie to manage) the company if necessary.

The CJEU has also interpreted the freedom of establishment more widely than just the right to set up primary and secondary establishments. Already in 1988, in the *Daily Mail*<sup>18</sup> case, the CJEU delivered a judgement according to which freedom of establishment includes the right to transfer the seat of a company from one Member State to another (with the exception of connecting factor which is up to the home Member State to define)<sup>19</sup> which was later reaffirmed in the *Überseering*<sup>20</sup> and *Cartesio*<sup>21</sup> cases. The broader interpretation of the freedom of establishment (including the right to manage undertakings) can also be seen from the *Centros*<sup>22</sup> judgement, in which the CJEU dealt with the question of whether a national choosing to form a company in a Member State whose rules of company law seem the least restrictive and, subsequently, to set up branches in other Member States where the economic activity would actually be carried out constitutes an abuse of the right of establishment. The CJEU stated that the right to form a company in accordance with the law of a Member State and to set up branches in other Member States is inherent in the exercise of the freedom of establishment and such conduct in itself cannot constitute abuse.<sup>23</sup> Therefore, the CJEU provided a wider interpretation of the freedom of establishment and affirmed that it includes the liberty to choose between different legal and organisational structures.<sup>24</sup>

The rationale for the wider interpretation of the freedom of establishment could be that corporate restructurings are seen to fall within the scope of the actions trying to abolish the obstacles to the internal market and to produce a more efficient allocation of resources, which are the objectives found in the primary legislation of the European Union.<sup>25</sup> However,

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<sup>18</sup> 81/87 *The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc* [1988] ECR 05483.

<sup>19</sup> *Ibid*, paras 16, 25.

The problem of the connecting factor will not be thoroughly analysed in this thesis. For that see for example Veronika E Korom, Peter 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' (2009) 6 *European Company and Financial Law Review* 125.

<sup>20</sup> C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-09910.

<sup>21</sup> C-210/06 *Cartesio Oktató és Szolgáltató Bt* [2008] ECR I-09641.

<sup>22</sup> C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-01459.

<sup>23</sup> *Ibid*, para 27.

<sup>24</sup> Thomas Papadopoulos, 'EU Regulatory Approaches to Cross - Border Mergers: Exercising the Right of Establishment' (2011) 36 *European Law Review* 71, 75; Wolfgang Schön, 'The Mobility of Companies in Europe and the Organizational Freedom of Company Founders' (2006) 3 *European Company and Financial Law Review* 122, 130.

<sup>25</sup> Thomas Papadopoulos, 'EU Regulatory Approaches to Cross-Border Mergers: Exercising the Right of Establishment' (2011) 36 *European Law Review* 71, 73.

regardless of the rationale behind the wider interpretation, with the corporate restructuring benefitting from the freedom of establishment, the latter includes the right to allocate assets within the Union, to build up an organisational structure and reshape it by primary and secondary establishments, to opt for a preferred specific legal regime, and even to transfer the company's seat<sup>26</sup> or all of its activities into the host state.

## **2.2. Extending the scope of freedom of establishment to cross-border mergers**

### 2.2.1 Cross-border mergers as a means for increasing competitiveness

Over the years, restructuring companies by conducting cross-border mergers has moved from being a rare exception to becoming a very common business practice. Cross-border mergers seem to be a growing trend around the globe, and Europe is no exception to that.<sup>27</sup> The main reason for that is the need for the companies to increase their competitiveness and market position on both, the European Union level and global level. The ongoing elimination of barriers and further integration of the internal market increases the number of companies doing business across their national borders. However, in order to compete with other players on the market, the companies conducting business in several Member States need to align the structure of their activities by rearranging their organisation structure and the assets of their companies.<sup>28</sup> Also, the ongoing globalisation creates high business pressure and entails the need for the companies to improve their competitiveness and market position not only in the EU, but also on global level. In order to do so, companies need to rationalise their corporate structure to aim at increasing their productivity and maximising their profits by efficiency savings.<sup>29</sup> Cross-border mergers give companies the freedom to move within the EU and, thus to rationalise their corporate structure and reach economies of scale and scope by, for example, acquiring a customer, competitor or a supplier.<sup>30</sup> Additionally, cross-border mergers are vital for the

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<sup>26</sup> However, keeping in mind the problem regarding the connecting factor which is up for the home Member State to determine.

<sup>27</sup> Patrick A. Gaughan, *Mergers, Acquisitions, and Corporate Restructurings* (5th edn, Wiley & Sons 2011) 3

<sup>28</sup> Commission 'Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward' (Communication) COM (2003) 0284 final, para 3.4; Thomas Papadopoulos, 'EU Regulatory Approaches to Cross - Border Mergers: Exercising the Right of Establishment' (2011) 36 European Law Review 71, 75.

<sup>29</sup> Thomas Papadopoulos, 'EU Regulatory Approaches to Cross-Border Mergers: Exercising the Right of Establishment' (2011) 36 European Law Review 71, 93; Philip Rogers, Anne-Sophie Cornette De Saint-Cyr, 'Cross-Border Mergers' (2002) 13 International Company and Commercial Law Review 343, 343, 351.

<sup>30</sup> Arianna Ugliano, 'The new cross-border merger directive harmonization of European Company Law and Free Movement' (2007) 18 European Business Law Review 585, 597; Donald M. DePamphilis, *Mergers, Acquisitions, and Other Restructuring Activities: An Integrated Approach to Process, Tools, Cases, and Solutions* (7th edn, Elsevier Inc 2014) 5-7.

companies to increase their competitiveness by penetrating new markets.<sup>31</sup> Instead of establishing subsidiaries or branches in another Member State, companies can merge with a company which already exists in that Member State, increase their market share, and enjoy the procedure of a merger which entails automatic dissolution of the acquired company without costly and timely liquidation process.

The important aspect of cross-border mergers as a means of increasing competitiveness is that not only EU companies benefit from that, but the whole internal market. When there are no barriers for the EU companies to reorganise and reshape their structure and their activities, when they are free to move towards more efficient structures and more beneficial markets, the EU companies have the possibility to increase their competitiveness and through that, the competitiveness of the whole internal market.<sup>32</sup> Thus, it is in the interest of the European Union to eliminate those barriers and to grant the owners of the EU companies the right to conduct cross-border mergers.

#### 2.2.2. *SEVIC* broadening the scope of the freedom of establishment

The exercise of the freedom of establishment by company owners in the EU would contribute to the competitiveness of the whole internal market and the latter would gain benefits from corporate restructuring only if the owners of the companies are free to exercise their freedom of establishment by deciding on the best future legal framework for their companies.<sup>33</sup> The most beneficial legal framework could include, for example, the need for secondary establishments in other Member States, to transfer the seat of the company to another Member State or to merge with a company which already exists in another Member State. If a company owner considers a cross-border merger to produce efficiencies for the company and increase its competitiveness, it should also be in the interest of the internal market and, thus, in the interest of the EU to protect the company owner's freedom of such restructuring transaction.

Since the primary legislation, and more precisely arts 49 and 54 TFEU do not elaborate on the scope of freedom of establishment and whether the latter shall include the freedom to conduct

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<sup>31</sup> The highest ranked motivator for cross-border mergers in Europe was to enable presence in a new market. See Keith W. Glaister, Mohammad Faisal Ahammad, 'Motives for Cross Border Mergers and Acquisitions: Perspective of UK Firms' (2010) 18 <<http://ssrn.com/abstract=1549812>> accessed 6 April 2015.

<sup>32</sup> Thomas Papadopoulos, 'EU Regulatory Approaches to Cross-Border Mergers: Exercising the Right of Establishment' (2011) 36 *European Law Review* 71, 72-73.

<sup>33</sup> Thomas Papadopoulos, 'EU Regulatory Approaches to Cross-Border Mergers: Exercising the Right of Establishment' (2011) 36 *European Law Review* 71, 72; Wolfgang Schön, 'The Mobility of Companies in Europe and the Organizational Freedom of Company Founders' (2006) 3 *European Company and Financial Law Review* 122, 141.

cross-border mergers, it was up to the judiciary to provide an interpretation of its scope. The first case in which the CJEU dealt with the question of cross-border merger in the context of freedom of establishment was a preliminary reference case from a German regional court (*Landgericht Koblenz*), called the *SEVIC*<sup>34</sup> case.

In the *SEVIC* case, the CJEU dealt with the question of whether German national law which allowed mergers only between legal entities established in Germany was in compliance with the freedom of establishment.<sup>35</sup> The national legislation providing solely for mergers between legal entities established in Germany had brought about the rejection by the local court (*Amtsgericht Neuwied*) for the registration of a merger between a German company (*SEVIC AG*) and a Luxembourg company (*Security Vision SA*) in the German national commercial register. *SEVIC AG* brought an action against the rejection decision before the regional court in Koblenz and the latter, doubting the compliance of the German national law provision with the (now)<sup>36</sup> arts 49 and 54 TFEU, stayed proceedings and referred the case to the CJEU for a preliminary ruling.<sup>37</sup>

When interpreting the scope of freedom of establishment, the CJEU approached the problem by stating that in accordance with the second paragraph of art 49 TFEU, read in conjunction with art 54 TFEU, the freedom of establishment for companies referred to in the latter article includes in particular the formation and management of those companies.<sup>38</sup> Thus, the CJEU relied on the right to ‘form and manage’ companies, and used this for which could be argued to be a very broad interpretation of the scope of freedom of establishment. It then adopted the interpretation of the AG Tizzano according to which ‘the right of establishment covers all measures which permit or even merely facilitate access to another Member State and/or the pursuit of an economic activity in that State by allowing the persons concerned to participate in the economic life of the country effectively and under the same conditions as national operators’.<sup>39</sup> The CJEU emphasised the importance of cross-border mergers to the internal market and found that they respond to the needs for cooperation and consolidation between

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<sup>34</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805.

<sup>35</sup> Note that even though the *SEVIC* judgement was delivered roughly two months after the adoption of the 10<sup>th</sup> Company Law Directive on cross-border mergers, the transposition time of the latter was 15 December 2007, and Germany had not yet implemented it.

<sup>36</sup> In the thesis, reference will only be made to the articles of the primary legislation after the entry into force of the Lisbon Treaty on 1 December 2009.

<sup>37</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, paras 6-15.

<sup>38</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, para 17.

<sup>39</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, opinion of AG Tizzano, para 30.

companies established in different Member States, they are an effective means of transforming companies, and they constitute particular methods of exercise of the freedom of establishment.<sup>40</sup>

AG Tizzano elaborated more on the essence of a cross-border merger and how it relates to the right to primary and secondary establishment granted by the freedom of establishment. When the German and Dutch Government argued that the disappearing company cannot be exercising its freedom of establishment since it loses its legal personality as a result of being taken over by the acquiring company, the AG disagreed and found that during the cross-border merger process, before it is finalised, both companies involved in the merger are in full possession of their legal capacity and are exercising their freedom of establishment.<sup>41</sup> The AG specified that from the point of view of the acquiring company, cross-border merger involves a particular means of exercising the right to secondary establishment. Acquiring a company already existing in another Member State results in the acquiring company operating a stable basis in the Member State of the disappearing company. Article 49 TFEU provides for the possibility of exercising the freedom of secondary establishment through both, entities which have legal personality, such as subsidiaries, and entities which are devoid of such autonomy, such as branches and agencies.<sup>42</sup> Thus, acquiring a company in another Member State constitutes a particular means of exercising the right to secondary establishment.

The AG and the CJEU did not elaborate more on the exercise of the freedom of establishment from the point of view of the disappearing company. However, as the company being acquired does not continue to exist, the freedom of establishment it exercises before the finalisation of the merger constitutes the right to primary establishment. As the AG emphasised, before the merger becomes effective, the company being acquired is capable of negotiating and entering into the merger contract.<sup>43</sup> This should be understood as the disappearing company exercising its right to manage its primary establishment. Conferring the protection of the freedom of primary establishment also on the disappearing company while the latter is involved in the cross-border merger process cannot be underestimated. In its well-established case law, the CJEU has maintained the position that in case of a transfer of primary establishment, the so called connecting factor does not fall under the freedom of establishment, and is for the Member States to determine.<sup>44</sup> However, a company can be acquired by another company established in

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<sup>40</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, paras 19, 21.

<sup>41</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, opinion of AG Tizzano, paras 22-27.

<sup>42</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, opinion of AG Tizzano, paras 35-41.

<sup>43</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, opinion of AG Tizzano, para 26.

<sup>44</sup> n 19.

another Member State and at the same time enjoy the protection of the freedom of establishment. Thus, in a cross-border merger process, the issue of a connecting factor will not raise and the Member States do not enjoy the right to determine it.

The rationale behind the *SEVIC* judgement is to ensure the proper functioning of the internal market. National legislation such as the one at issue in the *SEVIC* case makes a clear distinction between the treatment in a merger situation of national companies and companies established in other Member States but, at the same time, the primary legislation of the Union does not provide an express restriction on the adoption of such domestic legislation. However, national legislation prohibiting cross-border mergers can diminish the competitiveness of the EU companies and the competitiveness of the internal market as such. The CJEU as an EU court cannot directly harmonise the national laws of the Member States, but it can extend or impose common principles and by doing that, harmonise and overrule national legislation by effect.<sup>45</sup> This is exactly what the CJEU did in the *SEVIC* case by bringing cross-border mergers within the scope of the exercise of freedom of establishment and, thus, by broadening the previous understanding of the fundamental freedom. For this reason, the *SEVIC* judgement has even been seen as the ultimate judgement on equal treatment of national and foreign companies.<sup>46</sup>

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<sup>45</sup> Jonathan Rickford, 'Current Developments in European Law on the Restructuring of Companies: An Introduction' (2004) 15 *European Business Law Review* 1225, 1237.

<sup>46</sup> Thomas Rønfeldt, Erik Werlauff, 'Merger as a Method of Establishment: on Cross-border Mergers, Transfer of Domicile and Divisions, Directly Applicable under the EC Treaty's Freedom of Establishment' (2006) 3 *European Company Law* 125, 127.

However, the importance of the *SEVIC* judgement has also been doubted because of the following adoption of Cross-Border Mergers Directive. Mathias M Siems, '*SEVIC*: Beyond Cross-Broder Mergers' (2007) 8 *European Business Organization Law Review* 307.

### **3. LACK OF HARMONISATION HINDERING THE FREEDOM OF ESTABLISHMENT**

#### **3.1. The effect of cross-border mergers on the creditors of the merging companies**

As seen from arts 3(1) and 4(1) of the 3<sup>rd</sup> Company Law Directive<sup>47</sup> on mergers of public limited liability companies and from arts 3(1) and 4(1) of the directive repealing the latter<sup>48</sup>, the essence of a merger, either a merger by acquisition or by formation of a new company, is the winding up of one or several companies, by transferring their assets and liabilities to another company without going into liquidation. The directive applies the principle of universal succession under which no liquidation process is conducted and, instead, creditors must accept a new debtor.<sup>49</sup> The same principle applies in case of cross-border mergers, as seen from art 2 of the 10<sup>th</sup> Company Law Directive<sup>50</sup> on cross-border mergers. In contrast, winding up a company without conducting a merger generally results in liquidation proceedings and the obligatory nature of the latter is aimed at the protection of creditors.

Even though a merger entails the winding up of one or several companies (the disappearing companies), it also results in the assets and obligations of the disappearing company being transferred to the acquiring or newly founded company (the latter acting as the acquiring company). As a consequence, the creditors of the disappearing companies still maintain their claims. However, the result of a merger for the creditors of the disappearing companies is the automatic change of debtor, which could clearly give rise to possible risks for the creditors. For the creditors of the acquiring company, the merger does not bring about automatic change of the debtor, but the effect on them should still not be underestimated. A situation where the liabilities of the disappearing company exceed the assets of the acquiring company could bring about serious risks for the creditors of the latter and to the probability of their claims being satisfied.<sup>51</sup> Therefore, it is clear that legislators need to provide creditors with safeguards in merger situations regardless of the latter being domestic or cross-border.

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<sup>47</sup> Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies [1978] L295/36 (3<sup>rd</sup> Company Law Directive).

<sup>48</sup> European Parliament and Council Directive 2011/35/EU of 5 April 2011 concerning mergers of public limited liability companies [2011] OJ L110/1 (Directive on Domestic Mergers).

<sup>49</sup> Thomas Rønfeldt, Erik Werlauff, 'Merger as a Method of Establishment: on Cross-border Mergers, Transfer of Domicile and Divisions, Directly Applicable under the EC Treaty's Freedom of Establishment' (2006) 3 European Company Law 125, 128.

<sup>50</sup> European Parliament and Council Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies [2005] OJ L310/1 (10<sup>th</sup> Company Law Directive).

<sup>51</sup> Geert TMJ Raaijmakers, Thijs PH Olthoff, 'Creditor Protection in Cross-Border Mergers: Unfinished Business' (2008) 5 European Company Law 305, 305.

The main difference between the creditors of the companies involved in domestic mergers and the ones involved in cross-border mergers is that the latter will not only become creditors of a different company, but also of a company that is subject to the laws of another Member State, which may give rise to several problems. First, the laws of a different Member State may not provide the same level of creditor protection and, second, enforcing a claim against a debtor located in another Member State can be more costly and time-consuming. For this reason, it has widely been argued that the necessary level of protection granted to the creditors of merging companies is higher in case of cross-border mergers.<sup>52</sup>

The need for the higher level of creditor protection in cross-border mergers compared to the level of protection in case of domestic mergers has also been recognised by several Member States. Before the implementation of the 10<sup>th</sup> Company Law Directive on cross-border mergers into their national legislation, there were many Member States which either allowed only domestic mergers or which allowed also cross-border mergers but at the same time provided for the requirement of an expensive and time-consuming liquidation process for the acquired company.<sup>53</sup> The main goal of the adoption of the 10<sup>th</sup> Company Law Directive was to set up a framework for the possibility of cross-border mergers between companies established in different Member States and to avoid the complex and costly requirement of the liquidation of the disappearing company.<sup>54</sup> This understandably raises a concern on how and whether the 10<sup>th</sup> Company Law Directive manages to maintain a balance between its main goal and the obvious need to provide creditors with sufficient safeguards.

## **3.2. Protection of creditors under 10<sup>th</sup> Company Law Directive**

### **3.2.1. The underlying principle**

The adoption of the 10<sup>th</sup> Company Law Directive on cross-border mergers was intended to provide guidelines that should be followed by the Member States when implementing the directive, but was not aimed at unifying national laws on cross-border mergers.<sup>55</sup> The underlying principle provided by the 10<sup>th</sup> Company Law Directive is that the cross-border

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<sup>52</sup> Thomas Rønfeldt, Erik Werlauff, 'Merger as a Method of Establishment: on Cross-border Mergers, Transfer of Domicile and Divisions, Directly Applicable under the EC Treaty's Freedom of Establishment' (2006) 3 European Company Law 125, 128; Mathias M Siems, 'SEVIC: Beyond Cross-Border Mergers' (2007) 8 European Business Organization Law Review 307, 309.

<sup>53</sup> Commission, 'Proposal for a Directive of the European Parliament and of the Council on cross border mergers of companies with share capital' COM (2003) 0703 final; European Commission-IP/05/1487.

<sup>54</sup> Ibid.

<sup>55</sup> Thomas Papadopoulos, 'EU Regulatory Approaches to Cross-Border Mergers: Exercising the Right of Establishment' (2011) 36 European Law Review 71, 95.

merger procedure is governed in each Member State by the principles applicable to domestic mergers in that particular State, unless otherwise stated in the directive because of the cross-border nature of the merger.<sup>56</sup>

Article 4 of the 10<sup>th</sup> Company Law Directive, which, *inter alia*, deals with the protection of creditors is an example of the underlying principle. The first sentence of art 4(1)(b) of the 10<sup>th</sup> Company Law Directive states that a company taking part in a cross-border merger shall comply with the provisions and formalities of the national law to which it is subject. Article 4(2) specifies that the provisions and formalities referred to in art 4(1)(b) include, *inter alia*, the protection of creditors of the merging companies, taking into account the cross-border nature of the merger. Thus, not only does the directive leave it up to the Member States to regulate the protection of creditors, but also it fails to provide any guidelines on the level of protection that should be granted, and provides for the adoption of distinct measures varying from one Member State to another. Some of the references to national provisions governing domestic mergers could be justified because before the adoption of the 10<sup>th</sup> Company Law Directive, the 3<sup>rd</sup> Company Law Directive<sup>57</sup> on (domestic) mergers of public limited liability companies had already been adopted and implemented by the Member States.<sup>58</sup> However, this does not seem to be valid rationale for the provisions regulating the protection of creditors. First, the 3<sup>rd</sup> Company Law Directive and the Directive on Domestic Mergers repealing the former cover only mergers between public limited liability companies, but the 10<sup>th</sup> Company Law Directive covers mergers between companies with share capital, including for example private limited liability companies.<sup>59</sup> It could be argued the provisions of national legislation regulating the mergers between public limited companies could also be applied to other forms of companies by analogy, but the more serious obstacle for that is the lack of safeguards that was provided by the 3<sup>rd</sup> Company Law Directive and is provided by the Directive on Domestic Mergers. The recitals of both, the 3<sup>rd</sup> Company Law Directive and the Directive on Domestic Mergers require that creditors of the merging companies should be protected so that the merger does not adversely affect their interests. However, the following provision regarding the protection of creditors only requires the Member States to ‘provide for an adequate system of protection of the interests of creditors of the merging companies whose claims antedate the publication of

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<sup>56</sup> COM (2003) 0703 final, para 3.2.

<sup>57</sup> Which was repealed by Directive on Domestic Mergers.

<sup>58</sup> Thomas Papadopoulos, ‘EU Regulatory Approaches to Cross - Border Mergers: Exercising the Right of Establishment’ (2011) 36 European Law Review 71, 95.

<sup>59</sup> 3<sup>rd</sup> Company Law Directive, art 1(1); Directive on Domestic Mergers, art 1(1); 10<sup>th</sup> Company Law Directive, arts 1, 2.

the draft terms of merger and have not fallen due at the time of such publication’ and to ‘at least provide that such creditors shall be entitled to obtain adequate safeguards where the financial situation of the merging companies makes such protection necessary and where those creditors do not already have such safeguards’.<sup>60</sup>

First, the guidelines requiring ‘adequate system’ and ‘adequate safeguards’ provide a certain minimum framework but are still up for different interpretations by the Member States and leave ample flexibility regarding the specific measures they will adopt for the protection of creditors when implementing the directive. Second, it has been argued that provisions of national laws which regulate the protection of creditors in domestic mergers, but are rather a creation of the legislator of the Member State voluntarily inserted into national law, and not based on the 3<sup>rd</sup> Company Law Directive or the Directive on Domestic Mergers shall also be applicable in a cross-border merger situations.<sup>61</sup> Third, under the 3<sup>rd</sup> Company Law Directive and the Directive on Domestic Mergers, Member States may provide different level of protection for the creditors of the acquiring company and for those of the acquired company.<sup>62</sup> Finally, article 4(2) of the 10<sup>th</sup> Company Law Directive, when requiring the Member States to take into account ‘the cross-border nature of the merger’, provides no additional guidelines, but can rather be seen as grounds for giving rise to additional interpretations and the adoption of even a wider range of distinct measures. Different interpretations of ‘adequate safeguards’ and ‘adequate system’, the possible application of voluntarily adopted national laws regarding the protection of creditors, the possible difference in the level of protection offered to the creditors of the acquired and acquiring companies and the requirement to take into account the cross-border nature of the merger may entail a situation where the system for the protection of creditors of merging companies varies from one Member State to another in case of both, domestic and cross-border mergers. While non-harmonised and distinct systems for protecting creditors may function properly in domestic mergers, they are likely to cause conflicts and be inefficient on a cross-border level.<sup>63</sup>

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<sup>60</sup> 3<sup>rd</sup> Company Law Directive, arts 13(1), 13(2); Directive on Domestic Mergers, arts 13(1), 13(2).

<sup>61</sup> Gerco C. van Eck, Erwin R. Roelofs, ‘Ranking the Rules Applicable to Cross-Border Mergers’ (2011) 8 European Company Law 17, 21-22.

<sup>62</sup> 3<sup>rd</sup> Company Law Directive, art 13(3); Directive on Domestic Mergers, art 13(3).

<sup>63</sup> Thomas Papadopoulos, ‘The Magnitude of EU Fundamental Freedoms: Application of the Freedom of Establishment to the Cross-Border Mergers Directive’ (2012) 23 European Business Law Review 517, 536.

### 3.2.2. Differences in creditor protection offered by Member States under the 10<sup>th</sup> Company Law Directive

As the disappearing company will cease to exist once the merger becomes effective, without a liquidation procedure being conducted, there is an inherent risk of bringing creditors of either the disappearing or acquiring company in a worse financial position than they were before the merger. With no further guidance provided by the 3<sup>rd</sup> Company Law Directive or the Directive on Domestic Mergers, and with the 10<sup>th</sup> Company Law Directive providing for the possibility to adopt different measures for the protection of creditors in cross-border merger situation, the safeguards adopted by the Member States are different, but can roughly be divided into two groups: system of *ex ante* protection and system of *ex post* protection.<sup>64</sup> In *ex ante* system, the creditors of the merging companies can object to the merger even before the decision to merge is adopted by the general meeting of shareholders, and in *ex post* system the creditors can only do so after the decision to merge is adopted by the general meeting.<sup>65</sup>

There are benefits and disadvantages to both, *ex ante* and *ex post*, systems which is also the reason why the Member States have not unanimously opted for one of them. Since in *ex ante* system creditors of the merging companies are provided with protection even before the adoption of the merger decision, there is clearly more certainty concerning the situation and protection of creditors at the time the merger is decided. At the same time, such pre-merger protection could also entail disadvantages for the merging companies. The rights the creditors can enjoy in an *ex ante* system before the merger is even decided by the general meeting of shareholders may cause additional delays in the process of the whole merger.<sup>66</sup> However, in a competitive market, mergers are often most beneficial when they can be executed rapidly and the decision to merge needs to be taken as soon as possible, without additional difficulties. The *ex post* system avoids additional delays before the adoption of the decision to merge because creditors can only invoke their rights after its adoption. The *ex post* system can go as far as to offer the creditors the right to invoke their claims after the merger has become effective. This, however, provides no legal certainty regarding the position of creditors at the time of the merger being executed, because after the merger, only the acquiring company will be liable for the

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<sup>64</sup> Geert TMJ Raaijmakers, Thijs PH Olthoff, 'Creditor Protection in Cross-Border Mergers: Unfinished Business' (2008) 5 European Company Law 305, 305-306.

<sup>65</sup> Study on the Application of the Cross-Border Mergers Directive (2013) 53  
<[http://ec.europa.eu/internal\\_market/company/docs/mergers/131007\\_study-cross-border-merger-directive\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/mergers/131007_study-cross-border-merger-directive_en.pdf)> accessed 12 April 2015.

<sup>66</sup> Geert TMJ Raaijmakers, Thijs PH Olthoff, 'Creditor Protection in Cross-Border Mergers: Unfinished Business' (2008) 5 European Company Law 307.

claims.<sup>67</sup> Creditors of the then already disappeared company must accept the acquiring company as the new debtor can only address their claims to it. Creditors of the acquiring company (in case of a merger by acquisition), even though their claims can still be addressed to the initial debtor, may already be in a worse position when the liabilities of the acquired company exceed its assets to the extent that affects the satisfaction of their claims.

*Ex ante* system has been adopted in the Netherlands, for example. The Dutch legislator has not made a distinction between creditors of the disappearing company and creditors of the acquiring company<sup>68</sup>, and the level of protection offered for creditors of the merging companies is the same in case of domestic and cross-border mergers. Under the Dutch Civil Code, the creditors of the merging companies can raise an objection to the merger proposal by lodging a petition with the District court within one month after the announcement of the merger proposal<sup>69</sup>, mentioning the guarantee they are seeking.<sup>70</sup> If the required security is not provided, the court shall declare the objection to the merger to be valid, unless the creditor already has adequate guarantees, or if the financial position of the acquiring company provides similar or better safeguards for the satisfaction of the claims than before.<sup>71</sup> Once an opposition to the merger proposal has been filed, the notarial deed of merger cannot be executed, unless the opposition has been withdrawn or dismissed by a court judgment<sup>72</sup>, meaning that the Netherlands has adopted the *ex ante* system with the possibility for the creditors to block the merger.

Estonia is an example of a Member State which has taken into account the ‘cross-border nature of the merger’<sup>73</sup> when implementing the 10<sup>th</sup> Company Law Directive. The Estonian Commercial Code makes a distinction between the level of protection offered to the creditors of the companies involved in a cross-border merger and the ones in a domestic merger. In case of a domestic merger, within six months after the publication of the merger notice, the creditors of the merging companies can submit their claims to the acquiring company in order to receive a security.<sup>74</sup> The acquiring company shall then secure the claims submitted by the creditors, if

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<sup>67</sup> Geert TMJ Raaijmakers, Thijs PH Olthoff, ‘Creditor Protection in Cross–Border Mergers: Unfinished Business’ (2008) 5 European Company Law 305, 307.

<sup>68</sup> See 3<sup>rd</sup> Company Law Directive, art 13(3); Directive on Domestic Mergers, art 13(3).

<sup>69</sup> The merger proposal is the Dutch equivalent to the common draft terms referred to in the 10th Company Law Directive art 5. Paul van der Bijl, Frits Oldenburg, *Cross-Border Mergers in Europe*, vol 1 (Dirk Van Gerven ed, Cambridge University Press 2010) 234.

<sup>70</sup> Dutch Civil Code, art 2:316(2).

<sup>71</sup> Dutch Civil Code, art 2:316(1).

<sup>72</sup> Paul van der Bijl, Frits Oldenburg, *Cross-Border Mergers in Europe*, vol 1 (Dirk Van Gerven ed, Cambridge University Press 2010) 246.

<sup>73</sup> See 10<sup>th</sup> Company Law Directive, art 4(2).

<sup>74</sup> Estonian Commercial Code, art 399(1).

the creditors have no possibility to demand satisfaction of the claims and they prove that the merger may endanger the fulfilment of the claims.<sup>75</sup> Thus, the Commercial Code provides for an *ex post* system for domestic mergers. In case of a cross-border merger, the *ex post* system was considered to be insufficient because the protection of one's interests in another Member State can be more costly and present additional difficulties.<sup>76</sup> When implementing the 10<sup>th</sup> Company Law Directive by amending the Commercial Code, the creditors of the merging companies were offered *ex ante* protection. It is important to note that the *ex ante* protection in cross-border mergers is only offered if the acquiring company falls under the jurisdiction of another Member State (when the disappearing company is Estonian).<sup>77</sup> The creditors can submit a claim, within two months after receiving the notice concerning the publication of the common draft terms of the cross-border merger, and have the right to receive a security provided they are not able to demand satisfaction of claims, and they have proved that the merger is likely to endanger the fulfilment of their claims.<sup>78</sup> However, creditors have the right to demand a security only for claims which arise before or within fifteen days after the publication of the notice concerning the entry into the merger agreement.<sup>79</sup> Thus, the Estonian system is a mixture of *ex ante* and *ex post* protection, depending on domestic or cross-border nature of the merger, and in case of the latter, on the jurisdiction the acquiring company is subject to.

An example of *ex post* system is Spain. Spanish law does not make a distinction between the level of protection offered to the creditors of the merging companies in domestic and cross-border mergers. The creditors of the merging companies have the right to object to the merger within one month after the last publication of the merger approval by the general meeting of shareholders.<sup>80</sup> The right to object is only granted to creditors whose claims arose before the date of the publication of the notice concerning the entry into the merger agreement, were not due at that date, and are not sufficiently warranted.<sup>81</sup> The merger shall not become effective until the company has provided warranty for the satisfaction of the creditors' claims.<sup>82</sup> Thus, the creditors of the merging companies can block the merger until they are provided with sufficient safeguards for the satisfaction of their claims.

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<sup>75</sup> Estonian Commercial Code, art 399(2).

<sup>76</sup> Explanatory memorandum to the bill to amend the Estonian Commercial Code as of 15 December 2007, para 1.2.8.

<sup>77</sup> Estonian Commercial Code, art 433<sup>8</sup>(1).

<sup>78</sup> Estonian Commercial Code, arts 433<sup>8</sup>(2), 433<sup>8</sup>(3).

<sup>79</sup> Estonian Commercial Code, art 433<sup>8</sup>(4).

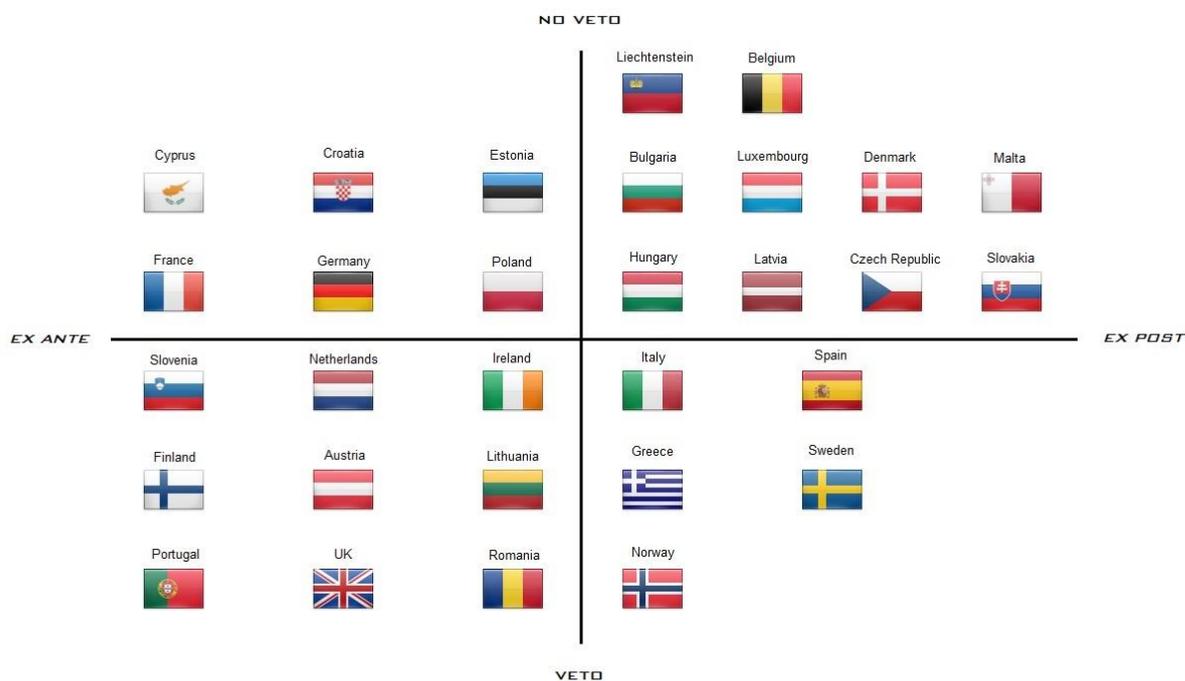
<sup>80</sup> Spanish Structural Modifications Law, arts 44(1), 44(2).

<sup>81</sup> Spanish Structural Modifications Law, arts 44(1), 44(2).

<sup>82</sup> Spanish Structural Modifications Law, art 44(3).

The date when the protection of creditors starts (the distinction between *ex ante* and *ex post* systems) is not the only variation that exists between the Member States. There are more aspects that noticeably vary from one Member State to another. For example the duration and also the consequence of the creditor protection. Member States have adopted systems with different duration periods, varying from one month<sup>83</sup> up to six months<sup>84,85</sup>. As for the differences in the consequence of the protection system, there are several Member States which provide creditors of the merging companies with the right to block the merger by granting them effective veto rights, and other Member States which do not.<sup>86</sup>

The approach not to harmonise national laws regarding the protection of creditors and the underlying principle of trusting Member States with the adoption of adequate safeguards has given rise to a situation where the measures adopted by the Member States vary from one Member State to another. The differences in the systems concern the commencement, duration and consequences of the creditor protection. The following illustrative figure should give an overview of how the systems of creditor protection vary between different Member States, regarding the commencement and consequences of the adopted systems.



Figure<sup>87</sup> – creditor protection systems adopted by the Member States regarding the commencement of the protection and the right to object to the merger

<sup>83</sup> For example Denmark, France, Greece, Hungary.

<sup>84</sup> For example Slovakia and Czech Republic.

<sup>85</sup> Study on the Application of the Cross-Border Mergers Directive (2013) 54.

<sup>86</sup> Study on the Application of the Cross-Border Mergers Directive (2013) 55-56.

<sup>87</sup> Study on the Application of the Cross-Border Mergers Directive (2013) 53-56, 318-319.

### 3.3. Different systems of creditor protection hindering the freedom of establishment

The exercise of many corporate restructurings containing a cross-border element which the CJEU has found to fall under the scope of freedom of establishment, including cross-border mergers, entail the need for effective coordination of different systems of law. Such transactions which cross borders, involve several Member States and give rise to situations where the result in one Member State has to be built on what is achieved in another.<sup>88</sup> Thus, the laws of different Member States need to work together without clashes which could impede or prevent the exercise of the freedom of establishment.

The aim of the 10<sup>th</sup> Company Law directive was indeed to provide legal certainty regarding the procedure of the cross-border mergers by providing a suitable legal instrument that abolishes legislative and administrative difficulties and enables the EU companies to benefit from the freedom of establishment under the most favourable conditions.<sup>89</sup> In order to ensure the proper functioning of the internal market, the 10<sup>th</sup> Company Law Directive was intended to lay down a common framework and facilitate the carrying-out of cross-border mergers.<sup>90</sup> Also, even though the 3<sup>rd</sup> Company Law Directive and the Directive on Domestic mergers regulate mergers within one Member State, their further aim was also to provide common basis within the Member States for the coordination necessary in cross-border merger situations through harmonisation.<sup>91</sup> However, one area which the relevant directives have not managed to harmonise is the protection of creditors and this has brought about a situation where one aspect of the cross-border merger process remains to hinder the whole process.

The main importance of the 10<sup>th</sup> Company Law Directive is not to provide the EU companies with the right to conduct cross-border mergers. The legislation of some Member States already provided for the possibility to conduct cross-border mergers, and in the remaining Member States, this right could have been derived from the *SEVIC*<sup>92</sup> judgment where the CJEU stated that conducting cross-border mergers is a method of exercising the freedom of establishment. Instead, the principal importance of the 10<sup>th</sup> Company Law Directive was to coordinate the process of cross border mergers by laying down the framework of procedural rules for the exercise of such right, because this could not have been established by Member States

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<sup>88</sup> Jonathan Rickford, 'Current Developments in European Law on the Restructuring of Companies: An Introduction' (2004) 15 European Business Law Review 1225, 1232.

<sup>89</sup> COM (2003) 0703 final, para 3.2; European Commission-IP/05/1487.

<sup>90</sup> 10<sup>th</sup> Company Law Directive, recital 1.

<sup>91</sup> Jonathan Rickford, 'Current Developments in European Law on the Restructuring of Companies: An Introduction' (2004) 15 European Business Law Review 1225, 1237.

<sup>92</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805.

independently and could not have been derived from the CJEU case law.<sup>93</sup> However, the 10<sup>th</sup> Company Law Directive failed to do so in the area of protection of creditors and this has resulted in several difficulties when conducting cross-border mergers.

In case of a cross-border merger between two companies, one established in an *ex ante* system and the other in *ex post* system, as a result of distinct creditor protection regulations, the whole merger process may result in uncertainties and long delays. A hypothetical situation of a cross-border merger between a company established in the Netherlands and another company established in Spain could illustrate the possible difficulties. First, under Dutch laws, within one month after the announcement of the merger proposal, the creditors of the Dutch company can raise an objection to the merger proposal by lodging a petition with the district court. Thus, the creditors can block the merger until they are provided with sufficient safeguards. Then, since Spain has adopted a system of *ex post* protection, the creditors of the Spanish company can object to the merger after the decision to merge has been adopted by the general meeting of shareholders, and more specifically, within one month after the last publication of the merger approval. The existence of the right to object however depends, *inter alia*, on the date when the claim arose and when it is due. And similarly to the Dutch system, the creditors can block the merger, and it shall not become effective until they are provided with a warranty for the satisfaction of their claims. The differences in the commencement of the creditor protection give rise to delays before and after the decision to merge can be adopted and essentially the two periods for filing an opposition to the merger need to be added up. However, the source of the difficulties is not just the difference in *ex post* and *ex ante* systems. There are additional problematic aspects to the merger process than just the delays which are the result of different commencement and duration of the creditor protection systems. Other difficulties pointed out by practitioners in cross-border mergers derive from the lack of legal certainty regarding the procedure adopted by different Member States. A potential impediment is considered to be the option for creditors to block the merger through veto rights, the variations as to the identity of the authority deciding on whether a security should be provided and whether this is a legal decision taken by the court or an administrative decision rendered by the registry.<sup>94</sup> The differences in the procedure give rise to the legal advisors having to deal with complex systems,

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<sup>93</sup> Johannes Pieper, 'European Cross-Border Mergers after SEVIC' (2009) 30 Company Lawyer 169, 173; Thomas Papadopoulos, 'EU Regulatory Approaches to Cross - Border Mergers: Exercising the Right of Establishment' (2011) 36 European Law Review 71, 95.

<sup>94</sup> Study on the Application of the Cross-Border Mergers Directive (2013) 53-57.

lead to high level of uncertainties regarding the execution of the merger, and might even trigger the companies not to carry out the merger at all.<sup>95</sup>

The existence of procedural differences leading to uncertainties have been seen as a psychological obstacle to both, creditors of the merging companies and the companies themselves. Creditors are more likely to oppose strongly to a possible cross-border merger and demand securities, if they cannot be sure that the laws the acquiring company is subject to will provide them with sufficient safeguards.<sup>96</sup> At the same time, the legal uncertainties regarding the procedures established for the protection of creditors can also create psychological obstacles for the companies contemplating the merger.<sup>97</sup> The 10<sup>th</sup> Company Law Directive was adopted with the view to combat obstacles to cross-border transactions, but the current lack of harmonisation regarding the creditor protection decreases the level of legal certainty and, instead of combating obstacles, creates additional ones. This, consequently, constitutes a hindrance to the full effectiveness of the 10<sup>th</sup> Company Law Directive, to conducting cross-border mergers and, thus, discourages the exercise of the freedom of establishment through cross-border mergers.

Instead of creating obstacles, the 10<sup>th</sup> Company Law Directive should seek to solve clashes between systems established in different Member States that are trying to regulate the same questions. National legislation dealing with the protection of creditors in cross-border mergers should be harmonised in order to ensure the full effectiveness of the 10<sup>th</sup> Company Law Directive and more harmonious exercise of the freedom of establishment.<sup>98</sup> Either amending the 10<sup>th</sup> Company Law Directive or by adopting a new directive harmonising the creditor protection process in the Member States would lead to increase in legal certainty, would decrease unnecessary delays, and would make it possible for the EU companies to benefit more from the freedom of establishment. This would lead to additional efficiency gains for the EU companies and, through that, would increase the competitiveness of the whole internal market.

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<sup>95</sup> Study on the Application of the Cross-Border Mergers Directive (2013) 58.

<sup>96</sup> Thomas Papadopoulos, 'The Magnitude of EU Fundamental Freedoms: Application of the Freedom of Establishment to the Cross-Border Mergers Directive' (2012) 23 European Business Law Review 517, 536.

<sup>97</sup> Thomas Papadopoulos, 'EU Regulatory Approaches to Cross - Border Mergers: Exercising the Right of Establishment' (2011) 36 European Law Review 71, 95.

<sup>98</sup> Thomas Papadopoulos, 'The Magnitude of EU Fundamental Freedoms: Application of the Freedom of Establishment to the Cross-Border Mergers Directive' (2012) 23 European Business Law Review 517, 542; Study on the Application of the Cross-Border Mergers Directive (2013) 58-60.

## 4. ARTICLE 4(2) OF THE 10<sup>TH</sup> COMPANY LAW DIRECTIVE RESTRICTING THE FREEDOM OF ESTABLISHMENT

### 4.1. The interpretation of article 4(2) of the 10<sup>th</sup> Company Law Directive

#### 4.1.1. The compliance of article 4(2) with the freedom of establishment

The legal basis for the company law harmonisation programme, including the adoption of the 10<sup>th</sup> Company Law Directive, is article 50 TFEU.<sup>99</sup> According to the latter, the aim of adopting directives is to attain freedom of establishment. The freedom of establishment, as interpreted by the CJEU in the *SEVIC*<sup>100</sup> case, includes the right of establishment in another Member State through cross-border mergers. This means that the 10<sup>th</sup> Company Law Directive should ensure that the EU companies can benefit from this fundamental freedom and establish themselves in other Member States through cross-border mergers.

While the 10<sup>th</sup> Company Law Directive as a whole undoubtedly facilitates the cross-border merger process, it is arguable whether every single provision has the effect of facilitating the process and eliminating the obstacles thereof. Article 4(1)(b) of the 10<sup>th</sup> Company Law Directive stipulates that a company taking part in a cross-border merger shall comply with the provisions and formalities of the national law to which it is subject. Article 4(2) reads as follows:

The provisions and formalities referred to in paragraph 1(b) shall, in particular, include those concerning [...] and, *taking into account the cross-border nature of the merger*<sup>101</sup>, the protection of creditors of the merging companies [...].

The requirement of taking into account the cross-border nature of the merger has been seen as granting the Member States the right to adopt so called ‘special provisions’ which confer higher level of protection on creditors in case of cross-border mergers than in domestic mergers.<sup>102</sup> However, such interpretation raises concerns regarding art 4(2) giving rise to difference in treatment, depending on whether mergers include a cross-border element or not. Difference in treatment generally goes against the principle of equal treatment which constitutes the foundation of freedom of establishment.<sup>103</sup> At the same time, not only national measures but also secondary EU legislation shall respect the fundamental freedoms of the EU and shall be in

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<sup>99</sup> Thomas Papadopoulos, ‘The Magnitude of EU Fundamental Freedoms: Application of the Freedom of Establishment to the Cross-Border Mergers Directive’ (2012) 23 European Business Law Review 517, 518.

<sup>100</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805.

<sup>101</sup> Emphasis added.

<sup>102</sup> Jonathan Rickford, ‘The Proposed Tenth Company Law Directive on Cross Border Mergers and its Impact in the UK’ (2005) 16 European Business Law Review 1393, 1408.

<sup>103</sup> Alberto Santa Maria, *European Economic Law* (2nd edn, Kluwer Law International 2009) 63.

conformity with them.<sup>104</sup> Secondary legislation cannot serve as a limitation of the fundamental freedoms and should be interpreted as having a supporting function for the freedom of establishment.<sup>105</sup> Thus, art 4(2) and, more precisely, the possibility to take into account the cross-border nature of the merger when adopting domestic legislation regulating the protection of creditors in cross-border mergers should be interpreted in a way which would be in compliance with the freedom of establishment.

What could be the possible interpretation of art 4(2) of the 10<sup>th</sup> Company Law Directive that would be in compliance with the freedom of establishment and its underlying principle of equal treatment? It could be deduced from the second sentence of paragraph 3 of the recital of the 10<sup>th</sup> Company Law Directive which reads as follows:

None of the provisions and formalities of national law, to which reference is made in this Directive, should introduce restrictions on freedom of establishment [...] save where these can be justified in accordance with the case-law of the Court of Justice and in particular by requirements of the general interest and are both necessary for, and proportionate to, the attainment of such overriding requirements.

The recital clearly refers to one of the most important principles of EU law, which is the principle of proportionality. However, this paragraph refers to the application of domestic provisions to the cross-border merger, which is the underlying principle of the 10<sup>th</sup> Company Law Directive, but makes no reference to the so called ‘special provisions’ which could be adopted under art 4(2) of the 10<sup>th</sup> Company Law Directive. Even national provisions which regulate domestic mergers but are also applicable to cross-border mergers could constitute a restriction on the freedom of establishment and shall then have a legitimate aim and comply with the principle of proportionality. ‘Special provisions’ adopted under art 4(2) of the 10<sup>th</sup> Company Law Directive should at least be subject to the same requirements, but it is questionable how far the Member States can go to add additional impediments to the merger process only because it involves a cross-border element.<sup>106</sup> Thus, art 4(2) should be interpreted as giving the Member States the possibility to adopt national measures offering different treatment for creditors in case of a cross-border merger only when such measures could be justified: they have a legitimate aim, and are suitable and necessary for achieving the aim.

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<sup>104</sup> Case C-15/83 *Denkavit Nederland v Hoofdprodukschap voor Akkerbouwprodukten* [1984] ECR I-2171, para 15; Case C-51/93 *Meyhui NV v Schott Zwiesel Glaswerke AG* [1994] ECR I-03879, para 11.

<sup>105</sup> Clemens Philipp Schindler, ‘Cross-border mergers in Europe-Company Law is catching up! – Commentary on the CJEU’s Decision on *Sevic Systems AG*’ (2006) 3 *European Company and Financial Law Review* 109, 118.

<sup>106</sup> Jonathan Rickford, ‘The Proposed Tenth Company Law Directive on Cross Border Mergers and its Impact in the UK’ (2005) 16 *European Business Law Review* 1393, 1408.

#### 4.1.2. The interpretation of article 4(2) by the Member States

When a directive regulates a certain matter in a fully harmonised manner, national measures that are adopted in its implementation process shall be assessed in the light of the provisions of the harmonising secondary legislation.<sup>107</sup> However, when a directive only establishes minimum standards and allows Member States to enact stricter rules, the provisions of the national legislation shall be assessed in the light of EU primary legislation and, thus, in the light of fundamental freedoms.<sup>108</sup> The 10<sup>th</sup> Company Law Directive does not harmonise creditor protection regulation in Member States. Instead, it provides minimum standards requiring Member States to apply the rules applicable in domestic mergers, and additionally, its article 4(2) gives Member States the possibility to adopt stricter rules for cross-border mergers. Therefore, national legislation adopted by the Member States regarding the protection of creditors in cross-border mergers should not be assessed in the light of the 10<sup>th</sup> Company Law Directive, but in the light of primary legislation, including the freedom of establishment. After the *SEVIC* judgement which conferred the protection of the freedom of establishment upon cross-border mergers, Member States should consider the 10<sup>th</sup> Company Law Directive to be a ‘floor’ and freedom of establishment a ‘ceiling’, and the national legislation should be located somewhere between those two.<sup>109</sup>

The majority of the Member States have not used the option to ‘take into account the cross-border nature of the merger’ when implementing the 10<sup>th</sup> Company Law Directive, and have either adopted additional provisions offering the same level of protection or have just amended the already existing regulation and added a reference to cross-border mergers.<sup>110</sup> However, there are still several Member States that have used this possibility given by art 4(2) of the 10<sup>th</sup> Company Law Directive. Estonia, Germany and Slovenia are examples of Member States which have adopted national legislation offering higher level of protection to creditors in cross-border mergers than in domestic mergers.<sup>111</sup> The difference in the level of protection offered to

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<sup>107</sup> Case C-37/92 *Vanacker and Lesage* [1993] ECR I-04947, para 9.

<sup>108</sup> Mads Andenas, Tilmann Gütt, Matthias Pannier, ‘Free Movement of Capital and National Company Law’ (2005) 16 *European Business Law Review* 757, 783.

<sup>109</sup> Benjamin Angelette, ‘The Revolution that Never Came and the Revolution Coming – *De Lasteyrie du Salliant, Marks & Spencer, Sevic Systems* and the Changing Corporate Law in Europe’ (2006) 92 *Virginia Law Review* 1188, 1204.

<sup>110</sup> Eg Belgium, Czech Republic, Denmark, France, Hungary, the Netherlands, Spain. Study on the Application of the Cross-Border Mergers Directive (2013) <[http://ec.europa.eu/internal\\_market/company/docs/mergers/131007\\_study-cross-border-merger-directive\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/mergers/131007_study-cross-border-merger-directive_en.pdf)> accessed 12 April 2015.

<sup>111</sup> Jurij Dolžan, Matija Knapic, Samo Heric, *Cross-Border Mergers in Europe*, vol 1 (Dirk Van Gerven ed, Cambridge University Press 2010) 143-144; Study on the Application of the Cross-Border Mergers Directive (2013).

the creditors of the merging companies relates to the commencement of the protection. Estonia, Germany and Slovenia all have adopted provisions giving creditors of companies involved in a domestic merger the right to demand their claims to be secured within six months of the entry of the merger into the registry, and to creditors of the companies involved in a cross-border merger to demand the same, but already when the common draft terms of the merger<sup>112</sup> have been publicly announced.<sup>113</sup> Thus, in a cross-border merger, the creditors can demand their claims to be secured already before the merger decision has been adopted by the general meeting of shareholders, while in a domestic merger situation, creditors can only act after the merger has already come into effect. The latter need to address their claims to the acquiring company, since after the merger has finalised, their initial debtor has ceased to exist. However, it is important to note that the provisions offering higher level of protection are only applicable if the acquiring company<sup>114</sup> is subject to the laws of another Member State.<sup>115</sup> When the acquiring company is subject to the Estonian, German or Slovenian laws respectively, the creditors enjoy the same level of protection as they would in a domestic merger.

Article 4(1) of the 10<sup>th</sup> Company Law Directive stipulates that every company taking part in a cross-border merger is to comply with the provisions of the national law to which it is subject. Those provisions of national law include provisions dealing with the protection of creditors in cross-border mergers.<sup>116</sup> The 10<sup>th</sup> Company Law Directive entrusts Member States with the task of ensuring the protection of creditors in cross-border mergers. However, Member States cannot introduce national provisions which could constitute restrictions on the freedom of establishment, unless they are justified.<sup>117</sup> Thus, the question is whether the national provisions conferring higher level of protection upon creditors in cross border mergers could be seen as a restriction on the freedom of establishment, and if so, whether they could be justified.

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<sup>112</sup> Or the national equivalent to that.

<sup>113</sup> Estonian Commercial Code, arts 399, 433<sup>8</sup>(2); German Reorganisation Act, arts 22, 122(a), 122d; Slovenian Companies Act, arts 592; 622j(1).

<sup>114</sup> Or the newly founded company acting as the acquiring company.

<sup>115</sup> Estonian Commercial Code, arts 399, 433<sup>8</sup>(2); German Reorganisation Act, arts 22, 122(a), 122d; Slovenian Companies Act, arts 592; 622j(1).

<sup>116</sup> 10<sup>th</sup> Company Law Directive, art 4(2).

<sup>117</sup> Gerco C van Eck, Erwin R Roelofs, 'Ranking the Rules Applicable to Cross-Border Mergers' (2011) 8 European Company Law 17, 18-19.

## 4.2. Difference in treatment constituting a restriction on the freedom of establishment

### 4.2.1. Higher level of creditor protection as a directly discriminatory restriction

A national measure constituting a restriction has been subject to a very broad interpretation by the CJEU. It is established case law that all measures which prohibit, impede or render less attractive the exercise of the fundamental freedom, shall be regarded as restrictions thereof.<sup>118</sup> Consequently, as AG Tizzano in the *SEVIC* case has pointed out, all national measures which are merely likely to discourage a company from availing itself of the right of establishment can also be covered by this prohibition.<sup>119</sup>

National legislation adopted in Estonia, Germany and Slovenia give creditors of companies involved in a cross-border merger the right to demand security for their claims even before the decision to merge has been adopted. At the same time, creditors of companies involved in a domestic merger cannot do so until the merger has already become effective. Such legislation can be characterised as providing for difference in treatment. Having to provide security even before the merger is decided causes uncertainties as to the finalisation of the merger and additional delays before the merger comes into effect, when compared to domestic mergers where creditors can only demand securities after the merger becomes effective. Such delays can certainly cause the owners of the company to reconsider the plan to merge when a merger needs to be finalised as soon as possible. In the *SEVIC* case, the CJEU found that German national legislation only allowing for domestic mergers constituted a restriction because such difference in treatment between companies according to the domestic or cross-border nature of the merger is likely to deter the exercise of the freedom of establishment.<sup>120</sup> The same reasoning could also be used for the national legislation offering higher degree of protection which could cause additional delays in cross-border mergers, compared to domestic mergers. In situations where time is the primary concern, such legislation can clearly discourage a company from conducting a cross-border merger and from exercising its freedom of establishment. Thus, national legislation such as adopted in Estonia, Germany and Slovenia gives rise to difference in treatment and constitutes a restriction on the freedom of establishment.

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<sup>118</sup> Case C-55/94 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-04165, para 37; Case C-108/96 *Dennis Mac Quen and Others* [2001] ECR I-00837, para 26; Case C-79/01 *Payroll and Others* [2002] ECR I-8923, para 26; Case C-442/02 *Caixa Bank France* [2004] ECR I-08961, para 26.

<sup>119</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, opinion of AG Tizzano, para 44.

<sup>120</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, para 22.

However, establishing the existence of a restriction does not suffice for deeming the latter to be discriminatory. A restriction should be deemed discriminatory if it violates the principle of equal treatment. The principle of equal treatment constitutes the cornerstone of the four fundamental freedoms and can be explained as the legal principle of non-discrimination, including both, direct and indirect discrimination. Direct discrimination<sup>121</sup>, prohibited by the TFEU, means different and less-favourable treatment on grounds of nationality, and indirect discrimination, also prohibited by the TFEU, means the prohibition to adopt measures that are applicable to nationals and non-nationals, but have a greater impact on the latter.<sup>122</sup> The meaning of nationality does not generally cause any problems when talking about natural persons, but could be a more questionable when companies are involved. Article 54 TFEU confers upon companies 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 the same level of protection as to nationals of the Member State. The CJEU relied on art 54 TFEU in the *Commission v France*<sup>123</sup> case and ruled that the seat of a company has the same function as nationality of a natural person and, thus, direct discrimination means discriminating against companies based on the state where it has its registered office, central administration or principal place of business.<sup>124</sup>

AG Tizzano in the *SEVIC* case emphasised the distinction between discriminatory and non-discriminatory restrictions and stated that the German legislation which only allowed domestic mergers treats companies differently depending on their place of establishment constitutes a directly discriminatory restriction.<sup>125</sup> The CJEU, however, ignored the question of discrimination. This has given rise to different interpretations of the judgement. Some have interpreted that as the CJEU implicitly considering the German national legislation non-discriminatory, because it is not just foreign companies that are not allowed to merge with German companies, but also the latter cannot merge with foreign companies.<sup>126</sup> Others disagree and find that the rationale behind the CJEU's ruling to confer the protection of a fundamental

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<sup>121</sup> Also referred to as distinctly applicable.

<sup>122</sup> Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (4th edn, Oxford University Press 2013) 17, 246, 247.

<sup>123</sup> Case 270/83 *Commission of the European Communities v French Republic* [1986] ECR 00273.

<sup>124</sup> Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (4th edn, Oxford University Press 2013) 341.

<sup>125</sup> AG Tizzano did not make a distinction between directly discriminatory and indirectly discriminatory national measures, but him considering it to be directly discriminatory can be deduced from the fact that he considered the express Treaty derogations as the only possible justification. C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, opinion of AG Tizzano, paras 56-57.

<sup>126</sup> Gert-Jan Vossestein, 'Companies' Freedom of Establishment after Sevic' (2006) 3 *European Company Law* 177, 180; Peter Behrens, 'Case C-411/03, *SEVIC Systems AG*' (2006) 43 *Common Market Law Review* 1669, 1684.

freedom upon cross-border mergers was to eliminate discrimination between foreign and domestic companies.<sup>127</sup> The latter seems to be more plausible as the CJEU did expressly state that there was a difference in treatment between domestic and cross-border mergers.<sup>128</sup> Difference in treatment between domestic and cross-border mergers by its nature suggests that the latter is being discriminated against. The argument suggesting that the companies established in other Member States are not being directly discriminated against when the national provision in question also prohibits domestic companies from merging with them is not a valid one. Cross-border merger always includes a domestic company and if this argument was to be followed, national legislation regulating the cross-border merger process would never be discriminatory as it would always also be applicable to the domestic company involved in the merger. This would diminish the principle of equal treatment and would not be in compliance with the freedom of establishment. Thus, the question should not be whether the merging party established in another Member State is being discriminated against, but whether cross-border merger as a process is being discriminated against domestic mergers. This interpretation could also be deduced from the *SEVIC* judgement where the CJEU referred to the difference in treatment between companies ‘according to the internal of cross-border nature of the merger’.<sup>129</sup> National legislation constituting a restriction which applies only to cross-border mergers and not to domestic ones should be deemed directly discriminatory.<sup>130</sup> Therefore, difference in treatment by providing creditors with higher level of protection in cross-border mergers than in domestic mergers, just like allowing only domestic companies to merge, should be understood as a directly discriminatory measure.

#### 4.2.2. Possible justifications for the restriction

According to the well-established case law by the CJEU, directly discriminatory national measures breach articles 45, 49, 56 or 21 TFEU, meaning that national measures giving rise to direct discrimination violate the fundamental freedoms of the EU. Such measures can only be lawful if they can be justified by one of the express derogations provided by the TFEU.<sup>131</sup> At

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<sup>127</sup> Mathias M Siems, ‘*SEVIC*: Beyond Cross-Broder Mergers’ (2007) 8 European Business Organization Law Review 307, 313-315.

<sup>128</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, para 14.

<sup>129</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, para 22.

<sup>130</sup> The same art 4(2) of the 10th Company Law provides similar grounds for the adoption of national measures offering minority shareholders higher level of protection in cross-border mergers than in domestic mergers. This has been found to constitute a directly discriminative measure restricting the freedom of establishment. G van Solinge, ‘Een nieuwe rechtsfiguur met oude wortels’ (2007) Weekblad voor Privaatrecht, Notariaat en Registratie 674, 679.

<sup>131</sup> Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (4th edn, Oxford University Press 2013) 246-247.

the same time, imperative requirements<sup>132</sup>, developed by the CJEU case law, can only be taken into account in case of national measures which are indistinctly applicable.<sup>133</sup> The express derogations which could justify national measures restricting the freedom of establishment are provided in art 52 TFEU and include public policy, public security and public health. None of them seem to be relevant for national measures offering creditors higher level of protection in cross-border mergers. This, consequently would mean that national measures adopted by Estonian, German and Slovenian legislator are restricting the freedom of establishment and cannot be justified.

However, there have been signs of change in approach in the CJEU case law regarding the possible justifications for directly discriminatory measures. In several cases the CJEU has overlooked the fact that the national measure was directly discriminatory and has allowed recourse to mandatory requirements.<sup>134</sup> The first highly criticised case where the CJEU started to blur the line between possible justifications for directly discriminatory and other measures was the *Walloon Waste*<sup>135</sup> case. Even though a national measure made a clear distinction between domestically produced waste and waste produced in other Member States, the CJEU ignored the AG's opinion, relied on the principle that environmental damage should be rectified at source, and found that the protection of environment, even though not an express derogation provided by the TFEU, could be used as a possible justification.<sup>136</sup> The CJEU's reasoning has been characterised as 'dissatisfactory' and the case as 'clearly wrongly decided'.<sup>137</sup> Regardless of the criticism, the CJEU still continued blurring the line and diluting from its own well established case law, including in the area of the freedom of establishment. For example in the *Centros* case, the CJEU found that a refusal to register a branch of a company established in another Member State could hinder or make less attractive the exercise of the freedom of establishment and, thus, constituted a restriction.<sup>138</sup> Similar obstacle based, instead of discrimination oriented approach was followed in cases such as *Commission v Italy*<sup>139</sup>, *Hughes*

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<sup>132</sup> Also called mandatory requirements, overriding reasons or objective justifications.

<sup>133</sup> Joined Cases C-1/90 and C-176/90 *Aragonesa de Publicidad Exterior and Publivia* [1991] ECR I-4151.

<sup>134</sup> Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (4th edn, Oxford University Press 2013) 87, 247.

<sup>135</sup> Case C-2/90 *Commission of the European Communities v Kingdom of Belgium* [1992] ECR I-04431.

<sup>136</sup> *Ibid*, paras 34-35.

<sup>137</sup> Nicolas Bernard, 'Discrimination and Free Movement in EC Law' (1996) 45 *International and Comparative Law Quarterly* 82, 94.

<sup>138</sup> Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-01459, paras 30, 34.

<sup>139</sup> Case C-439/99 *Commission of the European Communities v Italian Republic* [2002] ECR I-00305, para 36.

*de Lasteyrie*<sup>140</sup> and *Marks and Spencer*<sup>141</sup>. The already discussed *SEVIC* case can arguably<sup>142</sup> also be an example of the obstacle based approach where the CJEU chose not to establish discrimination and instead continue with the mandatory requirements in the general interest as possible justifications.<sup>143</sup>

If the obstacle based approach was applied when assessing the compatibility of national measures offering higher level of protection to creditors in cross-border mergers than in domestic mergers, the latter could arguably be justified by mandatory requirements in the general interest. A relevant mandatory requirement which has been developed by the CJEU case law and repeatedly considered as a possible justification for measures restricting the freedom of establishment would be protection of creditors.<sup>144</sup> However, the CJEU's approach can be characterised anything but consistent. For example in 2007 in the *Laval* case, the CJEU reaffirmed that discriminatory rules may be justified only by reference to the express derogations provided by the relevant TFEU articles.<sup>145</sup> Indications of the CJEU moving back to the more discrimination based approach can also be seen from several tax law cases where the CJEU analysed whether national provisions giving rise to difference in treatment constituted discrimination prohibited by art 49 TFEU.<sup>146</sup>

National provisions that could be saved by mandatory requirements, such as protection of creditors, still need to be proportionate for achieving the aim. Finding a possible legitimate aim is not usually a problem, but the test gets complicated when the proportionality of the measure is being assessed. Making sure whether the measure is suitable and whether there are less restrictive measures which could achieve the same legitimate aim can lead to very different results and is almost never predictable.<sup>147</sup> The CJEU, keeping in mind the internal market

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<sup>140</sup> Case C-9/02 *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-2409, para 42.

<sup>141</sup> Case C-446/03 *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* [2005] ECR I-10837, paras 34-35.

<sup>142</sup> It has been argued that the CJEU considered the restriction to be non-discriminatory (n 126).

<sup>143</sup> C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, paras 22-23.

<sup>144</sup> C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-01459, para 35; C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-09910, para 92; Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* [2003] ECR I-10155, para 135.

<sup>145</sup> Case C-341/05 *Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet* [2007] ECR I-11767, paras 116-117.

<sup>146</sup> Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, para 72; Case C-446/04 *Test Claimants in the FII Group Litigation (No 1) v Commissioner or Inland Revenue* [2006] ECR I-11753, para 97.

<sup>147</sup> Karsten Engsig Sørensen, 'Company Law as a Restriction to Free Movement: Examination of the Notion of 'Restriction' Using Company Law as the Frame of Reference' (2014) 11 *European Company Law Review* 178, 179.

objective, is very likely to scrutinise such national measures giving rise to difference in treatment in the area of creditor protection, and to find them to be disproportionate and, thus, restrictions on the freedom of establishment which cannot be justified.<sup>148</sup> For this reason, even the obstacle based approach may not save national provisions granting creditors higher level of protection in cross-border mergers than in domestic mergers.

Article 4(2) of the 10<sup>th</sup> Company Law Directive, and more precisely, the interpretation given to it by the Member States when implementing the directive has led to a situation where national provisions adopted by the Member State constitute restrictions on the freedom of establishment. First, national measures offering creditors higher level of protection in cross-border mergers as adopted in Estonia, Germany and Slovenia constitute directly discriminatory measures which could in principle be justified only by the express derogations stipulated in art 52 TFEU. However, none of them are relevant for such measures. Second, the CJEU has applied the obstacle based approach, ignored the question of discrimination, and accepted the protection of creditors as a mandatory requirement in the general interest as a possible justification to the measures restricting the freedom of establishment. However, the inconsistency in the CJEU case law regarding the obstacle based approach instead of establishing discrimination should be kept in mind when assessing the compatibility of national measures adopted under art 4(2) of the 10<sup>th</sup> Company Law Directive. And, third, even if the obstacle based approach was followed and the protection of creditors accepted as a legitimate aim, the measure is still likely to be found to fail the proportionality test. Thus, the interpretation given to art 4(2) of the 10<sup>th</sup> Company Law Directive by the Member States is incompatible with the freedom of establishment, and national legislation adopted under it offering higher level of protection to creditors in cross-border mergers constitutes a restriction on the freedom of establishment which is unlikely to be found justified.

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<sup>148</sup> Jonathan Rickford, 'The Proposed Tenth Company Law Directive on Cross Border Mergers and its Impact in the UK' (2005) 16 *European Business Law Review* 1393, 1408

## CONCLUSION

The adoption of the 10th Company Law Directive in October 2005 and its further implementation into the national laws of the Member States brought about a rapid increase in the cross-border merger transactions. This is a clear indication of the effectiveness of the 10<sup>th</sup> Company Law Directive when aiming at facilitating the cross-border merger process. However, such a rapid increase in the number of transactions conducted has also demonstrated to the legal practitioner the possible shortcomings of the 10<sup>th</sup> Company Law Directive. One of those shortcomings, as indicated by the feedback given to the Commission's public consultation is the creditor protection system currently in force. The main aim of the thesis was to analyse whether the current creditor protection regulation provided by arts 4(1)(b) and 4(2) of the 10th Company Law Directive impedes the cross-border merger process. The hypothesis of the thesis to be defended was that the current regulation of creditor protection under the 10th Company Law Directive on cross-border mergers constitutes an impediment to the freedom of establishment.

With the *SEVIC* judgement the CJEU gave a wider interpretation to the scope of the freedom of establishment and stated that cross-border mergers constituted a particular method of exercise of the fundamental freedom. Thus, after the *SEVIC* judgement, the main importance of the 10<sup>th</sup> Company Law Directive was not to provide the EU companies the right to conduct cross-border mergers because this right could already be derived from the CJEU case law. Instead, the main importance of the 10th Company Law Directive is to coordinate and facilitate the process of cross-border mergers. However, the creditor protection regulation under the 10<sup>th</sup> Company Law Directive does not coordinate nor facilitate the process. Instead, it creates additional obstacles to cross-border mergers.

The first research question established was to make sure whether the lack of harmonisation of creditor protection systems in the Member States provided by the 10<sup>th</sup> Company Law Directive hinders the freedom of establishment. Articles 4(1)(b) and 4(2) which regulate the protection of creditors do not provide for any harmonising rules. Instead, they provide for the application of national provisions regulating the protection of creditors in domestic mergers also to cross-border mergers. Such lack of harmonisation, however, impedes the effectiveness of the 10th Company Law Directive as a whole when trying to facilitate the cross-border mergers. Procedural differences adopted by national legislators, concerning the commencement, duration and consequences of creditor protection, lead to uncertainties and give rise to a situation where

creditors of the merging companies are more likely to oppose to the merger, and where the companies contemplating the merger face additional difficulties which may even lead to the interruption of the whole merger decision. The 10<sup>th</sup> Company Law Directive was adopted with the view to combat obstacles to cross-border transactions, and as a whole, it clearly does that. However, the current lack of harmonisation regarding the creditor protection, instead of combating obstacles creates additional uncertainties and impedes the cross-border merger process and the exercise of the freedom of establishment.

The second research question asked whether art 4(2) of the 10<sup>th</sup> Company Law Directive gives rise to the Member States adopting national measures restricting the freedom of establishment. After the *SEVIC* judgement which conferred the protection of the freedom of establishment upon cross-border mergers, the EU secondary legislation cannot provide for grounds that unjustifiably restrict the right to conduct cross-border mergers. However, art 4(2) of the 10<sup>th</sup> Company Law Directive which gives the Member States the possibility to ‘take into account the cross-border nature of the merger’, has been interpreted by the Member States as grounds for adopting national measures which offer higher level of protection to creditors of companies involved in a cross-border merger than in domestic merger. For example, Estonia, Germany and Slovenia have adopted national provisions giving the creditors of companies involved in a cross-border nature the right to demand a security for their claim even before the merger decision has been adopted. At the same time, in domestic mergers, creditors can only do so after the merger has become effective. The higher level of protection falls under the definition of restriction on fundamental freedom established by the CJEU case law. Thus, the interpretation of art 4(2) adopted by the Member States gives rise to difference in treatment, depending on the domestic or cross-border nature of the merger, and the national measures adopted by the Member States under art 4(2) constitute directly discriminatory restrictions on the freedom of establishment. When assessing the discriminatory measures in the light of the CJEU case law, according to which directly discriminatory provisions can only be justified on the express derogations provided by the TFEU, the national measures offering higher level of creditor protection in cross-border mergers could not be justified. Even if the CJEU’s obstacle based approach accepting mandatory requirements as possible justifications was followed, it would still be unlikely that the national provisions restricting the freedom of establishment are found proportionate to the attainment of the protection of creditors as the legitimate aim.

The lack of harmonisation creating difficulties and legal uncertainties hinder the cross border merger process, and art 4(2) of the 10<sup>th</sup> Company Law Directive gives rise to the Member States

adopting directly discriminatory national measures which restrict the freedom of establishment. Thus, it can be concluded that the current creditor protection regulation under the 10<sup>th</sup> Company Law Directive decreases the effectiveness of the directive and constitutes an impediment to the freedom of establishment. The system currently in force which leaves it up for the Member States to regulate creditor protection in cross-border mergers should instead aim at harmonising the area and eliminating obstacles created by differences in national legislations. At the same time, harmonising the creditor protection regulations in the Member States would eliminate the need for the Member States to adopt national measures offering higher level of protection to creditors in cross-border mergers than in domestic mergers. The need for the higher level of protection has been considered to derive from the fact that creditors are not only obliged to accept a new debtor, but a debtor located in another Member State. As harmonisation would eliminate differences in the level of protection offered by Member States, it would also eliminate legal uncertainty regarding the satisfaction of claims, and would thus serve as a sufficient substitute for the need for higher level of protection of creditors when a merger includes a cross-border element.

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