

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(90) 631 final-SYN 317

Brussels, 13 December 1990

Proposal for a

COUNCIL DIRECTIVE

amending Directive 77/91/EEC

on the formation of public limited liability companies
and the maintenance and alteration of their capital

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. General considerations

1. The Second Council Directive on company law of 13 December 1977 (77/91/EEC)¹ harmonizes the safeguards required by Member States of companies in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent.

In order to protect the interests both of shareholders and of third parties, the Directive provides that it should be possible for any interested person to acquaint himself with the basic particulars of a company at the time of its incorporation, including the exact composition of its capital. The Directive also makes provision for maintaining the subscribed capital and ensuring minimum equivalent protection for shareholders and creditors in the event of an increase or reduction of that capital.

To ensure that the subscribed capital is maintained, the Directive prohibits the distribution of dividends to shareholders in the absence of net profits and restricts the right of a company to acquire its own shares.

2. In this connection, it lays down more particularly the conditions under which Member States' laws may authorize companies to acquire their own shares. Thus with the twofold aim of ensuring maintenance of the subscribed capital and guaranteeing respect for the principle of equal treatment for all shareholders, the Second Directive imposes restrictions of both a procedural and a substantive nature. It also spells out the consequences of such transactions.
3. From the procedural point of view, it is for the general meeting to authorize proposed acquisitions and determine the terms and conditions thereof, including the duration of the period for which the authorization is given, which may not exceed 18 months (Article 19(1)(a)). However, the Directive allows Member States to derogate from the principle of authorization by the general meeting "where the acquisition of a company's own shares is necessary to prevent serious and imminent harm to the company" (Article 19(2)). In such a case, the decision may be taken by the company's board, which must subsequently inform the general meeting thereof.

Whichever organ is competent to take decisions in relation to the transactions in question, a number of substantive restrictions are also imposed. A public limited liability company may under no circumstances acquire its own shares in excess of 10% of the subscribed capital, and only fully paid up shares may be included in the transaction (Article 19(1)(b) and (d)). Moreover, the Directive

¹ OJ L 26, 31.1.1977, p. 1-13.

stipulates that the voting rights attached to the shares acquired by the company must be suspended (Article 22(1)). Lastly, the transaction must be mentioned in the company's annual report (Article 22(2)).

4. All the above rules apply not only to acquisitions made by the public limited liability company itself, but also to those made by a person acting in his own name but on the company's behalf.

On the other hand, the Directive does not apply to acquisitions by a subsidiary. But it is entirely feasible that, by virtue of its power of control, a company might use a subsidiary to acquire its own shares, thereby circumventing the safeguards provided for in the Second Directive. In view of this gap in Community law, national laws continue to deal with this matter in a variety of ways.

5. The lack of Community rules on the subject has also raised questions in connection with the Commission's declared policy of removing obstacles to takeover bids.

~~It should be stressed that~~ the Commission's aim in removing such obstacles is not to encourage takeover bids as ends in themselves. The Commission's standpoint is rather that, in general, takeover bids may be viewed in a positive light in so far as they encourage the selection by market forces of the most competitive companies and the restructuring of European companies, indispensable as this is to meeting international competition. In this context, the opportunities for acquiring companies must be broadly similar from one Member State to another.

6. In several Member States, however, takeover bids resisted by the board of the target company (hostile bids) have no chance of success, owing to the defensive measures which the company's board can take under national law to ensure that control of the company remains in the hands of "friendly" shareholders.
7. In its communication to the Council of 10 May of this year,² the Commission outlined the measures it intends putting forward with a view to removing obstacles to takeover bids.
8. The purpose of the measures is, generally speaking, to attain a higher degree of democracy in companies and increase shareholder involvement in company life. This strengthening of the power of shareholders is of particular importance in the context of a takeover bid as these new measures will ensure that the outcome of the bid is decided by all shareholders acting independently and with full knowledge of the facts.

² SEC(90) 901 final, 10.5.1990.

9. The proposed measures cover two categories of obstacle. The first category concerns the voting rights of shareholders, and the second the maintenance of company capital.
10. The obstacles relating to the exercise of shareholders' voting rights will, for their part, be dealt with in the amended proposal for a Fifth Directive, which already contains important provisions on the subject. However, with a view to strengthening the position of shareholders with regard to the exercise of their voting rights, those provisions need to be amended in several respects. A new text amending the proposal for a Fifth Directive along those lines has accordingly been drawn up.
11. The capital maintenance aspect involves obstacles linked to the acquisition by a company of its own shares. By such means the company seeks to shield a certain proportion of its subscribed capital from a hostile bidder and freeze the voting rights attached thereto with a view to frustrating the bid.
12. Firstly, mention must be made of the right to derogate under certain conditions from the principle of the authorization of the general meeting, which allows the board of a company to acquire up to 10% of the subscribed capital without any intervention by the shareholders, the addressees of the bid.
13. It is therefore necessary to no longer allow recourse to be had to this derogation for any acquisition of own shares during the takeover bid period. In this connection, it was made clear when the Thirteenth Council Directive, concerning takeover bids,³ was amended that Article 8 thereof, which requires the board to refrain from taking certain defensive measures while a bid is open, applies also to the acquisition of the company's own shares. Hence, notwithstanding Article 19(1)(a) and (2) of the Second Directive, such an acquisition is subject to the authorization of the general meeting, which must be given during the period for acceptance of the bid.
14. The second facet is that of the possibility for shares in a parent company to be acquired by its subsidiaries.

In view of the lack of Community rules on the subject, there is nothing to prevent a company from using a subsidiary to acquire its own shares in order to defend itself against a hostile takeover bid. In this way, the restrictions on the acquisition of own shares laid down in the Second Directive might be breached. Thus a subsidiary could acquire shares even beyond the threshold of 10% of the subscribed capital of the parent company and exercise the voting rights carried by those shares.

³ OJ C 240, 26.9.1990, p. 7.

15. It must therefore be ensured that the restrictions placed on the acquisition of own shares apply also to acquisitions made by subsidiaries.

11. Commentary

16. The purpose of Article 1 of this Directive is to extend the scope of Articles 19 to 24 of the Second Directive so as to include the acquisition of shares in a parent company by a subsidiary. Hence a subsidiary would be able to acquire shares in its parent only under the same conditions as the latter.

Such extension means notably that:

- (a) In calculating the maximum number of shares which may be held by a company (10%), shares held by all subsidiaries will be added to those held by the parent;
- (b) the voting rights attached to shares in a parent company held by its subsidiaries will also be suspended.

In short, in extending the arrangements provided for in the Second Directive, the transaction whereby shares in a parent company are acquired by a subsidiary must be viewed in the same way as if it were an acquisition of shares by the parent company itself.

This extension does not affect the legal nature of the above provisions. They are minimum provisions which permit Member States to impose more severe restrictions on the transactions in question.

17. For the purposes of this Directive, a company is deemed to be a subsidiary of another company if the latter satisfies one of the following requirements:
 - (a) It holds a majority of the voting rights in the former; or
 - (b) It has the right to appoint or remove a majority of the directors; or
 - (c) the right to control by itself a majority of the voting rights pursuant to an agreement or a control clause in the subsidiary's statutes.

These requirements are based on criteria applied by other Community legal instruments, namely Directive 83/349/EEC of 13 June 1983 on consolidated accounts⁴ and Directive 88/627/EEC of 12 December 1988 on the information to be published when a major holding in a listed company is acquired or disposed of.⁵

4 OJ L 193, 18.7.1983, p. 1.

5 OJ L 348, 17.12.1988, p. 62.

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Directive 77/91/EEC
on the formation of public limited liability companies
and the maintenance and alteration of
their capital.

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,
and in particular Article 54 thereof,

Having regard to the proposal from the Commission,

In cooperation with the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas in order to maintain the subscribed capital and ensure equal
treatment of shareholders, Directive 77/91/EEC¹ limits the right of a
company to acquire its own shares;

Whereas the restrictions on the acquisition of own shares apply not only
to acquisitions made by the company itself but also to those made by a
person acting in his own name but on the company's behalf;

Whereas a subsidiary company does not enjoy true independence in
determining its line of action; whereas in order to prevent a company
from using a subsidiary to make such acquisitions without regard to the
restrictions imposed in that respect, the arrangements concerning the
acquisition by a company of its own shares should be extended to cover
the acquisition of a company's shares by a subsidiary,

HAS ADOPTED THIS DIRECTIVE:

¹ OJ L 26, 31.1.1977.

Article 1

The Directive 77/91/CEE of the Council is amended as following: a new article 24bis is added after article 24.

"Article 24bis

1. A subsidiary company may acquire shares in its parent company only to the extent that the latter may acquire its own shares by virtue of provisions adopted pursuant to Articles 19 to 24. For the purposes of those provisions, acquisitions of shares in the parent company by its subsidiaries shall be deemed to have been made by the parent company.
2. For the purposes of paragraph 1, "subsidiary company" means any company in which another company (the parent company)
 - (a) holds a majority of shareholders' or members' voting rights; or
 - (b) has the right to appoint or remove a majority of the members of the administrative, management or supervisory body and is at the same time a shareholder in or member of that company; or
 - (c) has the right to control alone a majority of shareholders' or members' voting rights pursuant to an agreement entered into with other shareholders in or members of that company or to a provision in its statutes."

Article 2

1. Member States shall adopt before the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith inform the Commission thereof.
2. The date of entry into force which Member States lay down for these provisions shall be not later than
3. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.
4. When Member States adopt the provisions, the latter shall contain a reference to this Directive or shall be accompanied by such a reference at the time of their official publication. The methods of making such a reference shall be laid down by the Member States.

Article 3

This Directive is addressed to the Member States.

Done at

For the Council

The President

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