REGULATION X ON THE LAW APPLICABLE TO COMPANIES AND OTHER BODIES (2nd DRAFT)

Working document prepared by the Subgroup in view of the Luxembourg meeting (F. Garcimartin)

CHAPTER I: SCOPE

Article 1

Scope

1. This instrument determines the law applicable to companies and other bodies, corporate or unincorporated (hereinafter "companies"), including their creation, by registration or otherwise, legal capacity, internal organisation or winding-up, and the personal liability of officers and members as such for the obligations of the company or body.

[Alternative: "1. This instrument determines the law applicable to companies and other bodies, corporate or unincorporated, that, in accordance with that law, have their own personality different from the personality of their members"] [1].

2. The following matters shall be excluded from the scope of this Regulation:

(a) Jurisdiction and the recognition and enforcement of judgments;

(b) Contractual and non-contractual obligations, including the direct liability in tort of members and directors of a company, in particular liability resulting from

[1] The definition of the scope of the instrument was thoroughly discussed in the last meeting. We concluded that, in principle, two or even three approaches were feasible. **(I)** Defining the scope of this instrument by an explicit or implicit cross-reference to Article 1 (2) (f) Rome I Regulation. A Recital will then clarify that the scope of the new instrument should cover the questions excluded from the scope of Rome I Regulation as defined by Art 1 (2) (f) of this latter text (*infra* fn 2). **(II)** Defining the scope of the new instrument in an autonomous way, i.e. by using a "material element" that triggers its application. This material element would be the concept of "legal personality". Thus, the new text will only apply to entities that have their own personality, different from the personality of their members (the limited liability of their members is not a key element; furthermore, professionals with limited liability –eg entrepreneur individuel à responsabilité limitée- are excluded from the scope of this instrument). Conversely, organisation or partnership contracts that do not create an entity acting in the market independently from its members would not fall under the scope of the new instrument and, in principle, would fall under the scope of Rome I (as said, a recital may clarify this). Note, however, that the concept of legal personality may be ambiguous, though it is used in other EU instruments. Note also that this approach entails certain circularity, since the applicable law will determine whether an entity has legal personality or not. **(III)** Finally, a third alternative may be Art. 150 Swiss Law on PIL, that follows the concept of organized group of persons ("Au sens de la présente loi, on entend par société toute société de personne organisée et tout patrimoine organisé »). This is also the approach followed by most German scholars (RabelsZ, 2011, 547-555). However, this option would require a clarification of this concept, since the determination of when a group of persons is "organised" is rather difficult in practise.

misrepresentation or their allowing the company to continue carrying on business when undercapitalized[2];

(c) Rights in rem over shares or other participation rights;

(d) Insolvency[3];

(e) The constitution of trusts and the relationship between settlors, trustees and beneficiaries"[4];

(f) Labour relationships and employees rights [other than rights of participation in the organs [or other bodies] of a company][5]; and

(g) Public law, including taxes, social security or other administrative matters, and public-law entities.

Article 2

Universal application

Unless provided otherwise, any law specified by this Regulation shall be applied whether or not it is the law of a Member State.

CHAPTER II. APPLICABLE LAW

[2] This issue was also thoroughly discussed in the last meeting of the Group. The new paragraph is based on the difference between (i) the liability of members (including naturally parent companies) and directors of a company for acts committed by the company, which is based on Company law, (ii) and the *direct* liability of those persons vis-à-vis third parties, which is based on tort, ie. when there is a causal connection between the damage and the behaviour of the member or directors of the company. The term "direct liability", "tort" and the two examples (misrepresentation and undercapitalization) try to convey that idea. The new instrument should therefore cover non-contractual obligations arising out of the law of companies as defined by Art 1 (2) (d) Rome II Regulation. [See also ECJ C-147/12 ÖFAB *v* Koot, but see C-519/12 OTP *v* Hochtief, and also Articles 5 and 7 *infra*] A recital should then clarify the relationship between the three instruments: "*The scope of this Regulation should extend to matters excluded from the scope of Rome I and Rome II Regulations. The interpretation of this Regulation should as far as possible avoid regulatory lacunae between these instruments".*

[3] See Article 1, 6 (1) and 7 Regulation 2015/845. The opening of insolvency proceedings against a company usually interferes with the normal application of company-law rules, eg it may imply the divestment of the directors or even the substitution of the shareholders meeting. In principle, the effects of the opening of insolvency proceedings upon a company are not governed by the new instrument, but by Regulation 2015/845. Directors´ liability for reimbursement of payments made after the company becomes insolvent, as established by Para. 64 (2) GmbHG, is also governed by Regulation 2015/845 (ECJ C-295/13, H. *v*. H.K)

[4] See, Article 1 (2) (h) Rome I Regulation

[5] In principle, the participation of employees in the internal management and decision process of a company –eg as members of the supervisory body- is a company-law issue that should be governed by this instrument.

Article 3

General rule

A company shall be governed by the law of the country under which it has been incorporated or, if it is an unincorporated entity, under which it has been [formed][6].

Article 4

Default rule

Where the law applicable cannot be determined under Article 3, a company shall be governed by the law of the country within the territory of which its [centre of main interest/centre of administration] is located at the moment of formation of the company. [However, if the company is manifestly more closely connected with the law of another country, that law will apply]. [7]

Article 5

Scope of the applicable law

The law designated by articles 4 and 5 shall govern, in particular:

(a) the foundation of the company, its re-organization and winding-up[8];

(b) the name of the company;

(c) without prejudice to article 6, its legal nature, general capacity, capacity to act and representative bodies;

(d) its internal functioning, organization and capital structure[9];

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[6] Article 3 is based on the autonomy of the parties: it basically means that the founding members may choose the law applicable to the company. However, in Company Law parties do not usually include a choice of law clause, but express their consent by following the process called for by a particular law to "create" "organise" or "form" a company under such law. During the last meeting, the Group discussed the appropriate formulation, ie "incorporated under a law", "created under a law", "formed under a law" or "constituted under a law". Since the instrument applies to both incorporated and unincorporated entities, only the first alternative is not sufficient. Any of the other three may be kept.

[7] Article 4 applies when it is not possible to determine under the law of which country the parties have wanted to form the company. In this case, the provision is based on a combination of the "Sitztheorie" and an escape clause. The connecting factor traditionally followed by the Sitztheorie was the centre of administration, however the centre of main interests may be preferable, since it is used in other EU instruments. The inclusion of an escape clause should be discussed.

[8] Additionally, a recital should make it clear that the applicable law also governs the "formation process" and in particular the liability of the founding members for acts performed on behalf of the company: eg "The law applicable under this instrument should also cover the liability for acts performed on behalf of a company before its incorporation".

[9] A recital may clarify that this includes the capacity of legal persons to members of the board.

(e) accounts, auditing and disclosure;

(f) membership, including:

(i) conditions of membership;

(ii) the rights and obligations associated with membership;

(iii) the acquisition and disposition of those rights; and

(iv) entitlement to exercise the rights of shareholders against the company[10];

(g) the liability of directors vis à vis the members of the company and the company itself;

(h) without prejudice to article 7, the liability of directors and members for obligations of the company[11]; and

(i) the consequences of failure to fulfil the formal requirements for incorporation on the validity of the incorporation of a company.

Article 6

Capacity

The capacity of a company [governed by the law a non-Member State][12] to enter into legal relationships with third parties, and the powers of its organs or officers shall be governed by the law determined in accordance with Articles 3 and 4[13]. Nevertheless, any restrictions or limitations established by such law cannot be invoked against third parties when the relationship was concluded between persons in a country other than that of the governing law, under the law of which those restrictions or limitations do not exist, unless those third parties were aware of them or were not aware of them as a result of their negligence[14].

Article 7

Liability

[10] The concept of "rights" here includes both political (eg voting) and economic rights.
[11] A recital may clarify that this include the liability of the parent company for the debts of the subsidiaries.
[12] The limitation of this provision to non-EU companies should be discussed. The key issue is whether the application of these rules also to EU companies satisfies the "proportionality test" set out by the ECJ.
[13] Capacity to be liable in tort is governed by Rome II regulation (see recital 12)
[14] See Article 13 Rome I Regulation.

Companies [governed by the law of a non-Member State][15] operating in the European Union must disclose to third parties the country under the law of which the company was formed. Otherwise, any creditor of those companies may claim the liability of the persons acting on behalf of those companies, its members and directors under the law of the Member State where that person is acting, unless such creditor was aware of that information or were not aware of it as a result of his negligence.[16]

CHAPTER III. CHANGE OF THE APPLICABLE LAW

Article 8

Change of the applicable law

1. In this provision "old law" means the law applicable to a company before the change of applicable law and "new law" means the law applicable to a company after such change.

2. The law applicable to a company may be changed without its losing its legal personality if this is possible under both the old law and the new law.

3. Where such a change takes place, the old law shall apply, in particular, to measures for the protection of minority shareholders, creditors and employees of the company.

4. The new law shall determine the conditions of formation of the company.

Article 9

Companies of Member States

1. Within the European Union, a company may change its personal law without losing its legal personality. This change shall take place irrespective of the location or change of location of the central administration and/or the principle place of business of the company.

2. A company incorporated in a Member State may change its applicable law in favour of the law of a third country, without losing its legal personality, if this is permitted by the law of the third country.

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[15] The limitation of this provision to non-EU companies should be discussed. The key issue is whether the application of these rules also to EU companies satisfies the "proportionality test" set out by the ECJ.

[16] A recital should clarify the consequences of this provision: ie that the liability is governed by the law of the Member State where the person is acting and, in particular, by the rules that were applicable to an equivalent company created under the local law.

3. A company incorporated in a third country may change its applicable law in favour of the law of a Member State, without losing its legal personality, if this is permitted by the law of the third country.

CHAPTER IV. OTHER PROVISIONS

Article 10

Overriding mandatory rules

1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the company under this Regulation.

2. Nothing in this Regulation shall restrict the application of the overriding mandatory provisions of the law of the forum.

Article 11

Public policy

The application of a provision of the law of any country specified by this Regulation may be refused only if such application is manifestly incompatible with the public policy (*ordre public*) of the forum.

Article 12

States with more than one legal system

Where a State comprises several territorial units, each of which has its own rules of law in respect of company law, each territorial unit shall be considered as a country for the purposes of identifying the law applicable under this Regulation.

Article 13

Exclusion of renvoi

The application of the law of any country specified by this Regulation means the application of the rules of law in force in that country other than its rules of private international law.

Article 14

International agreements

This Regulation shall not prejudice the application of international conventions to which one or more Member States are parties at the time when this Regulation is adopted and which lay down conflict-of-law rules relating to companies.

Article 15

Entry into force and application in time

This Regulation shall enter into force and apply on the 20th day following its publication in the *Official Journal of the European Union*.