

Europa



# Business Support Programme

Phare Business Support Programme - SMECA

**European Company Law and Competition Law**



**HWK**

Handwerkskammer für München und Oberbayern

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# 1. Company Law

## 1.1. Background

The EU as a legislative body has done more in the field of company law than in any other area of private law. Harmonising legislation in the various member states is done principally by way of Directives and has a two-fold aim:

- limiting the risks ensuing from the differences in the member states' legislation, for the sake of protecting shareholders, creditors and business partners
- bringing about an economic area without internal frontiers, where the basic conditions under corporate law which apply to the companies in the individual member states are largely the same

The second point in particular is relevant to individual entrepreneurs and investors: the more "neutral" company law is in relation to the location, the easier it is for entrepreneurs to base their decisions on where to set up business solely on economic considerations.

In spite of efforts at harmonisation, however, company law is still on principle<sup>1</sup> a matter of national law. So far harmonisation has only affected companies limited by shares, the harmonisation of partnerships being extremely difficult due to the different legal traditions in the various states. The Directives listed in Item 1.2.3 are therefore irrelevant to small and medium enterprises (SME) organised as partnerships.

## 1.2. Existing European Rules & Regulations

### 1.2.1. The basic right of establishment

#### 1.2.1.1. Definition

If an internal European market is to be implemented, then firms need to be able to move freely as on a national market. They must be given an opportunity to decide freely on the basis of economic criteria as to their location throughout the entire EU territory, meaning that they must be able to choose a business location depending on production factors, infrastructure and sales markets. This freedom of movement is known as freedom of establishment.

#### 1.2.1.2. Freedom of establishment for individuals

- **Freedom of incorporation:** Each and every citizen of the EU – notwithstanding their place of residence – may set up a business in any country within the Community, complying with the statutory regulations under the national laws of that country. Nobody may be put at a disadvantage due to their nationality, and both open and hidden discrimination is prohibited.

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<sup>1</sup> The only exceptions to this are the EEIG (European Economic Interest Groupings) and the European Stock Corporations (SA), the introduction of which is presently being planned, because these two corporate structures are based on European law.

*E.g. If a member state prescribes that a certain number of partners must be nationals when a firm is set up, then this discriminates against members of other member states wanting to set up a firm in that particular country. A stipulation to this effect is thus inadmissible.*

Apart from EU citizenship, another requirement when setting up an agency or branch is that the main business has already been established in an EU member state.

- **Freedom of choice:** At a location of their choice, citizens of the EU may choose freely from amongst the types of business available at such location. Provisions whereunder members of other member states may only choose between certain forms of business organisation are inadmissible.
- **Freedom of participation:** Instead of setting up a new business in another member state, EU citizens may also participate in existing businesses in compliance with the provisions of the national laws of the country concerned.

### 1.2.1.3. Freedom of Establishment for Companies

Companies are treated as natural persons:

- if they have been set up in accordance with the statutes of a member state
- if their location (i.e. their registered headquarters as given in the articles of association), their central administration (i.e. the location where business decisions are taken), or their main establishment (e.g. factory) are all within the EU.

Freedom of establishment is guaranteed solely providing the above criteria are met, and notwithstanding the nationality of the shareholders or partners.

### 1.2.1.4. Practical Restrictions on Freedom of Establishment

- **Recognition of qualifications:**  
Freedom of establishment is still restricted for craftsmen because mutual recognition of qualifications has still not been arranged.
- **Transitional arrangements when joining the EU:**  
Particularly in the border areas between the EU and acceding countries (e.g. along the German-Polish border or the Austrian-Czech border), transitional arrangements will probably be introduced for the immediate period after accession, which for some years will restrict freedom of movement for both workers and employers (freedom of establishment)<sup>2</sup>. However, these restrictions will then gradually be lifted
- **Transferring headquarters from one EU state to another:**  
A sole trader may move his business from one member state to another. However, moving company headquarters from one EU state to another is not entirely unrestricted due to the different legislation in the member states<sup>3</sup>. This means that in practice, companies can

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<sup>2</sup> When Spain and Portugal acceded to the EU, similar restrictions came into force to avoid problems in the border areas.

<sup>3</sup> Exception: EEIG (European Economic Interest Grouping)

generally only exercise freedom of establishment by setting up agencies, branches and subsidiaries.

### 1.2.1.5. Freedom of Establishment as Distinct from other Basic Rights

➤ **Distinction from freedom of movement for workers:**

Freedom of movement means that every EU citizen has the right to settle down and take up work anywhere in the EU. Freedom of establishment for entrepreneurs is distinct from freedom of movement for workers in that an entrepreneur is self-employed, i.e. he operates abroad for his own account and at his own risk, and is not bound by a manager's instructions.

➤ **Distinction from freedom of services:**

If services are rendered across borders without the performing business moving its manufacturing location, then such services are covered by freedom of services. Temporary installation in another member state is not yet covered by freedom of establishment.

*E.g.: A building contractor who temporarily needs fixed installations in order to carry out a major project in another member state (machinery, accommodation for workers, etc), but who returns to his home country on completion of the assignment, is a party rendering services.*

➤ **Distinction from free movement of capital:**

The investments, financing and other capital transfers required for establishing a business are not covered by the right to freedom of establishment, but are subject to the provisions laid down on free movement of capital and money transactions.

### 1.2.2. Decrees:

#### **European Economic Interest Grouping**

Established under the decree dated 25.07.1985

#### 1.2.2.1. What is a European Economic Interest Grouping?

- A legal set-up for cross-border co-operation, having validity throughout the European economic area<sup>4</sup>
- Particularly suited to SME (small and medium enterprises) who have more difficulty in opening up the European market than big companies
- The members co-operate within the Grouping, but remain independent in legal and economic terms
- Does not aim to make a profit: its activities are solely to assist its members' business operations

#### **What is the purpose of a European Economic Interest Grouping?**

A European Economic Interest Grouping (EEIG) aims for co-operation in various business areas, e.g. for setting up purchasing or marketing associations, for joint research and development projects, or for co-operation in matters involving staff and further training. The Grouping aims to simplify or develop business operations for its members by bringing together funds, jobs and experience. This generally leads to better results than if the members act individually.

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<sup>4</sup> European economic area = EU plus Liechtenstein, Norway and Iceland

## Examples:

- *Purchasing: Several paper retailers have set up an EEIG for joint purchases and to develop a uniform marketing strategy. Similarly, several medium-sized manufacturers of paints and varnishes have strengthened their position for negotiating purchases of raw materials by setting up an EEIG.*
- *Joint Marketing: Several craft businesses in Eire and Northern Ireland have set up an EEIG to promote sales of local crafted products.*
- *Suppliers' Associations for public contracting*
- *Transport and Logistics: A series of mainly medium-sized European transport and removal firms has set up a EEIG for better co-ordination and more rational implementation of international transport and removals.*

### 1.2.2.2. Foundation

#### ➤ **Members:**

- So as to ensure that it crosses borders, an EEIG must have at least two members from two different states belonging to the European economic area<sup>5</sup>
- The members must each be independent in legal terms
- Both partnerships and companies governed by shares, as well as individuals providing they work in business, may become members

#### ➤ **The Institutions of an EEIG:**

An EEIG must have at least two institutions: the members who act jointly, and one or more general managers. However, members may make provision for further institutions, e.g. a supervisory board, expert committees.

#### ➤ **Deed of Incorporation:**

The agreement setting up an EEIG must be done in writing and contain minimum particulars (corporate name, registered headquarters, object of the business, members, term of the EEIG). However, it is recommended that apart from this minimum content, other matters also be arranged during set-up, e.g. details about institutions, co-operation, capital contributions, liability, distribution of profits and losses.

An expert needs to be consulted before drafting an agreement suited to individual circumstance.

#### ➤ **Publication:**

The regulation on EEIGs provides for a system of disclosure which fully guarantees protection of third parties.

- Entering the EEIG in the register designated for the purpose in the respective member state.
- Depositing the deed and any subsequent amendments with the same register, which is open to public inspection
- Publishing notices in the official national gazette
- Publishing notices in the official EU gazette

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<sup>5</sup> In the case of companies and legal entities, this depends on the location of the main administration, in the case of individuals it depends on the main place of work and not on the individual's nationality. If an EEIG no longer crosses frontiers, the association has to be dissolved.

➤ **Contributions:**

An EEIG may be set up with or without capital contributions, contributions in kind, contributed know-how, etc. Over 95% of all EEIGs are set up without any equity of their own. However, capital may be collected during the course of time.

➤ **Liability:**

An EEIG's members have unlimited joint and several liability for the Grouping. Internally however, various liability quotas may be agreed amongst the partners.

### 1.2.2.3. Miscellaneous

➤ **Advantages:**

- Taxes: An EEIG does not pay any tax on the results of its work, passing its profits on to the members who are then liable to tax in accordance with national legislation.
- Since different types of members may join (both partnerships and companies governed by shares, as well as individuals, e.g. lawyer, craftsman, sole trader), interesting and constructive combinations are possible in terms of both expertise, and commercial and financial know-how.
- EEIGs automatically meet certain requirements for EU promotion projects (e.g. it can be helpful if groups applying for EU grants act in the form of an EEIG)

➤ **Potential Difficulties with EEIGs:**

- Internal communication and its cost
- Language
- Initial uncertainty in tax matters
- Distribution of profits and losses unless arrangements have been made

➤ **Restrictions:**

EEIGs are subject to certain restrictions, e.g. as a rule they may not hold any shares in member companies, may not exercise any managerial or supervisory powers over other companies, and not grant any loans.

### 1.2.2.4. Practical Tips for SME in Central and Eastern Europe

➤ **Membership prior to accession to the EU:**

Membership in an EEIG is normally limited to businesses from the EU. However there are ways and means for businesses from acceding countries to join an EEIG even if the business is located in a non-member state.

➤ **Associated members:**

This is a good way of including a partner from a non-member country.

*E.g.: A Czech business can become a member of a German-Austrian EEIG, i.e. it co-operates with the Grouping, pays a given share of the costs, receives a proportionate share of the earnings, and assumes certain financial obligations within the Grouping.*

➤ **EEIGs and managing directors from non-member countries:**

Representatives or managing directors of businesses/members from non-member countries may also become managing directors of EEIGs.

*There are already several practical examples of persons acting as the managing directors of EEIGs, e.g. one of the managing directors of a South German EEIG is a Turk resident in Istanbul.*

➤ **Other possibilities:**

- A joint venture agreement
- Establishing an EEIG in a non-member country
- Establishing a business from a non-member country in the EU
- Including individuals from non-member countries, provided the focal point of their operations is within EU territory.

➤ **Information and advice**

More detailed information about EEIGs can be obtained from:

**EWIV-Informationszentrum**

Untere Vorstadt 11

D-71063 Sindelfingen (Stuttgart)

Tel: 0 70 31/61 86-80, Fax 0 70 31/61 86-86,

eMail: [ewiv@libertas-institut.com](mailto:ewiv@libertas-institut.com)

## 1.2.3. EU Directives

### 1.2.3.1. EU Directive on Disclosure

= 1<sup>st</sup> Directive dated 9.3.1968

#### Whom does the EU Directive on Disclosure affect?

In most countries, this Directive applies to **private limited companies, stock corporations, and partnerships limited by shares**. The aim of this Directive is to protect third parties vis-à-vis corporations.

#### What has to be disclosed?

- The deed incorporating the company and its articles of association, along with any amendments to the articles.
- The person(s) appointed to represent the company (and whether the persons authorised to represent the company have to do so jointly or may do so individually)
- Who runs and supervises the company
- The amount of subscribed capital (annually)
- The balance sheet, and the profit and loss account for each financial year<sup>6</sup>
- Any changes in the company's registered location
- Dissolution, invalidity (see below) and anything involving the liquidation of the company

#### Where must disclosures be made?

- A separate file has to be kept in a register. Exactly which register this is, is laid down by the member state concerned.
- Moreover, each member state stipulates an official gazette which publishes all the entries in the register, or at least makes reference to new entries.
- The company's notepaper and order forms have to give the following:
  - The name of the register where the file on the company is kept

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<sup>6</sup> There are special arrangements here which apply to SME: they may be allowed to submit a shortened balance sheet (see chapter on Accounting Directive).

- The number of the entry
- The company's legal structure and location
- A reference to the fact that the company is being wound up, if applicable  
Business partners are then able to confirm the company's identity, and get further details by inspecting the register if necessary.

Practical consequences:

- Others can find out about myself and the circumstances surrounding my business
- However, I can also find out about others, and before doing any business with future business partners I can obtain valuable information about them from the court keeping the register (what does the last balance sheet reveal, who is authorised to represent the company, etc.)
- Penalties are imposed for failing to publish the balance sheet and the profit and loss account.

Other provisions:

The Directive on Disclosure also governs the following:

- The validity of obligations which have been entered into:
  - whether such obligations arose before the company was officially entered in the register
  - the extent of the representatives' power to represent the business
- The invalidity (i.e. if mistakes have been made when incorporating the company such that the company has not in fact been set up) and its consequences

**1.2.3.2. Directive on Capital**

= 2<sup>nd</sup> Directive dated 13.12.1976

Applicable to:

**Stock corporations only**

Aim:

Harmonisation of incorporation procedure and fundamental issues relating to capital for stock corporations, for creating minimum equality to protect the company's shareholders and creditors.

Content:

- The nominal capital must amount to at least 25,000 Euro
- The deed of incorporation and the articles of association must be disclosed and contain at least the following details: amount of subscribed and approved capital, type and number of shares, object of the enterprise, registered headquarters, provisions on management institutions, etc.)
- Certain rules on maintaining capital so that creditors can be sure that a stock corporation has assets worth at least the sum of its nominal capital.
- Rules on increasing and decreasing capital

**1.2.3.3. Accounting Directive**

= 4<sup>th</sup> Directive dated 25.7.1978

### Whom does the Accounting Directive affect?

The Accounting Directive is applied to stock corporations, private limited companies, partnerships limited by shares, and to trading partnerships if the partner having unlimited liability is a company limited by shares (e.g. GmbH & Co KG).

### Aim of the Accounting Directive:

- What? The annual accounts for companies limited by shares in the various member states need to be comparable
- How? By applying common principles for drawing up balance sheets, and by prescribing a common lay-out for them
- Why? Persons inspecting balance sheets can thus more easily compare and assess annual accounts

### Regulations:

#### ➤ **Drawing up the annual accounts and the management report:**

Every company limited by shares has to draw up annual accounts and a management report. The annual accounts consist of three sections: balance sheet, profit and loss account, and appendix (see illustration). The balance sheet and the profit and loss account have to give certain particulars (see specimen balance sheet on p. 11), and there are minimum requirements for information given in the appendix (e.g. assessment methods used, number of subscribed shares, sum of obligations having a remaining term of over 5 years). The management report must also contain certain details at a minimum (e.g. information about how the company is expected to develop, such as in the field of research and development, etc.).

- **Assessment methods:** The principles relating to the assessment methods according to which a balance sheet is to be drawn up are as follows: caution (meaning e.g. taking into account foreseeable risks or losses), and continuity (manufacturing and procurement costs are generally used for assessing items)
- **Auditing:** The annual accounts and management report have to be checked by an independent qualified auditor<sup>7</sup> (see Directive on Auditors' Qualifications)
- **Disclosure:** The following has to be disclosed:
  - The annual accounts approved by the auditor (i.e. balance sheet, profit and loss account, appendix)
  - The management report approved by the auditor
  - The certificate of the auditor who has carried out the audit
  - A proposal for the appropriation of profits

### Simplifications for SME:

The member states may elect to introduce simplifications for SME:

**Small enterprises**

**Medium enterprises**

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<sup>7</sup> The member states may exempt small enterprises (but not medium enterprises) from submitting their annual accounts to an auditor (see Accounting Directive). However, the annual accounts must still be drawn up in accordance with the Directive (lay-out, assessment criteria, etc.).

Drafting the balance sheet	Shortened	
Disclosure of the balance sheet	Shortened	Shortened
Drafting the profit and loss account	Shortened	Shortened
Disclosure of the balance sheet	<b>Exempted</b>	
Drafting the appendix	Shortened	
Disclosure of the appendix	Shortened	Shortened
Audit	<b>Exempted</b>	
Disclosure of management report	<b>Exempted</b>	
Disclosure of auditor's report	<b>Exempted</b>	

Source: Günter Christian Schwarz, *Europäisches Gesellschaftsrecht – ein Handbuch für Wissenschaft und Praxis*, Baden-Baden 2000

When does a business count as an SME as defined in the Accounting Directive?

Other than in the EU's usual definition of SME, the following size criteria apply to businesses in the context of the simplifications of the Accounting Directive for SME:

	Small	Medium	Large
Balance sheet total	Up to 3.125 mill. Euro	Up to 12.5 mill. Euro	Over 12.5 mill. Euro
Net turnover	Up to 6.25 mill. Euro	Up to 25 mill. Euro	Over 25 mill. Euro
Employees	Up to 50	Up to 250	Over 250

Source: Günter Christian Schwarz, *Europäisches Gesellschaftsrecht – ein Handbuch für Wissenschaft und Praxis*, Baden-Baden 2000

The following must be taken into account here:

- A business is regarded as an SME if it meets at least two of the three given criteria during a period covering two or more consecutive financial years
- The balance sheet total is made up of the following: account form - items A-E on the assets side; report form - items A-E
- The net turnover is the proceeds from selling products or services typical for the company, minus value added tax [*Mehrwertsteuer*] and other taxes immediately relating to turnover
- When converting amounts into national currency, a difference of up to a maximum of 10% over the given amounts is allowed
- The size criteria for companies obliged to do accounting are reviewed and re-stipulated every five years. The next adjustment will be made in the year 2004.

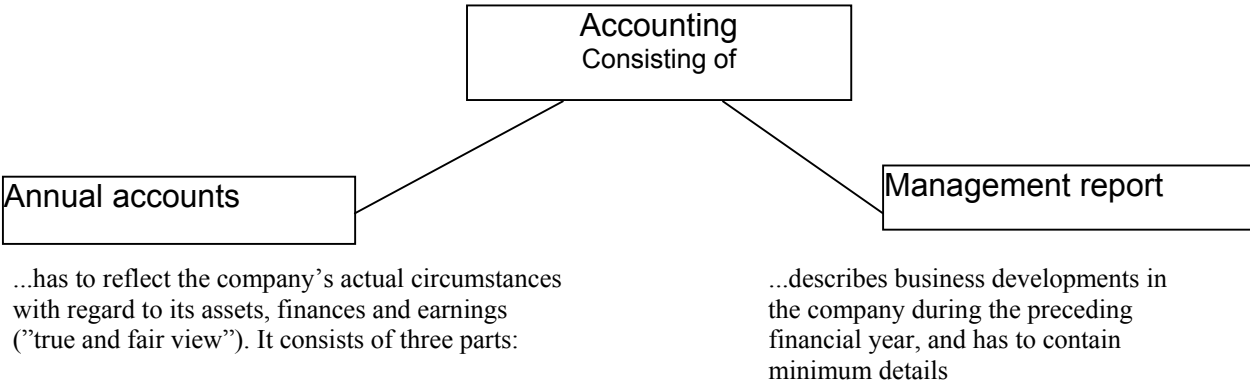
Summary:

With this Directive containing over 40 optional rights, no decisive harmonisation of the various accounting systems in the EU states has so far been brought about. The issues of

profits and equity in companies limited by shares in the various member states cannot yet be compared – it is difficult for anyone studying a balance sheet if they are not familiar with the national laws of the country concerned.

\* \* \* \* \*

Overview of the accounting records required under the Accounting Directive:



**Balance sheet**

- In account or in report form, depending on the member state
- Prescribed lay-out
- Member states may permit a shortened form for SME

**Profit and loss account**

- In account or in report form, depending on the member state
- Prescribed lay-out
- Member states may permit a shortened form for SME

**Appendix**

- Should explain the balance sheet and the profit and loss
- No prescribed lay-out
- Must contain certain minimum details
- Member states may permit a shortened form for SME

## Prescribed Balance Sheet Lay-Out for Companies Limited by Shares:

**Note:** In the balance sheet and in the profit and loss account, the respective figure for the preceding financial year must be given for each item. However, member states may prescribe that these figures have to be adjusted if the figures are not comparable (e.g. due to inflation).

Only the shortened balance sheet lay-out for small enterprises is given here (whether it is drawn up in account form or report form depends on the respective member state). The prescribed lay-out for medium and large companies limited by shares contains further categories, but the structure of the balance sheet remains the same.

### ***Shortened balance sheet for small enterprises: prescribed lay-out in account form***

Assets	Liabilities
A. Outstanding contributions towards subscribed capital	A. Equity I) Subscribed capital II) Premiums III) Reassessment provision IV) Reserves V) Result carried forward VI) Result for the financial year
B. Expenses for setting up and expanding the business	B. Accruals
C. Assets <b>I) Intangible assets</b> II) Fixed assets III) Financial assets	C. Obligations (also stating which obligations have a remaining term of up to 12 months, and which have a longer term)
D. Current assets I) Stocks II) Receivables (also stating the sum of receivables with a remaining term of over 12 months) III) Stocks IV) Credit balances at banks, post office giro accounts, cheques and cash on hand	D. Deferred items
E. Deferred items	E. Profits for the financial year
F. Losses for the financial year	

### ***Shortened balance sheet for small enterprises: prescribed lay-out in report form***

A. Outstanding contributions towards subscribed capital
B. Expenses for incorporating and expanding the business
C. Assets <b>I) Intangible assets</b> II) Fixed assets III) Financial assets
D. Current assets I) Stocks II) Receivables (also stating the sum of receivables with a remaining term of over 12 months) III) Stocks IV) Credit balances at banks, post office giro accounts, cheques and cash on hand
E. Deferred items
F. Obligations with a remaining term of up to 12 months
G. Current assets exceeding assets with a remaining term of up to 12 months
H. Total assets after deducting obligations with a remaining term of up to 12 months
I. Obligations with a remaining term of over 12 months
J. Accruals
K. Deferred items
L. Equity I) Subscribed capital II) Premiums III) Reassessment provision IV) Accruals V) Result carried forward VI) Result for the financial year

#### **1.2.3.4. Directive on Auditors' Qualifications**

= 8<sup>th</sup> Directive dated 10.4.1984

The Directive on Auditor's Qualifications establishes equal requirements throughout Europe for the qualifications of auditors checking the accounts of companies limited by shares (see Accounting Directive). Auditors must carry out each compulsory audit with due diligence. They may not carry out an audit unless they are independent! The names and addresses of all the individual auditors and auditing companies qualified to carry out compulsory audits must be made public.

#### **1.2.3.5. Directive on One-Man Corporations**

= 12<sup>th</sup> Directive dated 21.12.1989

Under this Directive, all the member states are obliged to permit the formation of companies by one person. This was not possible in all member states until the Directive was introduced. Now individual enterprises in the entire EU are able to set up one-man corporations with limited liability.

However, one-man private limited companies (and one-man stock corporations, in as far as member states permit these) are also subject to the Directive on Disclosure, i.e. they must be entered in the register and have the usual disclosure obligations. The remaining issues are dealt with in accordance with national law. This also applies to the provision of capital at the formation stage, so member states may demand minimum equity.

#### Problems:

Due to the optional rights which are left up to individual member states when implementing the Directive, "liability traps" may arise if anyone wants to set up a one-man private limited company and is not familiar with the respective national laws. Detailed consultation is thus advisable, particularly if the firm is to be set up abroad.

### **1.2.4. European Convention on Venue & Judicial Execution**

#### **1.2.4.1. Introduction**

- **The Convention regulates the following matters:**
  - With transactions abroad, when do courts in my home country have jurisdiction, and when do foreign courts have jurisdiction?
  - Are decisions taken by courts in my home country recognised abroad, and how can a writ of execution be enforced abroad?
- **Application:**
  - Only for civil and commercial matters
  - Not applicable to taxes and customs dues, administrative matters, bankruptcy or composition

**1.2.4.2. Which court has international jurisdiction in litigation?**

**On principle the following applies: The court having jurisdiction is that in the country party to the Convention on whose territory the company or legal entity being sued has its registered headquarters, or where the defendant is resident (notwithstanding the latter’s nationality).**

The location of the company’s registered headquarters is determined in accordance with the private international law of the respective country, whereby there are distinct differences in the interpretation of the law in the individual countries (theory of business location vs. theory of incorporation).

Exceptions:

In the following instances, the courts given have exclusive jurisdiction, notwithstanding the defendant’s place of residence:

Litigation involving:	Court having exclusive jurisdiction:
... Proprietary rights in buildings and property, or rent or lease of buildings and property:	Where the building or property is located (but there are special rules applying to rent/lease for private usage)
.... Validity of entries in public registers:	Where the register is kept
.... Registration or validity of patents, trademarks, designs and utility models:	Where the protected right is registered
.... Judicial execution:	Where judicial execution has to be levied

Special arrangements also apply to contractual performance (in the case of contracts in particular, manufacturers may be sued in a foreign country), to employment contracts, to insurance issues and consumer matters. In the latter, for instance, consumers may opt for the court either at their own place of residence or at the supplier’s business location.

Note:

Defendants should always check carefully whether the court before which the action is brought does in fact have jurisdiction<sup>8</sup>. If a defendant enters an appearance (i.e. sends the court a written answer to the complaint and makes pleas) and subsequently realises that there has been an error, it is usually too late – the court which really should not have jurisdiction usually automatically acquires jurisdiction once the defendant enters an appearance in the proceedings.

Apart from pointing out that the court may not have jurisdiction, a defendant should still comment on the case involved or enter a counterclaim as the case may be. The particular advantage of this is that later – if it turns out that the court does in fact have jurisdiction – the defendant’s pleadings cannot be termed a ”late submission” and excluded.

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<sup>8</sup> In this context, jurisdiction as regards matter and location as well as international jurisdiction has to be checked.

### 1.2.4.3. Recognition / Enforcement of Court Rulings Abroad

On principle the following applies: Court rulings issued in a state which is party to the Convention are recognised in other countries which are party to the Convention without any special procedure being required to this end. Similarly, rulings which are issued in a state that is party to the Convention and which may be enforced in that country will be enforced in another state that is party to the Convention, provided they are declared enforceable there in reply to an application from an interested party.

The plaintiff must therefore file an application in the other country first. The procedure is relatively quick, however, because an application of this kind may only be turned down for special reasons. In particular, it should be noted here that the matter itself is not checked, meaning that on principle rulings foreign to the law of the country involved (which for instance may be considered unjust under that country's legal system) can be acknowledged and enforced.

## 1.2.5. European Convention on Contracts

### 1.2.5.1. Introduction

In disputes it is important to know not only whether the home court or the foreign court has jurisdiction, but also which law applies. It can happen that litigation is conducted before a home court, but that the court has to apply foreign law in its judgement. The European Convention on Contracts lays down which national laws apply to obligations involving laws of various states.

Application is excluded in the following cases amongst others:

- Obligations based on bills of exchange, cheques, etc.
- Company law (e.g. formation of companies, liability matters)
- Insurance policies and agreements on venue (cf. p. 14/15).

### 1.2.5.2. Which law applies?

#### ➤ **Contracts between entrepreneurs:**

The parties to the contract are free to choose which national law governs the contract. This choice may be made expressly, or it may ensue from circumstance, e.g. regular trading activities. The choice can also be made at a later date, and a split choice is also possible.

If the parties to the contract fail to opt for a particular legal system, then the contract is governed by the law which applies at the place where the party having to render the performance stipulated in the contract has its branch of business, i.e. the law of the country of the seller<sup>9</sup> or of the party rendering services.

#### ➤ **Consumer contracts:**

Contracts which a business concludes with individual consumers are governed by Art. 5 of the European Convention on Contracts. This affords consumers relatively good

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<sup>9</sup> When purchasing goods, another international convention may be involved, namely the UN Convention Relating to a Uniform Law on the International Sale of Goods.

protection. Generally, the governing law is that of the country where the consumer is resident (an exception is only made in respect of services exclusively rendered in another country – e.g. if a customer crosses a border to go to the hairdresser).

➤ **Employment contracts:**

Choosing between legal systems is not allowed to result in workers losing certain rights (cf. Art. 6 of European Convention on Contracts).

### **1.3. Outlook: New Regulations being Drafted**

#### **1.3.1. European Private Companies**

It is agreed that there needs to be a corporate structure available to SME throughout the EU which caters to their requirements. The European Private Company is intended to be a kind of "Euro plc" which can freely choose its location, transfer its place of business without difficulty, and make relatively unrestricted arrangements in terms of organisation and management. A draft regulation was introduced in September 1998.

#### **1.3.2. European Stock Corporation (*Societas Europaea* - SE)**

The European Parliament is currently debating proposals for the introduction of a European Stock Corporation (*Societas Europaea* - SE). An SE gives companies operating in several member states the possibility of choosing a business constitution in accordance with Community law, meaning that they can operate throughout the EU pursuant to uniform rules, with one and the same management, and using a single reporting system, instead of having to set up subsidiaries in each member state which are then subject to the provisions applying there. An SE as a legal structure thus offers businesses operating on the internal market prospects of lower administrative costs.

In addition to the Directive on Workers' Status in an SE, the formation of an SE calls for negotiations on workers' co-determination rights. If no arrangement is reached to which all sides agree, the standard rules given in the appendix to the Directive apply. These rules stipulate that the management of an SE is obliged in particular to report at regular intervals on business matters, and to inform and consult the workers' representatives on the basis of such reports.

These two legal instruments will probably be issued at the beginning of 2001 and come into force in 2004.

#### **1.3.3. European Co-Operative**

The introduction of a European Co-Operative is also being planned, designed to promote the economic interests of its members, whether they be craftsmen, farmers, traders, consumers or employees. The liability of a co-operative's members is to be restricted to their capital shares unless otherwise provided by the statutes.

### **1.4. Effect on SME**

In view of the fundamental right to freedom of establishment guaranteed within the EU, businesses in applicant countries have the prospect of completely new possibilities being opened up to them on accession. However, they must also expect more foreign businesses to establish themselves in their own country, thus increasing competition.

Depending on the member country, some changes in company law and in the law on one-man corporations may result. On top of this, certain obligations on disclosure and an obligation to register will apply to all incorporated firms. The Accounting Directive brings about greater transparency in the accounting/annual accounts of companies limited by shares. In future, annual accounts will have to be drawn up in accordance with specific principles, which might call for some reorganisation in accounting and for a new approach in the way balance sheets and profit and loss accounts are drafted, so that they comply with the standards and accounting models in force throughout the EU.

## **1.5. Adjustment Strategies**

### **1.5.1. Risks & Opportunities of Freedom of Establishment**

For businesses, freedom of establishment opens up new opportunities on new markets. Firms wanting to sell products abroad or already doing so can attempt even now (e.g. by forming an EEIG) to build up business partnerships across frontiers and improve their market potential by using joint sales offices or joint marketing strategies, or they can use their partner's existing marketing set-up and know-how.

On the other hand, the tougher competition to which businesses will be exposed after the frontiers have been opened calls for new marketing strategies. So as to be able to hold their ground in the face of new firms pushing into the home market, entrepreneurs need to make the customer the focal point of all their considerations: only if customers appreciate the company's performance and only if there is sufficient demand will the company be able to survive on the market. Entrepreneurs therefore need to specifically define their target groups.

- Do I want to work for commercial customers (industry, craftsmen, the public sector)?
- Do I want to work for private customers (young or old, trend-conscious or conservative)?
- Which income group do I want to attract?
- What are the prices in my sector?
- How many potential customers do I have?

In addition, entrepreneurs need to ask themselves the following questions:

- Am I at the right location? (transport situation for customers/suppliers)
- How can I appeal to specific potential customers in advertising, and what forms of advertising can I use?
- How can I keep regular customers? Satisfied customers are the best advertisement for a firm, apart from which keeping old customers is easier and cheaper than obtaining new ones.
- Where are my competitors, and what are their strengths and weaknesses?
- What is my competitors' price policy, and what advertising measures do they use?
- How can I distinguish myself from them?
- Are there any market niches which nobody has moved into yet?

### **1.5.2. Choice of Legal Structure**

The implementation of European company law will have various effects in the various countries, above all on laws for incorporated firms. When choosing the right legal structure for a business, however, the following aspects in general need taking into account:

- Is a one-man company or a partnership more suited to my business?
- Are there any licensing conditions (e.g. for craftsmen's businesses)?
- Liability/distribution of risk within the partnership
- How is the management organised?
- Financing of the partnership (e.g. is there minimum nominal capital?)
- Transparency and practicality
- Tax aspects

### **1.5.3. Accounting Requirements**

For incorporated firms in the EU, accounting (annual accounts and management report) has to be done in accordance with specific criteria and using a specific lay-out. Businesses need to make themselves familiar in good time with the relevant rules applying here, which may vary from one member state to another. The following applies in all cases:

- All business transactions must be entered immediately, completely and accurately
- There must be a written record for each entry
- Cash movements must be recorded daily in the cash ledger
- At the end of the financial year, proper stock-taking must be done

However, not only incorporated firms are recommended to ensure proper accounting and balance sheets. Partnerships and one-man companies should be in the habit of doing this, too. Good accounting is always a sound basis for making calculations, and it can be used for answering the following questions:

- Economising: how much is possible in what areas?
- Cost analysis: which of my costs are way above average and why?
- What is the profit and loss for my specific services and products?
- What is my lowest price limit?

Proper accounting in turn enables the drafting of a meaningful balance sheet, the purpose of which includes the following:

- It serves as a basis for negotiations with banks, i.e. for obtaining capital
- It serves as a basis for talks with potential business partners and investors
- From inspecting the balance sheet, an expert can detect and analyse a firm's weaknesses and potential
- It serves as a basis for realistically planning the following financial year and the capital requirements

## 1.6. Checklist for Businesses

- Do I know which national register I need to apply to for information about other companies (e.g. if I want to inspect a potential business partner's most recent balance sheet, or know who is authorised to run the business)?
- If I want to offer my products and services across the border: have I got partners abroad with whom I could e.g. establish a joint sales set-up? Is it worth forming an EEIG?
- Am I familiar with the principles of proper accounting?
- Am I aware of the relevant rules on drafting annual accounts (prescribed lay-out for the balance sheet and the profit and loss account, assessment criteria, etc.)?\*
- Have I got a reliable auditor qualified to audit my accounts every year?\*
- Do I submit my annual accounts to the commercial register each year?\*
- Have I told the commercial register all the main particulars relating to my business?
- Is the following given on my business stationery\*: the commercial register where my business is registered, the number of the entry there, and the legal structure and location of the business?

\* only applies to stock corporations (AG), private limited companies (GmbH), partnerships limited by shares (KG auf Aktien) and to trading partnerships if the partner having unlimited liability is a company limited by shares

## 2. Antitrust Law

### 2.1. Background

It is the aim of fair trading policy in the EU to maintain a high degree of competition in the internal market. For consumers, this policy makes itself apparent in lower prices, a broader selection of products, and technical innovations. So as to avoid distortion of competition in the internal market, there is a need to supervise the conduct of businesses and of the individual states as regards their conformity with EU antitrust laws.

Antitrust policy aims to achieve the following:

- prevent the monopolisation of specific markets
- prevent businesses from conspiring to divide the market amongst themselves
- prevent one or more companies from abusing their economic strength over weaker companies (abuse of a dominant position)
- prevent the governments of member states from breaking the rules by discriminating in favour of public corporations or by assisting private companies (state subsidies)

However, EU antitrust law only concentrates on competitive restrictions designed to restrict trade amongst member states. Restrictions on competition which are only effective within a single member state are therefore always assessed in accordance with national antitrust legislation.

### 2.2. Existing European Rules & Regulations

#### 2.2.1. Ban on Cartels

##### 2.2.1.1. Art. 81 of the Treaty of Rome<sup>10</sup>, and its Application

According to Article 81, Paragraph 1 of the Treaty of Rome, there is a prohibition on all agreements between companies and on all concerted actions which "may impair trade between member states, and which are designed to or effectively prevent, restrict or distort competition within the Common Market."

This ban applies both to horizontal agreements (with all entrepreneurs deemed to be at the same stage of the economic process) and to vertical agreements (where the businesses concerned operate at various stages of the economic and trading process, and are not in competition with each other).

**Legal consequences of infringements:** Such agreements are null and void. The Commission may oblige the firms concerned to cease their antitrust violations and to refrain from further infringements, and may impose fines.

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<sup>10</sup> Treaty founding the European Community, as amended on October 2, 1997 (Treaty of Amsterdam).

Four criteria must be met if Art. 81 is to apply (see illustration):

**1. Inadmissible agreements between companies:** e.g. fixing buying and selling prices, dividing up the market, agreements on production quantities, etc. This applies to all areas of business: cartels are possible in relation to goods, services and capital.

*E.g. By reaching monthly agreements on production quantities and minimum prices, fifteen manufacturers of polypropylene plastic managed to keep the kilo price stable in spite of new manufacturers coming on to the market. The Commission regarded this as a violation of Art. 81 of the Treaty of Rome and imposed fines.*

*Companies A and B agree amongst themselves to split up a regional area and each promises not to do any business in the other company's territory. This reduces competition, and extra profits are made at the customers' expense.*

*Several companies reach a verbal agreement as to which of them should submit the cheapest offer in reply to a public invitation to tender. This undermines the aim of public invitations to tender, which is to objectively determine the most favourable offer in order to economise on tax money.*

Not only are specific agreements prohibited – there is also a ban on "concerted actions" (i.e. if companies use joint information or arrangements to co-ordinate their conduct in such a manner that the risks of competition are excluded, thus creating market conditions for consumers which are no longer compatible with fair trading).

## **2. Relevance to the internal market:**

The agreement is relevant to the internal market

- If it is suited to impair trade amongst member states (i.e. cartel agreements which "only" affect trade within a member state are covered by national antitrust laws, not by EU antitrust legislation).
- If there is noticeable impairment: in this case, the total turnover of the companies involved must be in excess of 300 mill. Euro.

## **3. Anti-competitive effect:**

Whether or not a company agreement has an anti-competitive effect depends on which market share is held by the companies involved. However, it is difficult to ascertain a market share: both the market in *geographical terms* (one member state or several member states) and the market in *material terms* (from the consumer's point of view, which products are identical or equivalent to the products of the company concerned) may be relevant. Generally a market share of 5% is taken as the threshold value, provided the agreement is reached between companies at the same manufacturing or trading level (horizontal agreement), or 10% if the agreement is reached between companies at different stages in the economic process (vertical agreement).

The following measures definitely have a restrictive effect on competition: bans on exports, bans on imports, bans on resale, territorial guarantees, terms of sale laid down by an organisation with a strong market position – i.e. unless they are covered by an exemption ruling issued by the Commission (see next chapter), **SME need not tolerate such terms!**

#### **4. Possibility of exemption:**

Agreements which restrict competition may be tolerated in individual or special cases (group exemption), provided they

- Let consumers share in the ensuing profits
- Improve the manufacture or distribution of the goods
- Promote technical or economic progress

Individual exemptions are given in rulings issued by the Commission, group exemptions are granted in decrees likewise issued by the Commission. Group exemptions have been given e.g. for certain types of franchise agreements, sole distribution agreements, and exclusive procurement contracts. If companies are unsure as to whether a planned agreement violates the ban on cartels, they can apply to the Commission for negative clearance before reaching the agreement. Provided it does not think the planned agreement poses any risks, the Commission will grant negative clearance stating that the conduct of the companies concerned will not be an infringement of Art. 81 of the Treaty of Rome. However, negative clearance does not have the status of an exemption, i.e. if circumstances alter, Art. 81 of the Treaty of Rome may be violated.

#### **2.2.1.2. Special arrangements for SME**

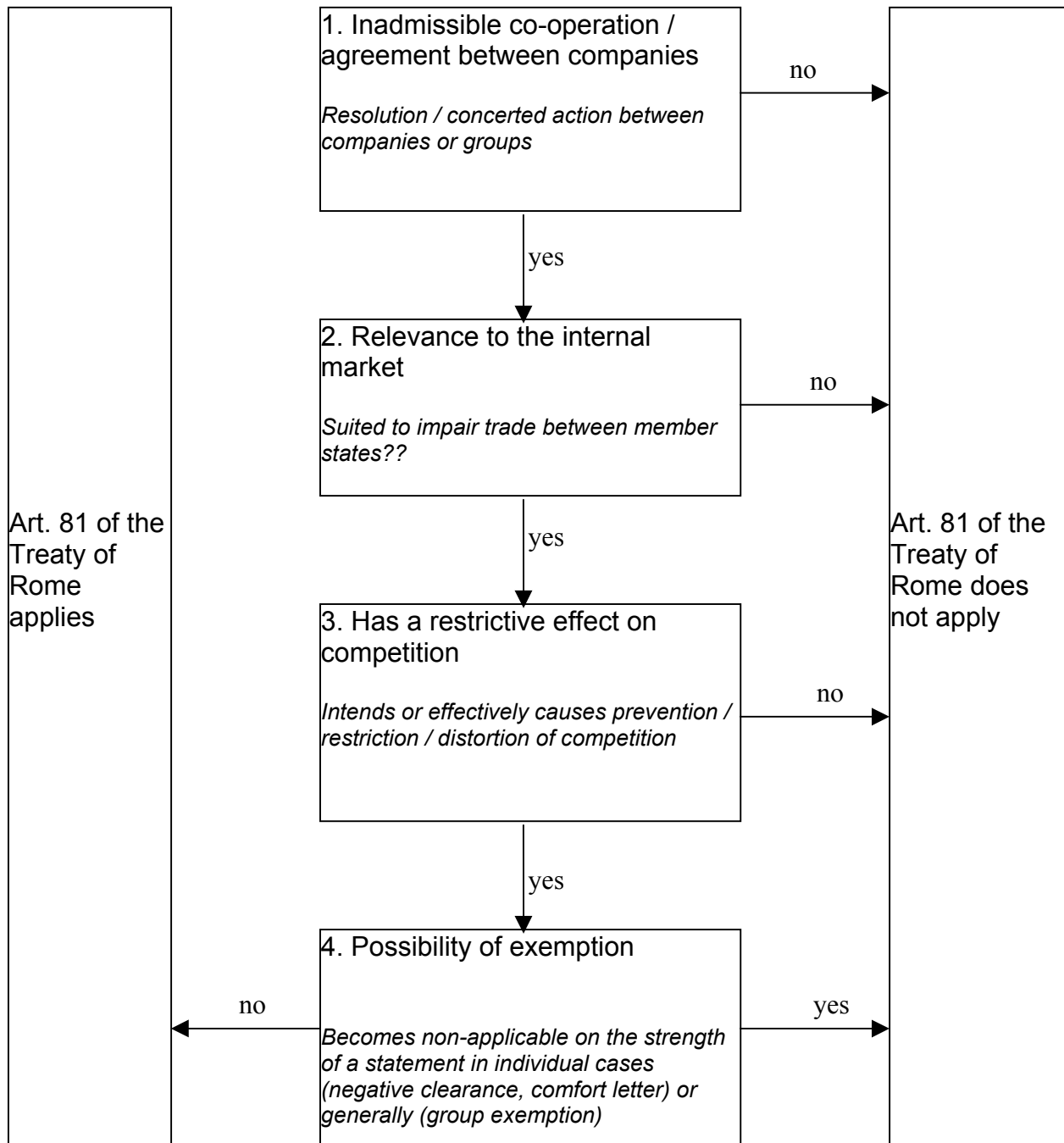
Agreements between small and medium enterprises are not usually such as will noticeably impair trade between member states or competition within the Common Market. The Commission therefore stated in a notice<sup>11</sup> dated 9.12.1997 that agreements between SME are not as a rule subject to the ban under Art. 81 (1). Thus the Commission will only institute proceedings against such an agreement in exceptional cases (if it sees a genuine threat to competition), in particular

- a) if the agreement poses a substantial obstacle to competition on a substantial part of the relevant market
- b) if competition on the relevant market is restricted by the cumulative effects of parallel networks of similar agreements set up by several manufacturers or traders.

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<sup>11</sup> "Notification of minor agreements not covered by Art. 85 (1) of the Treaty of Rome", issued by the Commission on 9.12.1997

## Art. 81 of the Treaty of Rome, and its Application



Source: Wolfgang Kilian, *Europäisches Wirtschaftsrecht: EG-Wirtschaftsrecht und Bezüge zum deutschen Recht*, Munich 1996

## 2.2.2. Ban on Abuse of a Dominant Market Position

Art. 82 of the Treaty of Rome prohibits improper exploitation of a dominant market position if this impairs trade between member states. If a company has a market share of 50% or more, then it is assumed that it has a dominant market position. The market relevant in each case is determined in accordance with material and geographical criteria (see above). If by its conduct the company can influence the structure of the market, which is already weakened due to the company's dominant position, then this is deemed abuse. However, only the abuse of a dominant market position is prohibited, not its creation in the first place.

*E.g. The company UBC has a dominant market position in the Benelux countries and in the FRG with its banana brand "Chiquita". It charged its customers various prices for the same deliveries without any objective reason for doing so. On principle a supplier may determine prices at its own discretion – normally, customers who are charged higher prices can then resort to a competitive product. However, due to UBC's dominant position on the market, its customers were unable to do this. Since there was no sound objective reason for UBC's charging different prices, this constituted abuse of its dominant market position.*

The following examples of cross-border obstacles or exploitation are regarded as abuse:

- Laying down unreasonable terms of business
- Creating artificial shortages of goods and services
- Discrimination of trading partners

There are no exceptions (neither individual exemptions nor group exemptions), but negative clearance may be granted. Legal consequences: as for ban on cartels.

## 2.2.3. EU Merger Control

Companies may merge to increase their competitiveness, but the bigger these companies are, the greater the risk that the merger will create an enterprise which has such a strong position on the market that competition is distorted. Mergers are therefore controlled by the Commission. The amount above which it is assumed that a merger is of significance to the EU as a whole is an overall turnover of all the companies involved of 5 thousand million Euro. SME are not therefore affected by EU merger control.

## 2.2.4. Advertising Rules

The following are prohibited:

- Discriminatory or excessively tight restrictions on foreign products' access to the internal market
- Incorrect advertising messages (this is to protect consumers)
- Rules which prescribe or prohibit certain advertising strategies for foreign companies
- Rules which prohibit advertising although it is correct in terms of content, thus creating an obstacle to trade
- Rules which prohibit advertising for certain goods or certain places (but there are exceptions made here)

## 2.2.5. Control of State Subsidies

Art. 87 of the Treaty of Rome prohibits state subsidies which may distort competition throughout the EU. Such distortion may result because the subsidised goods have better market opportunities due to their being offered more cheaply. Subsidies as defined in Art. 87 of the Treaty of Rome are not only grants but also advantages of monetary value, such as tax exemptions or loans on particularly favourable terms.

There is an extensive list of exceptions for subsidies which are permitted for social or regional reasons, or in order to promote structure. However, subsidies above a certain amount have to be published by the Commission before they may be distributed to the recipients. There have been cases where the Commission has demanded repayment of unapproved subsidies from the enterprises concerned.

## 2.2.6. Intellectual Property

### 2.2.6.1. Patent Law

So far, patent legislation in the individual member states has not yet been harmonised, but the European Patent Convention (EPC)<sup>12</sup> has derived and created a European patent. When a patent application is filed with the European Patent Office in Munich<sup>13</sup>, uniform national patents are created throughout the EU (whereby the applicant may choose in which member states the patent is to take effect). The procedure for granting patents lasts 44 months on average, but under certain conditions applications can be made for an acceleration of the procedure at no extra cost. The term of a European patent is 20 years as from the date of filing the application.

The protection afforded by European patent applications and patents can be extended to the following countries: Albania, Lithuania, Latvia, the former Yugoslav republic of Macedonia, Romania, Slovenia.

Eight countries in Central and Eastern Europe have so far applied to sign the European Patent Convention. These countries – Poland, the Czech Republic, Hungary, Estonia, Slovakia, Slovenia, Romania and Bulgaria – may effectively sign as from July 1, 2002.

### 2.2.6.2. Trademark Law

#### ➤ Introduction of an EU Trademark:

Holders of EU trademarks may market their products throughout the EU, applying uniform rules on protection. An EU trademark may be acquired for all marks which can be depicted, including colour combinations, three-dimensional designs, written and acoustic symbols (e.g. music). An EU trademark has to be registered with the "Internal Market Harmonisation Office (Trademarks, Registered Designs and Utility

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<sup>12</sup> Apart from the EU member states, the EES countries (Norway, Liechtenstein and Iceland) have also signed the European Patent Convention.

<sup>13</sup> The "inventive step" (peculiar to German patent law) has to be taken into account here. A European patent can only be granted if the invention really is new, i.e. if it is not background art, and if in an expert's view it is not an obvious outcome of the state of the art. Further details on application procedure can be obtained under <http://www.european-patent-office.org/index.htm>

Models)” in Alicante, Spain. Provided it does not conflict with a trademark which has already been registered or is actually in use in an EU member state, it is registered and thus becomes valid.

➤ **Harmonisation of the member states’ national trademark laws:**

In 1988 the EU Directive on Harmonising Trademark Law was passed. It gives trademark owners an exclusive right to approve or decline use of their trademarks by third parties, and they are entitled to charge a license fee. However, if the trademark is not put to serious use within 5 years of its registration, then the trademark is declared expired. The same applies if the trademark is misleading, offensive or confusing.

### **2.2.6.3. Copyright Law**

The Microchip Directive issued in 1986 affords microchips 10 years protection against piracy. The Software Directive issued in 1991 protects computer programmes, which are frequently copied because they are worth a lot in economic terms.

In a Directive issued in 1996, copyright protection was extended to cover electronic databases, with both the investment and the content of the database being protected.

## **2.3. Outlook: New rules being drafted**

A proposal for a new regulation was put forward in September 2000, aiming to replace the old system dating back to 1962 which stated that agreements restricting competition may only be approved by the Commission. Under the new regulation, government authorities and courts in the individual member states as well as the Commission may apply the full scope of Art. 81 of the Treaty of Rome. A decision to this effect has become necessary particularly in view of the enlargement of the EU, because a single instance on its own – the Commission – can no longer guarantee compliance with EU law. The Commission’s proposal thus aims to further involve the antitrust authorities and courts in the individual countries. State subsidies and merger control will remain unaffected.

In the field of patent law, the Commission has submitted a proposal for the creation of an EU patent. Currently, SME in the EU can opt when filing patent applications between their national offices and the European Patent Office in Munich. In the latter case, the patent application can be dealt with in three official languages – German, English or French –, but the national registration does not take place until the application has been translated into the language of the respective country. The Commission proposes restricting the language set-up for EU patents to the existing three official languages. EU patents will also be registered at the European Patent Office.

In addition, there are directives being drafted for laws on registered designs and utility models<sup>14</sup>, and for protective legislation in information society.

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<sup>14</sup> The law on utility models is also an absolute right which protects technical inventions. However, a utility model affords less reliability in terms of the law than a patent, and can thus be granted more quickly and cheaply than a patent.

## **2.4. Effect on SME**

European antitrust law rarely directly affects SME (because it is aimed at companies of other dimensions), but it does have an indirect effect in that it affords SME protection. It safeguards competition, ensures that weaker companies cannot be exploited by stronger ones, and tries to prevent unfair trading practices. SME could come into conflict with EU antitrust laws if they have a dominant market position (e.g. if they are the only supplier in their territory), if this dominance extends beyond their own country, and if they take unfair advantage of this.

## **2.5. Adjustment Strategies**

Under EU antitrust laws, SME can easily conclude far-reaching, cross-frontier co-operation agreements without being charged with inadmissibly forming a cartel, because the Commission essentially has a positive attitude towards such co-operation (see Ch. 2.2.1.2). However, as soon as the co-operation no longer crosses borders, i.e. as soon as the agreements are only effective on the home market, the national antitrust laws of the respective country apply.

As far as the improper exploitation of a dominant market position is concerned, it should be remembered that SME can easily have a dominant market position (e.g. if they have specialised in a certain area and there are no other suppliers on this market). In this case they must take care not to overcross the mark and start exploiting this position (i.e. they must not lay down unreasonable terms of business, or discriminate against trading partners, etc.) – but there again, this only applies if trade between member states is involved (as long as the dominant market position remains restricted to one member country, attempts at abuse are subject to national antitrust laws.)

In the field of trademark and patent law, SME in Central and Eastern Europe will have the following opportunities after accession:

- Registering trademarks as EU trademarks, which will allow them to market their products throughout the EU with uniform protective legislation applying
- Filing patents with the European Patent Office and thus extending protective rights to all the EU member states plus Norway, Liechtenstein and Iceland (provided the same patent does not already exist in the EU) – this will be possible as from the date of signing the European Patent Convention, which may be prior to accession to the EU.

## **2.6. Checklist for Businesses**

- Only in special cases: Has my business got a dominant market position (i.e. a market share of 50% or more), and do I exploit this position to such an extent that cross-frontier trade is affected? If so, there may be a conflict with EU antitrust legislation.
- Do I want to have my patents protected throughout Europe or at least in certain EU countries by applying to the European Patent Office? (only possible once countries from Central and Eastern Europe have signed the European Patent Convention)
- Do I want to have my trademark registered as an EU trademark after accession?

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<http://europa.eu.int/eur-lex/de/lif/index.html>

#### **Note:**

This guide has been drawn up to the best of our knowledge.

No guarantee can be given as to its completeness or accuracy.