Chicago Journal of International Law

Volume 5 | Number 2 Article 16

1-1-2005

Issues in Transactions within Groups of Companies: A Greek and European Law Perspective

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Issues in Transactions within Groups of Companies: A Greek and European Law Perspective

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The meaning of the terms "group of companies" and "affiliated companies"[1] is not defined by Greek law in a uniform way, but by a variety of provisions that serve different purposes. There are several regulatory frameworks in which one can find a definition of the notion "groups of companies," such as consolidated accounts and transfer pricing.[2] Business transactions may result in the creation of several types of groups of companies; this leads to the development of a uniform language among practitioners and law specialists. The creation of the groups can stem from a merger, a takeover, or a deliberate segmentation of a company into parts whose business is carried on by separate organizational (management) and legal entities.[3]

The common characteristic of all provisions related to companies limited by shares is the strengthening and completion of the legal provisions in force, by virtue of which the legislator opts to provide protection to several groups of persons (stakeholders).[4] They include (a) the persons who do business with

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1 Greek law uses both terms. The existence of the two terms derives from the original German Company Law, which served as a model for Greek legislators. Nikolaos D. Tellis, *Ennoia tis Epichirisis stis Diataxeis Peri Syndedemenon Epichiriseon*, 45 Epitheorisi Tou Emporikou Dikaiou 319–20 n 3 (1994).

2 The basic characteristic of groups of companies is that the management of the companies is coordinated in such a way that they are managed on a central and unified basis by the dominant company to serve the interests of the group as a whole. See Dimitrios Avgitidis, *Omiloi Epichiriseon* 33–38 (Sakkoulas 1992).

3 Nikolaos K. Rokas, *Emporikes Etereies* 388–89 (Sakkoulas 4th ed 1997).

4 *Pflicht Zur Aufstellung Eines Abhängingkeitsberichts Nach Abgeschlossener Rechnungslegung—VW-AG*, 28 Neue Juristische Wochenschrift 1855 (1997) (reporting BGH decision of Mar 17, 1997); see also Bernhard Grossfeld, *Zur Stellung des Kleinaktionärs im Wirtschaftssystem*, 30 Die Aktiengesellschaft 1 (Jan 1985).

companies, especially creditors; (b) employees; and (c) shareholders. Regulation of transactions between companies belonging to the same group also achieves, or hopes to achieve, a significant reduction in income tax avoidance. Traditional legislation has proved inadequate to treat effectively problems arising from transactions that take place within groups of companies.

Before addressing traditional Greek legislation and recent European Union ("EU") directives regulating groups of companies, it will be helpful to define such groups more precisely. An acceptable identifying characteristic of groups of companies could be that a company is in a position to control the administration and management of one or more other companies, with which it comprises a group. A group may exist on either a permanent or temporary basis, even by virtue of a single transaction, especially if the control results in a detriment to the other members of the group. This situation amounts to a relation of dependence of the latter companies on the controlling one. This phenomenon occurs either when one company controls another directly or indirectly through a parent-subsidiary relationship, or when companies of equal standing are run under the same administration, in which case there is also a relation of dependence. However, dependence in the sense of the de facto ability to control a different company's administration on a permanent or temporary basis does not always presuppose the existence of a group of companies, since dependence is a broader term than the term group of companies. As a result, it is imperative to monitor transactions within groups of companies wherever there is a relation of dependence, without focusing on whether we stand before a financial conglomerate or not.

A traditional subject matter falling under the general heading of our Article is related to the Greek and European legislators' reaction towards the negative consequences and unfair practices in which intragroup transactions may result. Such transactions may result in detriment to shareholders, employees, and creditors, as well as of the state's interests regarding taxation policies. Currently, these considerations are not fully addressed by the traditional legal regime in Greece; as a result, discussion is still in progress.

At an EU level, the recent legislative initiatives—in particular Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings, and investment firms in a financial conglomerate—seek to introduce specific prudential legislation for financial conglomerates. These directives also take the first steps to align the legislation on the European level with national laws concerning financial groups and financial conglomerates in the same sector, thus ensuring a minimum level of equal treatment of these groups throughout the European Union. The main objective, however, of the new EU regime is to ensure that separate state regulators—who typically focus on one sector in order to ensure capital adequacy of the entities under their supervision—are not hindered because of the existence of cross-sector financial conglomerates. This requires specific measures which will prevent situations, for example, where capital is used at the same time as a buffer against risk in two or more entities belonging in the same financial conglomerate ("multiple gearing") and situations where a parent company issues debt and directs the proceeds as equity to its regulated subsidiaries ("excessive leverage").[4]

I. THE COMMON JOINT STOCK PERSPECTIVE IN GREEK LAW

"Groups of companies" and "affiliated companies" are used by the law in a similar way, but their meaning does not coincide. Greek legislation currently does not have special provisions about affiliated companies. Law 2190/1920 on joint stock companies contains some provisions about the annual financial reporting and therefore refers indirectly to affiliated companies.

According to the above law on joint stock companies,[5] "affiliated companies" are:

(a) Companies of which one is the parent company and the other one is a subsidiary of it. The relationship of the parent company to a subsidiary exists when a parent company (aa) holds the majority of the share capital [group A] or of the voting rights of the subsidiary [group B], even if this majority is calculated after taking into account titles and rights that third persons hold on behalf of the company,[6] (bb) controls the majority of the voting rights of a subsidiary company by virtue of an agreement with other shareholders or members of the company [group C],[7] (cc) holds a participation in the share capital of a third company and has the right, directly or through third parties, to appoint or terminate the majority of the members of the company's administration [group D], (dd) holds at least a 20 percent share of the capital or of the voting rights of the other company and exercises a dominant influence upon a (subsidiary) company [groups E and F respectively].

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4 Proposal for a Directive of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and the Council, 2001 OJ (C 213 E) 227, available online at <http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/ce213/ce21320010731en02270244.pdf> (visited Nov 13, 2004).

5 See generally the Greek Institutional Law on Corporations, Codified Law No 2190/1920/A37, art 42e, as amended.

6 Leonidas N. Georgakopoulos, *Egchiridio Emporikou Dikaiou* 365 (Sakkoulas 2d ed 2002).

7 Konstantinos G. Pampoukes, *Entaxi Anonymis Etairias Se Omilo Polyethniko* 21 (Sakkoulas 1989).

(b) Every single one of the aforementioned—under category (a)—affiliated companies with every single one of their subsidiaries, as well as with the subsidiaries of the subsidiaries of these affiliated companies, as well as every company of category (a) with every one of category (b), regardless of whether each one of these subsidiary companies participates or not in the share capital of each other [group G].

(c) Every single one of the aforementioned—under (a)—affiliated companies with every other company that runs under the same administration by virtue of an agreement[8] [group H] or by virtue of a provision of their memorandum of association [group I].

(d) Companies, whose managerial, accounting or supervisory bodies, consist of the same persons [group J].[9]

The cases under category (a) constitute the so-called vertical groups of companies. In groups B–G there is always a subsidiary company that is dependent on a parent company. A group of category (b) consists of companies which are connected either directly as parent-subsidiary or indirectly as subsidiaries of the same parent company. The cases of category (b) constitute the so-called "multistage group." This means that two or more companies form a group with a relation of parent company to a subsidiary ("common vertical group") and their subsidiaries, as well as the subsidiaries of their subsidiaries also form a group ("multistage group").

In addition, categories (c) and (d) can be equally considered as vertical or multistage groups, but there is no link of dependence from a parent company (which marks vertical groups); there is only a relation of dependence on an equal or mutual basis. These constitute "mixed groups," for one of the members of a vertical group is connected horizontally with one or more other companies.

II. Legal Implications of Vertical Groups (Parent Company-Subsidiaries) under Greek Law

The terms "parent company" and "subsidiary" were introduced into Greek law by implementing EU Directive 1983/349 on Capital Companies.[10] Before the promulgation of this law, there were no requirements for the preparation of

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8 Hans-Joachim Gutjahr, *Der Begriff der Zusammenfassung unter einheitlicher Leitung im Konzerngesellschaftsrecht* 35 (unpublished PhD dissertation, Universität Hamburg) (1972) (on file with author).

9 Law No 2190/1920, art 42e(5) (Green).

10 Council Directive 83/349, 1983 OJ (L 193) 1, available online at <http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=31983L0349> (visited Nov 13, 2004).

consolidated accounts for such companies. The Directive aimed at the harmonization of national legislations of EU member States regarding the conditions according to which companies should submit consolidated accounts. In fact, the phenomenon of affiliated companies is still only partially dealt with by Greek law. Thus, the Greek Law 2190/1920 on joint stock companies provides only that financial reports and consolidated accounts with information about claims, obligations, and shares in affiliated companies must be published, in order to reveal the true picture of the group's activities and financial standing.[11]

Furthermore, several additional provisions reflect the legislators' mistrust towards vertical groups. Companies are prohibited from accepting the shares of a subsidiary company as a pledge to secure loans or other claims granted. Moreover, a subsidiary company is not entitled to invest even a part of its share capital in shares of its parent company. Several restrictions apply on a subsidiary company's capacity to provide loans, credit agreements and guarantees to a category of persons closely related to the parent company. As a result, the subsidiary is not allowed to grant loans, credit, or guarantees in favor of the founders of the parent company, members of its Board of Directors, its general managers, or managers, their close relatives, or third parties who intend to acquire shares of the company. These contracts, if entered into by a subsidiary, are null and void. Moreover, contracts of a noncredit character are subject to a specific and prior authorization of the shareholders' general meeting. The resolution of the general meeting approving such transactions must specify the type of contract to be concluded as well as its terms.

III. THE SPECIAL CASES: INSURANCE GROUPS, CREDIT INSTITUTIONS, INTRAGROUP TRANSACTIONS

A. ADDITIONAL SUPERVISION OVER INSURANCE GROUPS (EU DIRECTIVE 1998/78)

EU Directives place particular emphasis on the regulation of business transactions involving insurance companies. In this respect, Directive 1998/78 is particularly important, since it concerns the "supplementary supervision of insurance undertakings in an insurance group."[12] The operations falling under additional supervision are the transactions between an insurance undertaking and "(i) a related undertaking of the insurance undertaking; (ii) a participating

[11] Law No 2190/1920, art 42a (Greece).

[12] Council Directive 98/78, 1998 OJ (L 330) 1, available online at <http://europa.eu.int/eur-lex/pri/en/oj/dat/1998/l_330/l_33019981205en00010012.pdf> (visited Nov 13, 2004).

undertaking in the insurance undertaking; (iii) a related undertaking of a participating undertaking in the insurance undertaking."[13] It also regulates transactions between "an insurance undertaking and a natural person who holds a participation in (i) the insurance undertaking or any of its related undertakings; (ii) a participating undertaking in the insurance undertaking; (iii) a related undertaking of a participating undertaking in the insurance undertaking."[14]

Supervision on insurance groups under Directive 1998/78 is a form of additional oversight, supplementary to the existing State supervision system concerning insurance undertakings. It focuses on their financial activity regarding loans, guarantees, investments, reinsurance contracts, the assets that form their solvency margin, technical reserves, and transactions that are not indicated in financial reports. Insurance companies are mandated to maintain adequate procedures and mechanisms for risk management and internal audits, such as the publication of accounts and notification to the competent authorities of their major transactions.[15] These requirements are important, since intrainsurance group transactions may jeopardize the reserves that insurance companies need to maintain in compliance with Greek and EU legislation, thus putting the interests of shareholders and policy holders at risk. This explains the requirement of insurance companies that belong to an insurance group to submit an annual report containing all transactions in which they engaged.[16] Further, the Superintendent of Insurance may require that additional reserves be formed.[17] The Greek Superintendent of Insurance, for example, recently addressed the matter when a Greek-listed insurance company requested the permission to invest part of its technical reserves in another listed insurance company to such an extent that the former company would become a significant shareholder of the latter. The Superintendent of Insurance requested the former insurance company to form additional technical reserves to avoid a "double gearing" situation where the former insurance company would be leveraging its exposure to risk. The action of the Superintendent of Insurance was definitely neither required nor regulated by law prior to the adoption of the aforementioned EU Directive. Thus, the provisions of the current EU legal framework reflect a legislative initiative to introduce measures with a clear view to protect the rights of the insured, which could be endangered if technical reserves were reduced as a result of intragroup transactions.

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13 Id at 5.

14 Id.

15 See generally id at 5, 7–12.

16 Id at 5.

17 Id.

B. SUPPLEMENTARY SUPERVISION UNDER DIRECTIVE 2002/87

The recent EU Directive 2002/87, which ought to have been interposed into European national legislations by August 2004, provides for the establishment of supplementary supervision of insurance companies, investment companies, and credit institutions that belong to a financial conglomerate.[18] This Directive has two objectives. Firstly, to complete the sectoral prudential legislation of EU member states by introducing provisions applicable to financial conglomerates. These provisions are not taken into consideration by the Directives in force (such as 1998/78, above) or may come under several Directives. Secondly, the Directive integrates this new prudential level of supervision with the sectoral regulatory regimes applicable (such as regulations pertaining to banks, insurance, and investments) without contradicting them. The Directive ultimately aims at protecting the consumers, the depositors, and the investors, as well as at ensuring the integration, competition, and security of the European financial market. The Directive meets the growing need for a single European financial market to maintain level playing fields across the EU and the need to protect the financial stability of the EU financial system.

Directive 2002/87 also substantially changes the Greek legal regime with respect to the definition of group of companies. The Directive precisely states that a "group" shall mean "a group of undertakings, which consists of a parent undertaking, its subsidiaries and the entities in which the parent undertaking or its subsidiaries hold a participation, as well as undertakings linked to each other by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC."[19] The Directive goes on, in Article 2(13)(a), to define "participation" as a direct or indirect ownership of 20 percent or more of the voting rights or share capital of an undertaking and the control as defined in the Directive 1983/349. Consequently, in contrast to the provisions of Law 2190/1920, a "dominant influence on the administration" is not required. It is obvious that the term "participation" does not have the same meaning in Directive 2002/87 as it has in Law 2190/1920, and that the term "group" is much broader in the Directive than in Law 2190/1920. In addition, Directive 2002/87 applies to a group in which the companies are run under the same administration by virtue of an agreement, a provision of their memorandum of association, or de facto, when their Board of Directors consists of the same persons.

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18 Council Directive 2002/87, 2002 OJ (L 35) 1.

19 Id at 4.

C. SURVEILLANCE OF INTRAGROUP TRANSACTIONS UNDER DIRECTIVE 2002/87

Under Directive 2002/87, State supervision shall include all transactions by which regulated entities (credit institutions, insurance undertakings, and investment companies) within a financial conglomerate rely either directly or indirectly upon other undertakings within the same group—or upon any natural or legal person with "close links"—for the fulfilment of an obligation.[20] These obligations need not be contractual or financial. The term "close links" stands for a situation in which two or more natural or legal persons are linked (a) *by participation* (which means the ownership, direct or by way of control, of 20 percent or more of the voting rights or capital of an undertaking); or (b) *by control* (which means the relationship between a parent undertaking and a subsidiary in all the cases referred to in Article 1-1 and 1-2 of Directive 1983/349.)[21] Control may also connote a similar relationship between any natural or legal person and an undertaking. Finally, any subsidiary undertaking of a subsidiary undertaking shall also be considered a subsidiary of the parent undertaking which is at the head of these undertakings.[22]

Supervision focuses on the entity that is at the head of the conglomerate and on all the entities having as a parent company a mixed financial holding. The Directive intends to monitor solvency (including the elimination of multiple gearing of own funds); risk concentration and intragroup transactions; and the company's plan of internal control and the procedures for administering the risks according to the rules laid down in annexes I and II of the Directive 2002/87. These rules aim at a greater transparency. Such supervision is performed by a Coordinator, an administrative official designated by the competent authorities of the member state where the parent company has its headquarters. Business undertakings affected by the Directive will have to report to the Coordinator any "significant" intragroup dealings on an annual basis. Dealings are presumed to be "significant" when their amount exceeds at least 5 percent of the total amount of the share capital adequacy requirements at the level of a financial conglomerate.[23]

The procedure of supervision focuses on the conglomerate's solvency. In particular it seeks to prevent the same capital from being used more than once within the same conglomerate and to prevent "downstreaming" by parent

20 Id at 5.

21 Id at 4.

22 Id. The term "undertaking" is the exact wording that is used in the official text of the aforementioned EU Directive and stands for "enterprise."

23 Id at 8.

companies in which the parent firm issues loans to finance its regulated subsidiaries. It also focuses on risk to ensure that there is no inappropriate concentration of risk at the group level and to ensure that appropriate risk management and internal control systems are in place. Furthermore, control mechanisms under the Directive are introduced to ensure management suitability and professionalism. When overseeing the intragroup transactions and risk concentrations, the Coordinator shall monitor the possible risk of contagion in the financial conglomerate, the risk of conflicts of interests, the risk of circumvention of sectoral rules, and the level or volume of risks. The purpose of the supervision is to avoid uncontrollable intragroup transactions and financial hardship. Hence, this supplementary supervision aims at the best possible application of sectoral rules, that is, rules providing for surveillance and function of credit institutions, insurance undertakings, and investment firms.

IV. CONCLUSION

The development of groups has undoubtedly led to an increase of intragroup transactions that may not always have desirable results. Still, the current legal regime in the European Union neither bars nor discourages affiliation between different companies and the creation of groups. On the contrary, the aforementioned provisions recognize and support these structures. Directive 2002/87, for example, aims at giving viable answers in cases where risks threatening interests of individuals and groups of persons occur. Hence, it is not mandatory for companies to maintain financial and business independence: the choice falls solely on their own business planning. The legislator focuses on the protection of the interests of the State and of individuals, who would be less likely to be harmed if these transactions occured outside a group of companies.

The harmonization of the legal regimes of EU states is not to be regarded as a goal that can be easily achieved. However, Directive 2002/87 moves in the right direction by addressing important issues sometimes already covered by sector-specific directives while introducing similar regulation at the level of financial conglomerates and trying to address inconsistencies that have arisen in past implementation of similar regulations. What we, as practitioners, need is the uniform application of the Directives at the European level, as well as the collaboration between private entities and public organizations in evaluating financial information and making use of the accumulated data for the fulfilment of the directives' aims.

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