ELW-Network Conference

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Good afternoon, I want to thank the ELW Network and especially its Coordinating Committee for giving me the opportunity to address you on the issue of

Social dumping and abusive practices in the transport sector: the crucial role of letterbox companies.

1. Introduction

Recently I took part in a study, commissioned by the ETUC, on letterbox companies. In this study, we use the notion of letterbox companies for a company that has no or very little activity at the place where it is registered. Often, the same phenomenon is referred to with different names, for instance mailbox companies, brass-plate companies, shell companies or pro forma-companies.

A key feature of letterbox companies is that they can be very quickly, simply and cheaply set-up and wound down. Indeed, such entities may be established and disbanded in a matter of a few hours, making supervision very difficult.

Concerning the avoidance of labour and social security law, case studies were conducted in the German meat sector, the Swedish construction sector and the Dutch transport sector.

I will focus in this speech on letterbox companies facilitating social dumping practices in the transport sector.

2. Acknowledgement of the issue of social dumping in the road transport sector

Almost two years ago, in June 2015, Commisioner for Transport Violetta Bulc launched a 'Social Agenda for Transport' . There, she acknowledged that social dumping had become a critical issue :

« …. the current economic situation has led to increased competition and pressure to reduce costs, and the development of dubious employment practices such as letter box companies or fake self-employment.

- *Too often, truck drivers like Radu, 30, from Bucarest, are hired through **a very complex mix of companies, subsidiaries, agencies based in different EU Member States, some of which have no real existence**. As a result, they are hired at the lowest possible cost and they are not protected whenever problems arise.*

In January 2017, she repeated that one of the 'key areas of concern under the internal market for road transport is the establishment of so-called 'letterbox' companies and so-called **'forumshopping'**. According to Bulc, this is one of the main causes for tension between low-wage and high-wage countries.

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Certain transport companies have established letterbox companies in low-wage countries, without having (m)**any** real activity there.

They offer services below the prices in high price Member States. In the transport sector the prices consist for almost 40 percent of labour costs.

By regime shopping, letterbox companies aim to use the lower taxes, wages and social security premiums in the sending country, in order to offer services in host countries with high wages, taxes and social security contributions.

3. How are letterbox strategies possible under EU law?

Cleary, the primacy to freedom of establishment and deregulation of company law that dominates the internal market can make letterbox-type practices legal under EU law. This creates serious tensions with the enforcement of labour, social security and tax laws when such letterbox companies make use of the freedom to provide services in the EU.[2]

One of the basic problems is that posting of workers in the frame of the free provision of services by foreign entities leads to exemption from the host country social security, tax (and partly labour law) legislation. Letterbox companies are opened for the purpose of sending workers abroad in one or more countries. The workers seem most often to be made to work under the direct supervision of the user undertaking, thus creating a situation of bogus subcontracting or illicit provision of manpower. The absence of genuine activities in the country of origin may be combined with repeated cross-border work, in other Member States on an (almost) permanent basis.

The consequence, it was feared, would be enormous pressure on countries with social, fiscal and environmental standards that protect the general interest. Some 12 years later this is indeed visible and even proved by hard evidence in especially the construction and transport sector of countries such as Belgium and France.

In these sectors, a large part of cross-border shifts in profits and activities is actually based on two legal presumptions which are in reality to a large extent legal fictions:

- **The legal presumption that genuine posted workers do not access the labour market of the temporary host country** (see the 'access to the labour market test' in the Rush Portugesa judgment)
- **The legal presumption that posting and other forms of 'employer-led' intra-EU mobility of labour is initiated by genuinely established providers** of temporary cross-border services.

In our ETUC study we show that the last mentioned legal fiction is clearly facilitated or stimulated by the differing **legal approaches of letterbox companies across legal areas**, leading to loopholes paving the way for 'fake' firms, which easily disappear across borders, go bankrupt and start all over again. It also has led to an advisory industry of legal advisors and intermediaries that invite and persuade host company firms to profit from their 'business model' for cheap labour, by explaining how 'perfectly legal' the artificial arrangement is.

[2] The trade unions already predicted this and warned against it during discussions about the draft Services Directive, back in 2004.

4. *Which legal areas and which legal approaches are involved?*

In road transport it is a tale of (at least) five cities: the city of labour law, the city of social security law, the city of fiscal law, the city of (road) transport law and the city of corporate law. Below, I will give some examples of the different approaches in these legal fields.

In total, two main approaches may be distinguished:

- Legal approaches *underpinning* the real and genuine establishment of companies
- Legal approaches *undermining* the real and genuine establishment of companies

Legal approaches underpinning the genuine establishment of companies

In the EU legal areas of determining the applicable labour law and social security law and the rules on (cross-border) access to the road transport sector, the starting point is that only genuinely established companies (so companies with substantial real economic activities in the country of establishment) can make use of that. Anti-abuse rules are for instance included in:

- the **Enforcement Directive (2014/67/EU) for the posting of workers,** giving some guidelines in Article 4.2 (see slide ppt);

- The **Regulations for the coordination of the social security** (883/2004 and 2009/987), providing criteria for the assessment of the genuine character of an undertaking; Regulation 987/2009 Art 14. 2 says (see slide ppt);

- the **Regulation for the international transport** (1071/2009) on common rules to be complied with to pursue the occupation of road transport operator, formulating criteria on access to the sector, with provisions to eliminate letterbox firms; for instance Article 3 prescribes that undertakings engaged in the occupation of road transport operator shall have an effective and stable establishment in a Member State; and Article 5 provides a list of conditions relating to the requirement of establishment (see slide ppt).

Pursuant to Article 12 Member States should check that the conditions of a real and stable establishment (and other requirements stipulated in Art. 3) are fulfilled.

From e.g. the 'De Vos' case in the ETUC study, it was clear that in road transport the priority must be to verify and strengthen the effectiveness of the application of the rules.

Commissioner Bulc agrees that "enforcement" is a key issue: "Of course, if I sit here, as Transport Commissioner and ask for rules to be enforced, I must first ensure that any rule, be it old or new, is actually enforceable! Otherwise it is of no value. "

One of the problems is that a **Member State has no means of taking action against a Member State which does not observe the obligation in Art. 12 of the regulation 1071/2009.** Therefore, in our ETUC study we recommended to adapt Art. 12 and indicate more precisely what Member States of establishment should do to guarantee that the conditions of real establishment are fulfilled. Also the text of Art. 13 which asks Member States to withdraw transport authorizations if companies do not comply with the conditions of establishment, should be formulated more strictly, in particular regarding the time limits stipulated in Art. 13(1).

Interim conclusion (1)

Clearly, there is no integral approach nor an identical definition of a genuine established company in these three legal fields at (national and) European level. Moreover, competences to test the genuine character of the activities are fragmented and spread over different national institutions.

Violetta Bulc seems to agree that this: ".. has to come to an end. We plan to reinforce the criteria for stable and effective establishment to put an end to loopholes allowing such companies."

However, that will be easier said than done, as long as the European Commissiom turns a blind eye to:

Legal approaches undermining the genuine establishment of companies

Typical for letterbox arrangements is the allocation of the registered office and the actual centre of activity / administration to different jurisdictions.

Such strategies are facilitated by the fact that conflict-of-law rules in the area of company law are regulated by Member States. The divergence of conflict rules leads to complex situations where a company may be subject to the laws of various Member States at the same time.

Although some MS follow the so-called real seat theory, i.e. the law governing a company is determined by the place where the central administration and activities of that company is located, many others follow the incorporation theory, i.e. the law governing a company is determined by the place of its incorporation (where the registered office is located).

The TFEU, as interpreted by the CJEU in several landmark cases, seems to favour the incorporation theory. Some 17 years ago, around the turn of the century, the European Court of Justice was faced with three landmark cases on cross-border mobility of corporations.[3]

The essence of these cases is that the application of the real seat doctrine or substantive laws that impose minimal capital requirements, violate the corporation's freedom of establishment, and cannot be applied any more to corporations arriving at the borders of the new host state.

Under the influence of this case law a situation of 'regime competition' between the different national legislators in Europe was observed and often compared to the situation in the United States, whose corporate law is dominated by the law of Delaware.

Example: Given the massive rise in numbers of British Limited companies in the German territory, the German legislator decided to reform the German law on limited liability companies. Essentially, the traditionally strict capital requirements of German law have been eased and a new, "slim" form of limited corporation (Unternehmergesellschaft) has been created for start-ups and small business founders.

Interim conclusion (2)

To combat letterbox strategies, it would be best to guarantee that only genuinely "established" companies may benefit from the freedom of establishment and the freedom to provide services. This can be regarded as a form of "piercing the corporate veil" in favour of the economic reality and

[3] All of them concerning inbound mobility, i.e. from the perspective of the country of arrival), the "Centros" case of 1999 (Case C-212/97, ECR 1999 I-1459), the "Überseering" case of 2002 (Case C-208/00, ECR 2002 I-9919) and the "Inspire Art" case of 2003 (Case C-167/01, ECR 2003 I-10155)

would both reduce complexity and foster genuine establishment of business, legal certainty and effective monitoring and enforcement.

However, the ECJ case law on the freedom of establishment has eroded this anti-abuse function for a large part with respect to EU companies. Given the current situation, it is highly unlikely that a general real seat principle across the EU would be feasible in reality.

5. Main conclusion from the ETUC letterbox study

The regulatory framework related to the letterbox phenomenon is stretched over various national and EU policy areas, with non-coherent, contradictory or even conflicting rules. Of particular concern is that regulatory action taken in one field is often quickly undermined by another. 'Silo thinking' has opened-up avenues that allow firms to build up a smokescreen and circumvent rules and safeguards. In all this uncertainty and complexity, one thing is sure: the current situation creates an ideal environment for malafide cross-border business activities. The danger of lacunae is in practice most urgent when the worker does not have a relevant connection with the country of establishment of the service provider.[4] This again underlines the importance of ensuring that each service provider involved should perform a 'genuine activity' in the Member state where the posted worker habitually works and therefore should be a genuine undertaking.

6. What (realistic) steps can be taken?

Incentives for letterbox strategies should be eliminated.

According to Bulc, we must have:

• Rules that are fair; • Rules that are clear; and • Rules that are enforceable.

Arguably, effective prevention and combating letterbox companies requires a consistent and coherent enforcement frame. Hence, the focus cannot be limited to a stepping-up of monitoring and enforcement alone.

It is therefore deemed imperative:

- **(a)** to clarify and align as far a possible similar notions such as 'genuine establishment', 'effective and stable establishment' 'substantial activities' and 'centre of main interest' in EU law instruments across different legal areas,[5] by using similar indicators for assessment, based on factual elements such as office space, operating centre, place of performance of substantial business activities, size of turnover….
- **(b)** to delete (proposed) provisions, such as in the proposal for a directive on single-person limited liability companies, which could facilitate 'letterbox' strategies.

[4] Many fraudulent situations involve posted (temporary agency) workers who never actually have been employed on the territory of the Member State of establishment of the employer (although this state would allegedly be his habitual place of work).

[5] (e.g. Art 4(5) of the Services Directive 2006/123/EC, Art. 4 (2) Enforcement Directive of the PWD, Art. 3 on COMI in Reg 2015/848 on insolvency proceedings, Art. 12/13 Reg. 883/04 in combination with Art. 14 Reg 987/09 and Art. 5 Reg. 1071/2009).

Increase transparency and pierce the 'smoke screen'

In many Member States it is quite easy for shareholders and directors to keep their identity hidden from the authorities.[6]

In the ETUC study, Letterbox strategies have been identified where companies officially are run by a single person who acts as registered shareholder and managing director at the same time and who is either a front man from abroad or using a false identity. In some cases a front man represented at least 15 letterbox companies.

A promising step towards combatting such practices, is the requirement for MS to put in place national registers of so-called beneficial owners[7] of companies and some trusts. Such initiative will make it more difficult for the beneficial owner to hide. Meanwhile, the Commission has proposed for the direct interconnection of the registers to facilitate cooperation between Member States, and for full public access to certain information in these register and to information available to authorities.

7. Final remarks

Back to Violetta Bulc. In her speeches from which I quoted, she also shows her concern about:

'Diverging national rules create confusion among transport operators and drivers, and lead to higher compliance costs.'

Other than the concern for letterbox companies, this concern led to (preparatory steps towards) infringement procedures launched against France and Germany, concerning the initiative of **Germany and France** to **impose a minimal wage to foreign road transport carriers operating on its territory.**

"While fully supporting the principle of a minimum wage, the Commission considers that the systematic application of the minimum wage legislation by France and Germany to all transport operations touching their respective territories restricts in a disproportionate manner the freedom to provide services and the free movement of goods. (..) In both cases, the Commission considers that the application of the minimum wage to **certain international transport operations having only a marginal link to the territory of the host Member State** cannot be justified, as it creates disproportionate administrative barriers, which prevent the internal market from functioning properly."

How long do we have to wait for a press release showing a similar activist approach towards **certain international transport operations having only a marginal link to the territory of the Member State of establishment,** which prevent the national rules on social protection of international truck drivers from functioning properly**?**

[6] The PWD Enforcement Directive, the IMI and several registers such as in the Road Transport sector and EBR, but also the Services Directive (Art. 29) and the Anti-Money Laundering Directive (AMLD) as well as the company directives contain rules about exchange of information and disclosure requirements for certain types of companies.

[7] The person who actually – behind the scenes / smokescreens – is in control of the company.