Arbeitskreis Europäisches Unternehmensrecht

October 10, 2008

Comments and Suggestions in response to the Proposal for a Council Regulation on the Statue for a European private company (SPE)

General

1. The "*Arbeitskreis Europäisches Unternehmensrecht*" (hereinafter: "*the group*") welcomes the draft SPE Regulation as part of the "Small Business Act".

2. Small and medium sized business, which to some extent find the differences in company law between Member States if not insurmountable at least extremely costly, constitute the most important target group of the new legal form.

3. Rapid and unbureaucratic formation is an important pre-requisite for the establishment of a new business or foreign subsidiary in the legal form of the SPE.

4. The SPE Proposal is consistent with the aim of noticeably reducing the burden on SMEs caused by the plurality of legal systems. It offers a broadly conclusive European company law solution and offers the freedom to regulate the internal affairs of the company.

Applicable Law

5. The clear three regulatory levels in Art. 4 are welcome. The matters provided for in the Regulation and covered in Annex I, are removed from national law. It is preferable that gaps in the Regulation not be left to general principles of national company law of each Member State.

6. The freedom of the shareholders is the bedrock of the Regulation. This is not, however, adequately expressed in Art. 4 of the Proposal. It remains open whether all provisions of the Proposal are mandatory or whether some can be dispensed with or supplemented by the articles of association.

> Suggestion: Clarification in Art. 4 that the articles of association have priority over the Regulation in case of doubt. The provisions of the Regulation which are mandatory (especially, creditor and minority protection) must then be expressly stated to be such.
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> Alternative: Clarifying addition to the relevant provisions of the Proposal that the articles of association may provide otherwise (for example, at Artt. 17 ss. 3 and 18 ss. 5 the following sentence should be added: *"The articles of association can specify a particular method of calculation for ascertaining a reasonable price."*)

7. The subsidiary reference to national law (Art. 4 ss. 2) should be maintained as a last resort in the interests of legal certainty and clarity. However, the wording "*including the provisions implementing Community law*" is misleading. It raises questions, in particular if Community law has not been correctly implemented. These general methodological questions of Community law are not the subject matter of the SPE Regulation. It is therefore suggested that the wording referred to be deleted.

> Suggestion: In Art. 4 ss. 2, delete the words "*including the provisions implementing Community law*".

8. Individual references to national company law should – if at all possible – be avoided and replaced by provisions in the Regulation. References to draw the line between company law and other areas of law are useful. Art. 25 ss. 1 and ss. 2 sentence 2 are mentioned as examples. The reference to national law on procedural questions is also sensible (Art. 27 ss. 4 sentence 2).

9. The reference to "applicable national law" (Art. 4 ss. 2) could be rendered more practical if an Annex III to the SPE Regulation were added explicitly listing the relevant legal forms in national law comparable to an SPE. So far, Art. 45 provides only for notification by the Member States to the EU Commission.

> Suggestion: An Annex III to the Regulation shall list the private companies in national law corresponding to the SPE for the purposes of the applicable law (Art. 4 ss. 2).

Drafting Instructions

10. The instructions to the drafters of the articles of association contained in the Proposal (Annex I) facilitate the legislative process. Many issues disputed in the debate between the Member States or which would require complex statutory provision, can be dealt with by the shareholders themselves.

11. The instructions to the drafters of the articles of association restrict the references to national law and contribute to the achievement of a really European legal form.

12. Some of the instructions are mandatory, some discretionary. The text of the Proposal does not always express clearly which. Legal uncertainty is the result:

> Suggestion: A clear linguistic distinction should be made between mandatory and discretionary instructions:
>
> - The articles of association "*must*" provide (mandatory)
> - The articles of association "*may*" provide (discretionary)
>
> The present introductory sentence to Annex I ("*The articles of association of an SPE shall regulate at least the following*") is open to misunderstanding: It should read: "*The articles of association of an SPE must at least contain provisions on the following points*". The individual instructions then following would then show whether the articles of association can either state not to regulate a particular issue (discretionary instruction) or must contain a provision on it (mandatory instruction).

13. The functioning of an SPE will depend to a considerable extent on the correct implementation of the instructions. The Proposal should therefore state more clearly than it does at present that compliance with the instructions will be reviewed in the process of the registration of the SPE. This is not a review of content but a review of whether the shareholders have made some provision in their articles of association for each point on which they have instructions to do so – and thereby indicated that they have seen and considered the issues which require to be legally regulated.

Suggestion: Add to Art. 10 ss. 4:

"The control of legality also includes a review of whether the articles of association contain provisions on the matters stated in Annex I".

14. In order to avoid recourse to national law, the Regulation must make provision for what happens if the articles of association fail to carry out or adequately carry out an instruction. Recourse can be taken to model articles of association as supplementarily applicable law or at least a guideline to an appropriate provision. However, this requires to be given the force of law. Model articles need, on the other hand, to be flexible in case of later amendments. Both can be best achieved by the comitology procedure.

Suggestion: add sub-section to Art. 4:

„*Model articles of association shall be published and thereby made available to the founders of an SPE. The model articles as well as later amendments shall be confirmed by way of the comitology procedure.*""

15. A number of points in Annex I refer to issues provisions on which should not be left to the shareholders. Some of them refer to external matters (especially creditor protection), which must be uniformly regulated throughout Europe.

Suggestion: The following "instructions" be deleted and instead be specifically provided for in the Regulation:

- *"whether or not the SPE can provide financial assistance, in particular advance funds, make loans or provide security, with a view to the acquisition of its shares of the SPE by a third party,"*
- *"whether the acquisition of own shares is permitted and, if permitted, the procedure to be followed, including the conditions under which the shares may be held, transferred or cancelled,"*
- *"the procedure for increasing, reducing or otherwise changing the share capital, and any applicable requirements."*

Formation

16. The creation "ex nihilo" and the transformation of existing companies are important methods of formation in practice.

17 The formation by merger and division are helpful but not absolutely necessary. They create additional legislative requirements for many Member States because, according to Art. 5 ss. 2 SPE-VOE, mergers and divisions are intended to be governed by national law. Many Member States have no comprehensive mergers and divisions law and must introduce same especially for the SPE.

18. On the other hand, there is a major demand in practice for the transformation of existing companies into SPEs. However, it is not ensured that all Member States have national legislation for this process. As in Art. 37 SE Regulation, transformation should also be dealt with for the SPE in the Regulation itself. No great legislative effort is required provided that the transformation is limited to those national legal forms with which the SPE is comparable. Member States shall indicate which national forms they think are suitable for such transformation, the SPE Regulation shall list these national legal forms in an additional Annex IV.

> Suggestion for a provision on the transformation of the comparable national forms into SPEs:
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> *Article XXX*
>
> *"(1) An SPE can be formed by the transformation of any one of the companies listed in Annex IV in accordance with the following conditions:*
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> *(2) The transformation into an SPE does not result either in the winding up of the company nor the formation of a new legal person.*
>
> *(3) The managing or administrative organ of the relevant company shall draw up draft terms of transformation and a report explaining and justifying the legal and economic aspects of the transformation and indicating the implications which the transformation will have on the shareholders.*
>
> *(4) The draft terms of transformation shall be publicised in the manner laid down in each Member State's law in accordance with Art. 3 of Directive 68/151/EEC at least one month before the general meeting called upon to decide thereon.*
>
> *(5) The general meeting of the company in question shall approve the draft terms of transformation together with the articles of association of the SPE. The decision of the general meeting shall be taken in accordance with the legal provisions of the law of the Member State applicable to the company in question on amendments to the articles of association."*

19. The Proposal seems to permit the formation of an SPE from any company form, including – in any event based on the German version of the text – partnerships. The change from a partnership with personal liability into a private company with limited liability would require comprehensive provisions in national law. Likewise, a change from a public company into an SPE would also require considerable legal provisions. On the other hand, the transformation of a private company of national law, which already recognises limited liability and typically has only a small number of shareholders, is unproblematic to a great extent.

> Suggestion for a redraft of Art. 5 in accordance with Points 17-19:
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> *"1. An SPE can be formed by any of the following methods:*
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> *(a) the creation of an SPE in accordance with this Regulation*
>
> *(b) the transformation of an existing company in accordance with Art. XXX of this Regulation*
>
> *(c) by merger or division provided that the relevant national law provides merger or division for the comparable legal form of national law.*
>
> *2. The formation according to ss. 1 (b) and (c) is available only to companies comparable to the SPE and listed in Annex IV. For matters not covered by this*

Regulation or, where a matter is partly covered by it, for aspects not covered by it, each company involved shall be governed by the provisions of the law of the Member State to which it is subject."

The existing Art. 5 ss. 3 is thereby rendered unnecessary.

20. The absence of a requirement for a cross-border element is to be welcomed because it removes unnecessary formalities from the formation. If, in the course of further negotiations, a cross-border requirement should be included in the SPE Regulation, the overall interest of the unbureaucratic formation and its compatibility with the practically important use as a foreign subsidiary should be considered.

If a cross-border requirement should be included in the SPE Regulation, the following new ss. to Art. 5 is proposed:

"The formation of an SPE requires that at least one of the shareholders resides or – if a legal person is concerned – has its registered office in a Member State other than that in which the SPE is to be registered. In the case of the formation of an SPE by transformation, merger or division, it shall be sufficient if a founding company has a branch or subsidiary in a Member State other than that in which the founding company has its registered office."

21. A minimum capital to be raised at formation of the SPE is not absolutely necessary from the point of view of creditor protection. It may, however, contribute to establishing the reputation of the new legal form. The majority of the group, therefore, recommends to introduce a minimum capital of a moderate amount (e.g. 10.000 €).

22. The registered office and central administration of the SPE may be in different member states. This is a consequence of recent judgements of the ECJ. It should be adequate for the purposes of Art. 48 EC, however, that only the registered office be in a Member State of the Community.

Suggestion for redraft of Art.7 sentence 1:

"An SPE shall have its registered office in the Community."

Creditor Protection

23. The Proposal for the SPE pursues a new, quite consistent, creditor protection concept. The contributions need not be paid-in on formation. The shareholders cannot, however, be relieved of their obligation to contribute. They will, therefore, be called-upon at the latest in the case of insolvency to pay-in their contributions and they bear the burden of proof as to whether and to what extent they are freed from their contribution obligation. This could be a positive incentive to rescue the company in times of crisis.

24. The absence of necessity to check the capital contributions in the course of the formation procedure reduces the work of the register authorities and at the same time offers the shareholders an incentive to manage the company properly. They are personally liable for their contributions until they are paid-in and will, as the case may be, be called upon personally in the event of insolvency. The reference to national law contained in Art. 20 ss. 3, however, poses the danger that the claim to contributions is subject to national limitation provisions. Since the Regulation, for good reasons, does not specify a time at which the

contributions are to be paid-in, it should at least be ensured that the claim to the contributions does not become barred under the applicable national law.

Suggestion for an addition to Art. 20 ss. 2:

"Except in the case of a reduction of the company's capital, the shareholders may not be relieved of their obligation to pay the agreed consideration or make the agreed contribution in kind. The claim of the company to the consideration is not subject to any period of limitation".

25. The group welcomes the application of the balance sheet test as a reliable instrument for shareholders and directors of the company. In the interest of creditors, the broad definition of "distribution" (Art. 2) in connection with the balance sheet test (Art. 21) ensures as far as possible that the shareholders withdraw assets from the company only when the company's assets cover its liabilities even after the withdrawal.

26. In the light of this concept, however, the text of the Regulation should make it clear that the capital as specified by the shareholders in the articles of association and recorded in the register is protected against distributions. Even though this is already indicated by the reference to Art. 24, the omission of the word “capital” in Art. 21 has raised doubts amongst company lawyers whether it will be permitted to distribute the capital of an SPE.

Suggestion for redraft of Art. 21:

"Without prejudice to Art. 24, the SPE may, on the basis of a proposal of the management body, make a distribution to shareholders provided that, after the distribution, the assets of the SPE fully cover its liabilities and its capital as stated in the articles of association. The SPE may not distribute those reserves that may not be distributed under its articles of association."

27. The broad definition of "distribution" (Art. 2 ss. 1 b and ss. 2) is to be welcomed in the interest of creditor protection. However, in its present wording it could be misunderstood as preventing normal business transactions between the SPE and its shareholders. The present wording does not make clear enough whether such transactions are covered by the definition of "distribution". They may be excluded insofar as they are not derived from the SPE by a shareholder “in relation to the shares held by him”. Any doubt in this respect will, however, be an extreme impediment in practice because every distribution requires a shareholders' resolution (cf. Art. 27 ss. 1 e). Thereby, in practice, any business transactions between the SPE and its shareholders as well as cash pooling within groups of companies would be rendered almost impossible and the use of the SPE as a subsidiary in a company group would be considerably impaired. A provision which clearly removes financial benefits given in return for consideration of equal value or a full right to repayment from the definition of "distribution" is therefore proposed:

Suggestion for redraft of Art. 2 ss. 2:

"Financial benefits in return for consideration of equal value or a full right to repayment are not distributions in the sense of this Article."

28. If the SPE acquires its own shares, the voting and other non-pecuniary rights are suspended according to Art. 23. Logically, the asset rights should also be suspended.

Suggestion for addition to Art. 23 ss. 3:

"The rights attached to the SPE’s own shares shall be suspended while the SPE is registered owner of the shares.“

Internal Organisation of the SPE

29. Art. 30 ss. 3 and ss. 4 excludes as director only those who have been disqualified by a judicial or administrative decision. There are, however, in many Member States particular statutory criteria of lack of suitability as a director of a company which apply directly without the requirement of a judicial or administrative decision (e.g. lack of business capacity, guardianship or criminal conviction).

Suggestion for amending the wording of Art. 30 ss. 3:

"A person who is disqualified under national law from serving as a director of a company either by law or by a judicial or administrative decision of a Member State may not become or serve as a director of an SPE."

30. It should be clarified that the general meeting, as the highest organ of the company (cf. Art. 26), can issue instructions to the management body. In Art. 31 ss. 4 sentence 1, 33 ss. 2 sentence 2, this is so far at most indicated. This should be accompanied by a discretionary drafting instruction in Annex I.

Suggestion for a new discretionary drafting instruction in Annex I:

"The articles of association may provide whether and to what extent the management body is obliged to implement legal resolutions of the general meeting and whether and under what conditions such a right of the shareholders to issue instructions can be delegated to another organ."

31. The shareholders appoint and remove the directors (Art. 27 ss. 1 (j). This is appropriate. It should, however, be possible to assign this power to other bodies of the company, for example, to the supervisory board.

Suggestion for an amendment to Art. 27 ss. 1 (j):

"Appointment and removal of directors and their terms of office, unless the articles of association provide that this power can be assigned to a supervisory body or other organ of the company."

32. According to Art. 27 ss. 1 (h) together with ss. 2, capital increases can be passed not by a qualified majority but by a majority as defined in the articles of association while for a capital reduction and other amendments to the articles of association a qualified majority is required. The resolution to increase the share capital should also be subject to a qualified majority because of its significance for the shareholders and the creditors.

Suggestion for re-draft of Art. 27 ss. 2 sentence 1:

"Resolutions on the matters indicated in points (a), (b), (c), (h), (i), (l), (m), (n), (o) and (p) of paragraph 1 shall be taken by qualified majority".

33. The list of shareholders in Art. 15 should, in the interests of legal certainty, be the basis for the exercise of shareholders' rights.

Suggested second sentence in Art. 15 ss. 2:

"The entry of a shareholder in the list of shareholders is a condition for the exercise of the rights attached to the shares of that shareholder".

34. The Proposal contains no provision for the exclusion of a shareholder's right to vote. It should at least be clarified for the expulsion of a shareholder under Art. 17 of the proposal that a shareholder cannot be judge in his own case. The shareholder's interests are adequately protected by the court's review of the existence of good cause for his expulsion.

Suggestion for an addition to Art. 17 ss. 1:

"On the basis of a resolution of the shareholders, the affected shareholder having no right to vote thereon, the competent court can …….. "

35. In Art. 18, the Proposal lists a number of grounds for the withdrawal of a shareholder. Not all possible constellations are mentioned, however. Art. 18 should be worded in such a way that it is open to other situations (by the addition of the words "in particular"). In addition, a subsidiarity principle, by which the shareholder is not entitled to withdraw if detriment which is threatened can be avoided by other reasonable means, should be included.

Suggestion for an addition to Art. 18 ss. 1:

"A shareholder shall have the right to withdraw from the SPE if the activities of the SPE are being or have been conducted in a manner which causes serious harm to the interests of the shareholder as a result, in particular, of one or more of the following events …"

At the end of ss. 1, the following sentence should be added:

"The shareholder is not entitled to withdraw if the detriment with which the shareholder is threatened can be avoided by other reasonable means".

36. In accordance with Art. 17 ss. 3 and Art. 18 ss. 6, the court can order that the shares of an expelled or withdrawing shareholder be acquired by another shareholder. If this is contrary to the will of the acquiring shareholder – or if the articles of association do not so provide – it constitutes a breach of the principle that the liability of the shareholder in a company is limited.

The group therefore suggests an addition to Art. 17 ss. 3 and Art. 18 ss. 6:

"The court may order that the shares be acquired by another shareholder only if the latter has already agreed thereto or the articles of association provide for such compulsory acquisition."

37. The Proposal provides that the court, in the case of dispute regarding the price of the shares, shall determine the price of the shares (Art. 17 ss. 3, Art. 18 ss. 5). The determination of the value of the shares will at least require that an expensive expert report be obtained. The shareholders should, therefore, be given the opportunity to determine the price themselves. Such a provision must be included in the articles of association (cf. above the suggestion at No. 6).

38 The independent investigation provided for in Art. 29 ss. 2 imposes considerable costs on the company. It would therefore be preferable to give the shareholders themselves the right to investigate. The shareholder can, on is own initiative, call in an external investigator if necessary. The interests of the company are adequately protected by the right to refuse access to information in Art. 28 ss. 2.

> Suggestion: Delete Art. 29 and instead add to Art. 28 ss. 1:
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> *"The shareholders shall have the right to be duly informed about resolutions, annual accounts and all other matters relating to the activities of the SPE. They may ask the management body of the SPE questions relevant to the said subjects and inspect the books and documents of the company."*

Employee Co-determination

39. According to Art. 7 of the proposal, an SPE is not under the obligation to have its registered office and central administration in the same Member State. In addition, the SPE shall be subject to the rules on employee participation applicable in the Member State in which it has its registered office (Art. 34). If registered office and central administration are in different Member States, the employees could be deprived of their co-determination rights. In order not to endanger the political acceptance of the SPE, it should be ensured that the employees are neither more nor less favourably placed by the use of an SPE than by the use of a national legal form.

40. The negotiation solution introduced for the SE and cross-border mergers may be an appropriate means of balancing the conflicting interests and diverse national cultures for the SPE too. It must not, however, be permitted to prevent or delay the formation of the SPE. If an SPE with fewer employees than the national co-determination threshold is involved, there is no reason for negotiations. Negotiations are always appropriate where national co-determination rights are involved. This affects the transformation of a company already having co-determination into an SPE and an already formed SPE the number of the employees of which in the Member State in which its central administration is situated passes the co-determination threshold.

"*Arbeitskreis Europäisches Unternehmensrecht*" (www.akeur.eu) is an independent expert group on European company law. This paper has been prepared, discussed and approved by the following members of the group: Prof. Dr. *Arnold* (Kiel), Prof. Dr. *Bachmann* (Trier), Prof. Dr. *Casper* (Münster), Prof. Dr. *Dauner-Lieb* (Köln), Prof. Dr. *Drygala* (Leipzig), Prof. Dr. *Grunewald* (Köln), Prof. Dr. *Habersack* (Tübingen), Prof. Dr. *Hennrichs* (Köln), Prof. Dr. *Hirte* (Hamburg), Prof. Dr. *Kersting* (Düsseldorf), Dr. *Maul* (KPMG), Prof. Dr. *Müller* (Erfurt), Prof. Dr. *Noack* (Düsseldorf), Dr. *Pentz* (Rechtsanwalt, Mannheim), Dr. *Royla* (Siemens), Prof. Dr. *Schäfer* (Mannheim), Prof. Dr. *Siems* (Norwich), Prof. Dr. *Teichmann* (Würzburg), Prof. Dr. *Veil* (Hamburg), Dr. *Vetter* (Rechtsanwalt, Düsseldorf), Prof. Dr. *Weller* (Mannheim).