EUROPEAN PERPECTIVES : INITIATIVES IN FAVOR OF A EUROPEAN LAW COMPANY

The scheme of the regulation

Robert DRURY,
Solicitor, Senior Lecturer, University of Exeter

Introduction – The Construction of the Regulation

I trust that you have all got a copy of the Regulation in your conference pack. A drafting team including myself whose members were drawn from France, Germany and England constructed this Regulation. The team drew on their knowledge of the company laws of other jurisdictions in the Community as well, in drafting a piece of legislation which we hope works as a harmonious and coherent whole. The European Private Company has many features that will be familiar to British company lawyers as well as a few drawn from other jurisdictions which we feel will be very effective in this context.

1. Access

Under the Regulation a European Private Company can be formed by individuals or companies either by the straight registration of a new company from scratch or by way of the transformation of an existing national company into a European Private Company. Initial creation can be as a joint subsidiary or a holding company and access is not restricted to nationals of the European Union, but is open to all.

2. Basic Features

The European Private Company has limited liability with each shareholder being liable only to the extent of the contribution made for their shares. It may not issue securities to the public, in line with the conception of the private or close company form. It has legal personality from the moment of its registration. To assist with overcoming potential conflict of laws problems the registered office of the European Private Company must be located in the same jurisdiction as its central administration. There is considerable freedom in the choice of a name for the company provided that the name is " not misleading or liable to cause confusion. " The name must be preceded or followed either by the words " European Private Company " or by the acronym " EPC ".

3. Formation Procedure

The European Private Company is created by means of registration in the normal companies registry in the State where its central administration is to be located. This may be in the local Commercial Court or, as in the UK at a central Companies Registry. Certain basic information must be provided which will be put on the register and also sent on to a central EU register to be created for the purpose. This will be publicised both locally and at EU level in the Official Gazette and should be readily accessible by means of public search facilities. The relevant registry will issue a Certificate of Incorporation.

The initial capital provisions, requiring a minimum of ?25,000, reflect the need to establish economic credibility for this new form of company. To ensure that the money is forthcoming shares must be paid up in full before registration, and the company will only be registered if an official receipt for this money by a bank or a notary is submitted.

4. Organisation and Operation

The basic principle that we have adopted is freedom of choice, as long as this is consistent with the adequate protection of shareholders and third parties. Thus the founders may in the company's articles of association set up any form of management structure that they feel comfortable with. A single manager, a one tier board, with or without a managing director or a two tier board are all possible. These articles too will set out the rights of the shareholders, and considerable freedom is permitted, much on the British model, and the voting or other rights do not have to be proportionate to the nominal value of the shares. However, certain minimum rights are guaranteed to the shareholders. Although the articles will set out who does what, in the sense of allocating which matters are to be dealt with by the shareholders and which by the management body, certain matters are specifically reserved for the shareholders. These include the approval of the accounts, the allocation of the annual profits – to reserves or distribution – the appointment of auditors if necessary and the alteration of the articles.

Third party protection is achieved in a way consistent with a lot of European legislation, and will be familiar. The Regulation provides in Article 16 that " The company shall be represented in relation to third parties by one or more individuals or legal entities having full power to act in all circumstances in the company's name. ". The power allocation follows French phraseology, but is apt for its purpose. As the names of these representatives will be published, and accessible to third parties, all that they have to do is to access the right person and the deals made by them should be fully binding.

The Regulation lays down certain standards for the actions of the management body. Basically the company's officers on its governing body or bodies (boards of directors or management etc.) are liable if they breach the terms of the Regulation or the company's articles or other rules applicable. It was difficult to impose universally acceptable yet realistic standards of duty, but in the end we settled for the fairly open formula of " They shall be liable ... for breach of their duties and the standard of diligence reasonably required in the conduct of business. ". In terms of seeking a remedy for breach of these duties, individual shareholders may bring an action against the relevant officers for any losses suffered on a personal basis, as they can in France. Following the path of the majority of European jurisdictions, we have agreed that shareholders representing 10% of the capital may bring an action on behalf of the company. This brief avoidance of the problems of *Foss v Harbottle* may seem like a cop out, but does give a realistic prospect of broad acceptance in the EU as a whole.

5. Shareholders and Minority Protection

In this area a balancing act needed to be performed between a number of potentially conflicting forces. On the one hand we wished to create as much freedom and flexibility as possible to encourage use of this form. On the other we wished to provide what was felt to be as realistic a protection for the minority shareholders as possible, while not providing too many avenues which could lead to the break-up or self-destruction of the company. Because of the essentially close company nature of the entity which we were creating we needed to make it

clear that the shareholders could, if they wished, restrict the free right of a member to transfer their shares, usually by requiring the approval of some group or body within the company e.g. management or shareholders meeting.

Minority protection can take many forms, usually in combination. There can be rules relating to the provision of information from which minority shareholders can deduce that they are being oppressed, there can be rules enabling minority shareholders to enforce directors' duties and rules giving some statutory remedy for oppression. The draft Regulation has all of these elements and more. In terms of granting shareholders access to information, they must be informed of all collective decisions taken by the general meeting, and are to be allowed access to the company's principal management documents. Shareholders may also submit questions in writing which the company's officers shall be bound to answer. If no answer is forthcoming shareholders are given the right to petition the court for the appointment of a special auditor to report on certain acts of the management. This concept of appointing an *expert de minorité* is found in both French and German law.

As I have mentioned, shareholders holding 10% of the capital or the votes may bring an action against the company's officers for recovery of damage suffered by the company because of breaches of duty by the management.

A remedy may be provided in the articles themselves under which shareholders may claim to have their shares acquired in the circumstances and under the procedure specified in the articles. Another more forceful exit route is given by the Regulation which provides for any shareholder to petition the Court for the compulsory acquisition of their shares in certain defined circumstances including :

- a significant change in the articles,
- transfer of the company's assets to another company,
- a substantial change in the company's business or
- an unjustified withholding of distributions on their shares.

The drafting team did not want to be too liberal in providing an exit route because of fears that the most timid or even prudent shareholder might use it to bail out as soon as things began to get tough, and not stick with the venture that they had agreed to participate in. The boot was also put on the other foot by including provision for a majority to remove a minority shareholder who has become unacceptable because such a shareholder has seriously damaged the company's interests, or because their continuance as a shareholder is detrimental to the proper operation of the company. These rules were borrowed from Dutch private company law.

If a shareholder finds a potential purchaser for their shares who is unacceptable to the others the Regulation states that the articles " **shall** determine the manner of withdrawal of a shareholder to whom approval is denied. ". A price fixing mechanism must be provided which allows a disaffected member to leave the company by selling their shares at a reasonable value. Such an exit route is found in French law.

6. Capital, Accounts and Economic Credibility

These topics can be linked because they express different but possibly complementary approaches to the protection of third parties dealing with a company. Having a minimum capital

is still seen by many jurisdictions as providing some assurance to potential creditors. However, the efficacy of this device is doubted by many commentators, especially this one. Having access to information on a company's accounts can help a third party to evaluate the risks associated with extending credit to that company. Having both mechanisms might help to engender confidence in the European Private Company as a serious business form.

We agreed to include a minimum capital because so many Civil Law systems are still wedded to the idea and would not readily accept a new company form in their territory which lacked it, and also because of the need to reassure Member States that all of their companies will not flee to the European Private Company overnight to avoid this requirement. We have Centros very much in mind. The minimum capital chosen is, as I have said 25,000 Euros. The incorporation of a European Private Company is not something that should be undertaken lightly or frivolously, and we see the minimum capital at this level as a sufficient barrier for this purpose. Despite scepticism over the ability of a minimum capital to provide an effective guarantee for the company's creditors, there was general agreement on the application of rules for the **maintenance** of the company's capital once it has been subscribed. This could operate to boost the confidence of third parties dealing with the European Private Company. These rules should be at least up to the standard of those set out in the Second Directive. In fact, in an effort to create an atmosphere of economic credibility and rectitude the rules in the Regulation go further.

Bearing in mind the protection given to third parties by the publication of accounts, despite the fact that they can fall rapidly out of date, we agreed that the European Private Company must comply with the European Union's rules on the publication of the accounts for private companies.

7. Employee Participation

The area of employee participation proved to be a little controversial, as might be expected given its history in the European Company Statute. It is provided in the draft Regulation., that the rules relating to disclosure to and consultation of the employees should be determined by the law applicable to the registered office of the European Private Company. Each State would be able to go its own way, but this could, in my view, lead to undesirable diversity between different jurisdictions and fifteen different types of European Private Company and perhaps to unwelcome episodes of jurisdiction shopping. An alternative would be to provide a threshold limit on the number of employees that a European Private Company can have, perhaps using the successful EEIG rules as a precedent. That number is open to discussion but it is worth noting that 99.8% of the businesses in the EU have less than 250 employees.

8. Insolvency

Insolvency presented a completely different set of problems, and wisely I feel we simply referred this to the law applicable to companies of parallel type in the Member States.

9. Governing Law

The desire of the drafting team to avoid reference to the various national company laws as subsidiary laws was very strong. The Regulation has taken a very tough line on this point and lays down a hierarchy of rules governing the European Private Company. We begin obviously

with the Regulation itself and then refer to the provisions of the company's articles which are not inconsistent with the Regulation. Anything governed by the Regulation may never be subject to the application of the law of the Member States, even with respect to those points which it does not settle expressly. Instead the general principles of the Regulation, the general principles of Community company law (in so far as these can be determined) and the general principles common to the national laws are then applied in turn by the judge in order to form the basis of a solution to the relevant problem. National laws, as such, can only be applied where the Regulation expressly refers to them, as it does for example in the case of accounting rules and insolvency provision. The thinking of the majority of the drafting group was that the danger from the reference out of key areas of European Private Company law with the potential for the creation of 15 types of such company outweighed the difficulties that judges would be faced with in their search for an appropriate solution. Judges would thus be forced to come up with solutions in keeping with the concepts inherent in the European Private Company project.

The European Private Company - Model Articles

Andrew HICKS
(Andrew Hicks, Solicitor, Senior Lecturer at the University of Exeter was not present at the colloquium. His contribution was read by R. Drury)

The purpose of this talk is to describe briefly the proposed Model Articles of Association for the European Private Company. Article 13 of the draft Regulation envisages the inclusion in its first schedule of standard-form articles of association. Two sets of model articles have now been drafted by Andrew Hicks and myself working with Professor Peter Hommelhoff and Diemar Helms of Heidelberg.

1. Advantages and Difficulties

We are convinced that the European Private Company has much to offer the small business sector of the European economy, not least in this country where it is particularly vibrant ;.it offers entrepreneurs full flexibility to structure the organisation of their company as they wish ;.it gives them full freedom of contract in drafting their articles of association.

But there are possible difficulties for launching and gaining acceptance of a new European form of company ;

- it is unfamiliar : promoters of an EPC will be entering relatively uncharted waters ;
- it could impose additional costs on startups : drafting new forms of articles without any precedents would be expensive work. These costs and uncertainty can be minimised by annexing to the Regulation a choice of model articles that incorporators are free to adopt, vary or even ignore.

2. Special Importance of Model Forms

Producing model articles right from the beginning is perhaps particularly important for the European Private Company for a number of reasons.

First of all the Regulation itself, the primary legislation for the EPC, is relatively brief. It leaves the members of the company broad scope for defining how the company is to be run.

Secondly a number of provisions of the Regulation require certain specified matters to be put in the articles.

And thirdly, article 12 of the Regulation defines the Governing law which applies to the EPC. It is intended :

- to assure uniformity between EPCs incorporated in different jurisdictions and
- to minimise reference to distinctive national laws.

The uniformity of the European Company free of reference to national law is of course essential and perhaps one of its most desirable features. However, it places the onus on the incorporators to define their relationships fully within comprehensive and effective articles of association.

It seems likely that the model forms, will be widely used. If so, this should usefully supplement the legal principles supplied by the Regulation and should also help to establish a uniform way or ways in which EPCs are structured

3. Comparison with Table A

In this country we are very familiar with the statutory Table A model articles of association. These are of long standing and are widely followed by most small companies. This experience illustrates how model articles can have a harmonising effect on the style of association agreement.

The idea of providing model articles for the EPC is perhaps inspired by the British Table A. But it is different in principle. Table A applies to every new company as default articles, except to the extent that it is excluded by articles drafted and registered by its promoters ; But for the EPC it is not intended that model articles will apply automatically in default of articles being registered. On the contrary, promoters will be obliged to file articles ; they may simply choose to base their agreement on one of the Model Articles provided with the Regulation if they so wish.

4. Work So Far

We have now prepared two sets of Model Articles. These are in draft form for consultation and comment. Copies are obtainable from me at Exeter University by e-mail or fax.

Model A is for the smallest partnership type company.

Model B is for the perhaps larger company which may have some shareholders who are not actively involved as directors.

The drafting team were very conscious of the need to avoid merely trying to imitate our own national company structures. Instead we studied company constitutions from as many Member States as possible and took what seemed to be best and common practice from them. The forms are not therefore tied to any particular national tradition. While our aim was to come up

with something reasonable familiar and widely acceptable, if we thought a novel idea was a good one we included it.

We therefore hope that the model articles for the EPC will be as good as typical practice and in some respects better ; remembering of course that incorporators are always free to include whatever they wish.

5. Description of the Model Forms

It now remains only to briefly describe the structure of Model A and Model B.

Model A is designed for the small family or partnership business. Many small companies have no outside investors but are set up and run by a small group of associates. In the English context they would all generally expect to be directors. Model A deals with this by saying that the company shall be managed by the shareholders. Thus every shareholder is automatically a member of the management board. Its decisions are made by majority vote, each person having one vote. This system runs in effect like a partnership, though a person having at least 20% of the shares can ask for a particular resolution to be decided on the basis of one vote per share.

A novel feature is that the members can unanimously appoint a manager or managers to act in their place for a fixed period. Thus for example if elderly founders of the company wanted to appoint outside managers, or more probably to retire and hand over management to their children, they can appoint them as managers.

This therefore gives the option to change from management by all the shareholders to management by a board of managers. If managers are appointed, certain decisions are referred to the shareholders in the usual way. Model A then specifies these matters, such as the appointment of managers, approval of accounts and altering the articles, which are then reserved for decision by the members.

In contrast, **Model B** is for a larger company including outside members who don't intend to take part in management. In this case the general meeting of shareholders is responsible for appointing and approving the actions of the management and for altering the constitution of the company. They can either appoint a manager or managers – this fits the style of the French *geran,* – or they can appoint a board of directors following the common law practice.

Both Model A and B have provisions on share capital, transfer of shares and preemption rights, shareholder rights generally, compulsory acquisition of shares, auditors and dispute resolution.

Many of these provisions are relatively familiar and must of course comply with the relevant harmonisation Directives.

Conclusion

Entrepreneurs incorporating an EPC will of course be free to adopt articles of whatever style they wish. But these model articles are of considerable importance to the efficient launch of the European Private Company.

We now look forward to feedback on the drafts that have been prepared to make them as appropriate as possible throughout the European Union.