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Perspectives in Company Law and Financial Regulation

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The *Societas Privata Europaea*: a basic reform of EU law on business organizations

THEO RAAIJMAKERS

I. Introduction

It is a great pleasure to contribute to this *liber amicorum* in honour of Eddy Wymeersch. His vast and seemingly unlimited interest in company and securities law offered an equally broad choice of subjects for this article. Working with a team of researchers in Tilburg's Center for Company Law on a broader project aiming at revealing the basic elements and guiding principles of reform of company and enterprise law, I decided to carve out from this project some observations on the intended introduction of a statute for European Private Companies.

The idea for an EPC is not new. Shortly after publication of the first draft for the SE Statute, Mme Boucourechliev published her 'Pour une SARL Européenne'. Together with Drury, Hommelhof *inter alia*, she was involved in drafting a proposal that was published by CREDA/Medef in 1998. The High Level Group of Company Law Experts reiterated the case for an EPC and the EC in its 2003 Action Plan and gave it a mid-term priority. In 2006 a consultation document was published focusing on the scope and nature of an EPC statute: (a) should it be available to single-owned firms and quasi-partnerships or also to private firms with 'dispersed' ownership?; (b) should the statute be standalone and exhaustive or – like the SE statute – build on and refer to national law? Though the responses are somewhat diffuse, respondents focus on enhancing start-ups and cross-border activities of SMEs and almost unanimously plead for contractual freedom and flexibility, avoidance of complexities for subsidiaries and time-consuming, costly procedures and formal requirements (like notarization of documents) as well as for introduction of a stand-alone statute that does not create twenty-seven different statutes by referring to national law. The emphasis is on organization, not on *re*-organization. Meanwhile the EC

announced that it would take further decisions on a Statute (regulation) for a Societas Privata Europaea (SPE).[1]

The SPE project should be placed against the background of EU constitutional law, the Lisboa agenda (2000, as amended), the prevailing case law of the European Court of Jusitce (ECJ), the regulatory competition fuelled thereby and the reforms of the law on private (close) companies as now being scheduled and/or discussed in several member states. In the perspective of global competition, it is equally important to assess the regulatory actions in other jurisdictions, more specifically the Limited Liability Corporation and the Limited Liability Partnership, since both combine a high degree of contractual freedom with limitation of liability. This combination seems to cause one of the main obstacles to reform towards more flexible business forms for SMEs. This article therefore aims to contribute to the forthcoming debate by an analysis of the combination of contractual and corporate devices as developed in the LLC using the text of the US Model Act (ULLCA).

Taking the constitutional aspects first, the annex to the revised Roman Treaty follows the Social Charter (2000) and proclaims the freedom of entrepreneurship, the freedom of association (not excluding commercial cooperation) and the protection of property. These constitutional principles evidently do not prevent the EU nor its member states from protecting the business community and general public by rules on business organizations and their activities in providing goods or services, but it forces them to respect such limitations and contrast them to the overall societal objective of enhancing entrepreneurship by means of an advanced law on business organizations for SMEs and large firms. The ECJ plays an important role. It held that the freedom of establishment prevents member states from refusing to recognize (pseudo) foreign corporations (business organizations, firms) on the mere ground that these do not meet the protective standards that member states have set for their *national* business forms or pseudo-foreign corporations. Such restrictions by member states and others to prevent clear fraud are not completely foreclosed but their reach can be challenged before the ECJ. Its case law allows entrepreneurs to freely select business forms of *other* member states – the choice shall in principle be recognized in the case where registered office and real seat are not located in the same member

[1] See: http://ec.europa.eu/internal_market/company/epc/index_en.htm

state. The prohibition of such a 'split' in art. 9 of the SE Statute seems to be obsolete now.

The ECJ case law fuelled a certain degree of regulatory competition within the EU and an acceleration of reform initiatives for national statutes for close corporations, e.g. the amended French SàS regime and the Netherlands project to revise the BV statute. Since an SPE Statute would enlarge the menu of business organizations available to entrepreneurs in the EU, it would therefore also and *per se* have a competitive effect in the selection of business forms. The discussion on the outlines of an SPE Statute therefore is also relevant for such reforms of national law on business organizations. Reforms continuously appear to be burdensome, 'path dependent' as they are. The eligibility of close corporations providing limited liability and the concern to prohibit abuse and fraud is closely linked to the basic principles of company and partnership law or – in a wider sense – of the law on business organizations, including the most common form of sole ownerships. An SPE Statute offers the challenge to be drafted from scratch, but also at EU level this may be constrained by the *acquis communautaire* that effectively fixes starting conditions as an EU path of its own and prevents the creation of a competitive business vehicle for European entrepreneurs fitting into and serving the Lisbon agenda, the constitutional freedoms and the Treaty's principles of freedom of establishment and capital.

The Lisbon ambitions urge the development of the law on business organizations in the EU and also the SPE project as part thereof to be placed in the wider context of global regulatory competition and strengthening the EU common market. Furthering the integration of the EU common market as well as enhancing entrepreneurship and competitiveness in a globalizing economy, urges benchmarking with developments outside the EU to enable sharper identification of constraints to, as well as of, opportunities for change and the impact thereof. Specifically the development of the very successful Limited Liability Corporation (LLC) in the US offers such a fresh look to regulatory concepts as being developed over centuries in different jurisdictions. This modest contribution therefore contrasts the ideas on a possible SPE statute with these business forms. This article respectfully builds on research dedicated by many scholars who, I hope, will appreciate that the limited size of this article caused me to refrain from documenting these sources. This will follow in a more extensive publication anticipated by the Tilburg research team.

II. Preliminary observations: the need for a European flexible, cost-effective (corporate) vehicle for entrepreneurs in small- and medium-size enterprises

Entrepreneurs, whatever the scope of their business activities, usually start as sole proprietors but may soon be confronted with the need to select a corporate vehicle from the menu of business organizations to incorporate their business. Usually they will select a form from the menu of their home state, but may also select this from another member state's menu. If they develop permanent cross-border activities in other member states they have to decide whether to organize their business as a separate corporate vehicle ('sister', in a horizontal structure held by themselves), a branch of their home state firm or as a subsidiary. An SPE Statute should clearly envisage each of these organizational segments of cross-border activities and the practical need for *all* SMEs to organize their cross-border activities as a group of companies: a parent (SPE or other form) to be selected from the menu of the home or another member state and one or more subsidiaries in other member states. For the parent the European label of an SPE may enhance its image in the business community of other member states, also if cross-border activities are organized as branches, but less so in case the latter would be incorporated as 'local' SPE subsidiaries. The major concern that seems to drive the SPE initiative is to facilitate and enhance the organization of a multi-state business in the EU. The design of the SPE Statute should, however, clearly reflect that the structure of the European common market substantially differs from that of other major markets, such as in the US, China, Russia and India, that allow a simple single business entity to operate in other states or provinces in their own market. The EU will remain to consist of different jurisdictions characterized by different languages, cultures, traditions, commercial and societal customs, financing possibilities for SMEs, private and commercial law, taxation, insolvency rules and principles, labour relations, customer protection, environmental and other rules. These differences will in many cases urge EU entrepreneurs to separately incorporate as a subsidiary their permanent business activities in other member states. Thus they typically will prefer or be *de facto* forced to organize their multi-state business as a group of companies. This remains a disadvantage in comparison with other large multi-state markets where a multi-state business can be organized as a single entity headquartered in one state (province) and operating through local branches in other states (provinces). Size does

not make a decisive difference: although the initial and marginal costs of creating such a structure will be higher for SMEs, these have to be offset against the continuous costs and management risks of operating through branches in other jurisdictions.

An SPE Statute therefore should equally serve (the shareholders base and governance of) a stand-alone SPE as an entity that enshrines incorporation of a single-person company, quasi-partnership or family company, as well as an SPE that (also) operates as the parent of a group of SPEs (or other entities) and, moreover, looking from the perspective of a subsidiary SPE in relation to its parent to preserve the coherent and unified control of the parent over its operational and legal group structure in its multi-state group strategy and management. Hence the SPE Statute should explicitly take into account that expectedly an SPE will often be used to create cross-border subsidiaries, quasi-partnerships and joint ventures for cross-border cooperation. The Statute should envisage the use of an SPE as parent as well as at subsidiary level. Therefore the eligibility of an SPE should not be limited to multi-state cases.[2] If the 'European label' should allow the enhancement of cross-border marketing and business, also nationals should be able to benefit from the SPE in pursuing cross-border activities. Evidently the plea for flexibility and contractual freedom equally applies to the use of the SPE as cross-border subsidiary and as a vehicle for start-ups and quasi partnerships.

The main deciding elements for the initial selection of a business form to be considered in designing a flexible SPE Statute remain:

a) to partition the business-related assets and liabilities (enterprise) from the rest of his private property to enhance separate management thereof as a propriety interest under full control of the entrepreneur, e.g. distinct from matrimonial property and facilitating a transfer thereof;
b) in cross-border activities: similarly to partition his business abroad from that in his home country by creating a subsidiary to be party to all contracts and transactions in the other member state and to assume all the liabilities thereof;

[2] It would require complicated requirements and enforcement rules if the promoter should be resident in another member state and question the validity of the subsidiary's SPE form if he would be dissolved or acquire the same nationality as a subsidiary. Unnecessary set-up of special vehicles to meet requirements of multi-nationality should be avoided.

c) to manage business activities and fully control strategy, policies and management by a statutory off-the-peg organization model, which will be most relevant in case of a cross-border subsidiary to incorporate a permanent organization of activities in one or more member states;
d) to insulate entrepreneurial risks and protect non-scope private assets from bankruptcy of the firm by shielding off liability for its liabilities (again, also in case of subsidiaries in other member states);
e) to optimize taxation (corporate and personal income tax) under national law and in cross-border relations;
f) to facilitate financing of the business (equity, loans, credit) and to attract new business or financial partners by issuing (transferable or non-transferable) shares or rights thereto (this again relates both to a parent as to a subsidiary in other member states). In case of creating a quasi partnership or joint venture decisive factors may be:

   (i) flexibility to enter into enforceable agreements with one or more partners/shareholders (including venture capitalists and private equity firms) on the internal control and exercise of formal shareholder rights and obligations within the firm and
   (ii) contractual freedom to arrange for or – alternatively – fall back on flexible and cost-effective *default* rules on internal disputes, sell out, buy out and appraisal.

While these elements focus on the initial selection of a single business vehicle, the dynamics of business activities urge the promoter/entrepreneur also to consider the possibilities and degree of flexibility to *re*-organize the legal organization of the firm and its activities. Initially the question arises whether a business can be incorporated as going concern *uno actu* by operation of law. In the life cycle of the firm other reorganizations may present themselves and it should be considered whether and to what the extent the SPE Statute offers flexible opportunities for, amongst others, extension of the shareholders base to (new) partners or financiers, conversion into another business form, merger, split, takeover transaction and also going public.

An SPE typically would offer the additional advantage of a European label in cross-border activities. This may become more important in view of the increased multi-cultural character of the EU after the

extension of the EU to – at present – twenty-seven member states with their different legal traditions and company law.

In the selection from the menu of business organizations (home state and other member states) the above elements should be balanced against constraints to full control and costs of incorporation (initial and continuous) both under national law (parent) as under the law of the other member states involved:

a) costs of incorporation: procedures, notarization, registration, professional advice (legal, tax, accountancy);
b) initial and ongoing taxation (as well as possible choice between income and corporate tax);
c) administrative burdens of formalization of internal procedures (formal division of powers as – single or joint – shareholder(s) and manager; need for formal resolutions, e.g. on instructions/approvals of shareholders meeting; 12th directive);
d) constrains to control over strategy and management of the parent and 'foreign' subsidiaries respectively;
e) initial and ongoing administrative costs, fees and levies of registration;
f) costs of disclosure duties and audit services as provided for under the 1st, 4th and 7th EU directive or other statutory requirements; contractual monitoring requirements set by banks or other financiers (venture capitalists); again, both at the level of the parent and its 'foreign' subsidiaries;
g) costs of legal and other advice in the ongoing operations and any subsequent internal and external disputes at the level of the parent as well as of its 'foreign' subsidiaries.

Evidently the success of the SPE Statute will largely depend on its ability to shape an effective group organization consisting of an SPE-parent that will be in full control of its 'local' SPE-subsidiaries.

The EC's synthesis of the comments on the consultation document on a possible statute for an EPC[3] largely reflects the above elective elements both implicitly and explicitly. Asset partitioning and limited liability are apparently assumed, but the responses do not clarify the position on the 'price' in terms of (national or EU) protection of third parties, like capital protection, statutory disclosure of accounts and audit, liability of directors and shadow directors or wrongful trading rules.

[3] See: http://ec.europa.eu/internal_market/company/epc/index_en.htm

The most remarkable observations are in line with the earlier recommendations of the High Level Group of Company Law Experts (November 2003, Ch. VII) and can be summarized as follows:

a) The diversity of company laws and regimes are a significant source of costs and legal uncertainty. The existing legal framework is insufficient for cross-border activities. Providing a European label is regarded to be helpful as a marketing tool in a global environment. An SPE would allow significant costs savings by using the same legal form across the EU;
b) The SPE statute should be as open as possible and offer maximum flexibility. Even though a majority would still support a single shareholder SPE, most consider that the SPE should be open to single and multiple shareholders (legal and natural persons alike) and be allowed to have headquarters and registered office in different member states. A single shareholder model, however, would allow for a more simple and uniform SPE statute. A majority clearly favours a stand-alone and exhaustive SPE statute without reference to national law to provide for a set of unambiguous rules, prevent high legal costs and the emergence of twenty-seven different rather than one single EPC. This would be the real added value of the statute.
c) In a single shareholders SPE statute more matters could be left to the articles of association than in a multiple SPE; many matters pertaining to the management of an SPE should be left to contractual freedom.
d) Respondents' reactions were split on the issue of employee participation regimes, some opting for uniform rules and others believing that opting for the rules applicable in the member state where the SPE has its seat would be the only feasible solution.

Since the Lisboa ambitions, as rephrased, are formulated in a global, rather than internal European perspective, we should compare with developments in other important jurisdictions. Since the aims formulated by the EC to consider an SPE Statute evidently closely resembles those that lead to the introduction of the very successful business organizations of the LLC and LLP in the US and other jurisdictions, a closer comparative analysis of these regulatory innovations seems highly relevant for the design of a brand new SPE as a European business organization. These business forms offer starters and entrepreneurs a flexible business form in a start-up to incorporate their business

activities. The check-the-box rules allow a choice between corporate and income taxation.

III. Overall regulatory approach by the EU and starting conditions

The preamble of the EPC Statute should clearly lay down the legal basis for the nature of the Statute and its purpose in the socio-economic framework of our societies as reflected in the European Treaty for Human Rights, the Roman Treaty (as amended), the Social Charter (2000) and the Lisbon statements. Freedom of enterprise and association and protection of property shall be respected and undue state interference shall be avoided. Similarly the freedom of establishment (and recognition of pseudo-foreign corporations) as established by the ECJ in *Centros*, *Überseering* and *Inspire Art* shall be reflected. These basic concepts and policies should guide EU regulatory action to enhance entrepreneurship and private initiative as indispensable generators of wealth and innovation. The design of the Statute should strengthen the competitiveness of the EU business climate and environment in the global competition. Present but sometimes ineffective concepts to prevent and sanction abuse and fraud should be reconsidered in close connection with insolvency law since the ultimate test of such corporate behaviour emerges practically always in bankruptcy/insolvency. *Capitis deminutio* and *mort civile* may have been abolished but lifelong stigmatization replaced these sanctions and the approach of a 'fresh start' after insolvency is not common in Europe.

The *constitutional starting points and freedoms* can be summarized as follows:

a) the basic constitutional freedom of entrepreneurship as the autonomy of persons (citizens) to become and operate as an entrepreneur by starting, organizing, financing and operating a business under own control and discretion, accrue and receive earnings (salary and profits) therefrom and create value on top of the net asset value, which can be disposed of as a propriety interest by sale to third parties, by will or otherwise;
b) the constitutional freedom to *associate* with others (entrepreneurs and/or financiers) to pursue a joint enterprise by contract, partnership or any other form of joint ownership and association, and to *share* propriety interests (control, earnings and the accrued value of the joint firm);

c) the freedom to select without state intervention (or concession) any business form available within their own or any other (EU) jurisdiction;
d) the freedom to re-incorporate a business in another EU jurisdiction;
e) the freedom to *organize* the 'internal affairs' of the business organization as they think fit for their firm and resolve on matters concerning the firm upon the agreed upon scheme;
f) the freedom to reorganize the firm's business form and/or the members relationship thereto by changing its internal affairs, merger, split, conversion or any other such mechanism, including going public by issuing (tradable) securities in the market;
g) the freedom to *dissolve* the firm with or without continuation of the business.

These basic freedoms are guiding principles in our free market economy based on liberal democracy. On the other hand the general and public interest of our complex societies urges proper regulation of amongst others economic activities of entrepreneurs. They have to pay direct and indirect taxes, observe strict quality and safety standards in manufacturing and sale of products and services under public oversight, e.g. production/sale of food and drugs, banking, insurance, traffic, all kinds of professionals services, environmental risks. Regulators thus discharge their public tasks with respect to much more: care for personal health, quality of drinking water, food, medical and other professional care, personal and general safety and security, prevention and reduction of environmental risks et cetera.

However, such rules on *market activities* of entrepreneurs should be sharply distinguished from those on the *organization of their business form as such,* i.e. the law on business organizations. It is here that we encounter (diverging) historical roots that until today do influence our concepts and – often unveiled – assumptions. Free entrepreneurship was restricted by the medieval guilds, that were abolished in/after the French Revolution. Today membership of professional organizations is required for certain regulated professions only. Restrictions to free association did occur throughout history and recognition of associations as legal persons in The Netherlands required until 1976 Royal Approval which regularly was withheld. Cooperative associations were long distrusted for their 'political' aims. In commercial law over time *contractual* joint enterprises developed for cooperation between entrepreneurs and/or financiers in the form of (limited) partnerships giving

the (general) partners joint control and ownership and limited liability to 'silent' partners. Companies emerged as *continuous* partnerships with fixed capital divided in (tradable) shares and limited liability for the holders thereof. The Dutch East Indian Company (1602), created by Act of Parliament, received a concession to trade 'with the East' to act 'in the common wealth' under public oversight. Only after more than a century such a concession was gradually replaced by 'free covenant': promoters themselves without such approval could create a company-legal person, but the Napoleonic codification re-introduced a moderated form of state approval (non-objection). In the UK the South Sea Bubble caused parliament (in 1720) to ban public companies altogether, which remained effective until 1840. German 'Konzessionszwang' and public interest objectives were replaced in the 1892 Aktiengesetz by a set of detailed mandatory substantive rules ('materielle Normativbestimmungen') to protect shareholders, creditors and others. While the flexible and sober Netherlands statute also allowed the NV to be tailored for flexible closely held NVs, Germany created next to its strict AG statute a *separate* 'light' contract-based GmbH statute, which was copied in many countries. In The Netherlands such a separate BV form was only introduced as late as 1971 to avoid mandatory disclosure of accounts for closely held NVs as still allowed by the 1st EU directive.[4] The statute was copy pasted from

[4] Until 1976 company and partnership law were integrated in the Commercial Code (no separate form for private companies). 'Public' companies were '*corporate* species' of partnership, essentially based – at least its internal organization – on contract, albeit that a notarization and a ministerial decree of non-objection were required (public oversight). The statute was very flexible and at the start of the EU The Netherlands were feared to become the Delaware of Europe. In 1971 the BV, i.e. the 'close' corporation, was introduced to enable privately held companies to be exempted from the duty of the 1st Directive to disclose audited annual accounts. Its statute was, however, copy-pasted from the then modernized and institutionalized NV with employee participation for 'large' companies. NV *and* (!) BV were disconnected from partnership law and enacted in Book 2 Civil Code under the heading Legal Persons (together with public entities, churches, associations, cooperatives and foundations) and with overall general rules. Hence, until today, even single-owned BVs and quasi-partnership BVs are characterized as 'institute' and legal person in the first place. The original notion of contract is absent, but a broad rule establishes that all directly related parties should observe rules of equity. Anti-abuse provisions against acts contravening the 'own interest of the company' have been piled up in company law (minimum capital, capital protection, disclosure of accounts, directors' liability for non-compliance with disclosure duties also in bankruptcy, the duty to properly resolve and record resolutions in case of related party transactions and conflicts of interest also in one-man companies). Case law shows that non-observance of company law rules are used by receivers to hold directors and shadow directors liable in bankruptcy. The pending Bill to reform the BV deletes some rules on minimum capital and capital protection, but leaves many others in place and adds a new solvency test in case of distributions.

the NV statute and hence the BV inherited the influx of the stakeholders approach that characterized the amended 1970 NV statute.

The 'Rheinland' (stakeholders) model is well known from the debate on the governance of *public* issuers. It regards companies as an *institution* with a variety of stakeholders and interested parties, rather than as an *instrument* of entrepreneurs and/or shareholders. Creditors should be protected not only by means of general private law and specific insolvency law provisions, but also by company law itself (*inter alia* protection of capital, rules on external liability of directors and disclosure of annual accounts to allow assessment of the solvency of the company as – potential – debtor). After World War II, Germany and various other countries introduced rules on participation and co-determination of employees (not only at shop floor, but also at board level).

Thus close companies became a derivative of 'public' companies rather than of contractual 'partnership' or of sole ownershipship. So the stakeholders concept over time influenced close companies as well, including schemes of participation of employees. Creation of close companies as legal persons providing limited liability to shareholders in The Netherlands until recently required a ministerial declaration of 'non objection' and it is still subject to notarization. The latter requirement will be even extended to partnerships that elect to be 'legal person' (a status that thus be attributed rather than *recognized*). Moreover the close company law statute over time has been filled with strict mandatory rules to prevent abuse and fraud, not the least to protect collection of taxes. Further, companies regulation follows the regulatory concept of 'associations' of capital providers (*universitas personarum*) rather than that of contractual cooperation (*societas*) between entrepreneurs and financiers or a *universitas iuris* with particular beneficial interests (incorporation of sole ownership). The 'institutional' concept of companies shifts regulatory concern to the variety of stakeholders and mandatory rules to protect their interests. Applied to 'private' businesses it constrains their contractual character. The regulatory claim of this legislative approach necessarily tends to a closed shop (*numerus clausus)* of business organizations with mandatory

Co-determination for large BVs will not be changed. The Explanatory Notes to the Bill specifically state that the 'institutional' character of (also) the BV remains the guiding principle for reform. No contract, no split between memorandum of incorporation and articles of association, shareholders agreements remain non corporate contracts, still quasi-NV rather than quasi-partnership, mandatory law. Faced with requests to consider a Netherlands LCC and LLP the Minister of Justice recently responded in the same way. It illustrates the importance of going back to basics.

regulations, resulting in restrictions to the menu of possible reorganizations (conversions, mergers, splits, transfer etc.). The recent ECJ decisions (*Centros*, *Uberseering*, *Inspire Art* and *Sevic*) does however breach such ban.

Thus the statutory concepts and objectives for different 'legal persons'–business organizations – raises the basic question whether these forms are instrumental to the entrepreneur or rather institutional. This is not a soft, philosophical issue, but one that is highly relevant to guide regulation on a number of issues. Prevailing answers indeed form part, also in reform debates in member countries, of path-dependent directions and should therefore be unveiled. This is also true for the present debate on the SPE Statute.

Netherlands company law is framed in a broad regulation of 'legal persons', disconnected from partnership and commercial law. Also other jurisdictions do not have a coherent statute for business organizations but rather a dispersed variety of codes and statutes. Belgium and Austria did recently integrate their regulation.[5]

Overlooking EU company law the picture is not different. To achieve one common market the Roman Treaty established the freedom of establishment (arts. 42–49). Cross-border corporate mobility was hardly existent and regulatory competition restricted by the aim to harmonize corporate law (art. 44(g)) which reflects a broad 'institutional' and 'stakeholders' concept of companies/entities/legal persons (art. 48–2 and art. 44(g)).

The 1st (and for branches: the 11th) directive created a EU-style corporate disclosure system to facilitate access to basic data of '*companies*': instrument of constitution (incorporation) and amendments, (powers of) managers, subscribed and authorized capital *and* annual accounts as required by the 4th and 7th Directive (audited single and consolidated accounts). Initially 'private' companies were exempted, but were later included by extending their scope. The 2nd Directive introduced mandatory rules on protection and maintenance of capital and assets (minimum capital, evaluation and audit of contribution in kind, mandatory reserves, limits to distributions of profit and reserves; some member countries extended these rules to 'private' companies to prevent fraud and abuses of limited liability. The 4th and 7th directive require all companies (incl. private and one-man corporations; see 12th Directive) to draft single and consolidated annual accounts (balance sheet, P&L account and management report) in accordance with its standards,

[5] Belgian Wetboek van Vennootschappen and Austrian Unternehmensgesetzbuch (2007).

statutory audit and disclosure (filing with the commercial register/registrar). They thus typically reflect an institutional (stakeholder- rather than shareholder-oriented) approach. Specific disclosure rules are applicable in case of changes of capital and other incidental corporate reorganizations: (cross-border) legal mergers and splits (3rd, 6th and 10th Directive). The system focus at *disclosure* of accounts (and specific reports) to serve the public at large. The draft 5th Directive intended to harmonize corporate governance of 'large' formal public companies: board structure, co-determination, division of powers between management, non executive directors and GMS and other governance issues, but no agreement was reached on the choice between shareholder and employee orientation. The 9th Directive on the law on groups of companies,[6] *inter alia* providing for a special report on related party transactions between parent and a public type subsidiary, did not even reach the status of an official draft. Most of the scope and subject matters of the directives and regulations focus on the type of *public* companies and issuers. The directives are implemented into national corporate law, sometimes with voluntary extension to close and pseudo-foreign corporations.

The EU did not itself develop a clear concept of, nor a coherent statute for, *private companies* or partnerships (the EEIG resembles both partnerships and (cooperative) associations). It allows the EU to make a fresh start, deviate from and set aside the 'acquis communautaire' that largely originated as a top-down (from large enterprises to SMEs) rather than as bottom-up design, i.e. starting with small and medium-sized enterprises and building on such rules towards larger and big firms. The present EU company law in fact is very dispersed in concept as well as in substance. It reveals the opportunity to create a new, flexible and innovative SPE that avoids the petrification of existing EU company law.[7]

[6] This subject was covered in paras. 291–328 of the new Aktiengesetz (1965) and was copied into the first drafts for the SE Statute (Title VII of the 1970 draft). The text of the provisional draft for a directive was published in M. Lutter, *Europäisches Unternehmensrecht, Sonderheft Zeitschrift für Unternehmens- und Gesellschaftsrecht* (1991), 279–289.

[7] The societal and, hence, legal extension of the concepts of entrepreneur and enterprise caused a gradual linkage of traditional private and classical commercial law regulation. The basic 'entity', the sole ownership, in which the entrepreneur 'owns' his enterprise and acts as party to all contracts and transactions, is not generally but only incidentally addressed (e.g. EU Directive protection of employees in case of transfer of business). 'Civil' and commercial partnerships may be regulated in civil and commercial codes and/or in separate statutes, sometimes as specimen of joint ownership, sometimes as specific contracts and yet in other times as separate entities. Similarly *corporate* business organizations are sometimes linked to 'associations', sometimes to partnership or to trustlike devices or simply to artificial persons (e.g. Book 2 DCC), each time – though not necessarily exclusively – addressee of all assets and liabilities.

The overriding question for the SPE statute – and more generally for the development of the EU and national law on business organizations – appears to be how it can contribute to enhancing economic and innovative strength of EU enterprises in the rapidly changing global economy. At the level of regulatory design an equally relevant question is how in this changing reality of our EU market and society the primary freedoms and proprietary interests of entrepreneurs shall be respected and balanced against the interests (an appropriate protection) of other interested parties. The most promising approach seems to be to think bottom-up or – as was the device in the UK – to think small first.

Entrepreneurship should be enhanced, its imminent entrepreneurial risks should be acknowledged and divided properly, acquired and accrued value in business should be properly protected as a propriety interest, creditor self-help should in business be the lead theme, not accumulation of statutory protective rules that are ineffective and burdensome.

If these elements are taken as starting points for drafting the statute it allows a sharper view on where and to what extent such specific corporate law protection should be provided for. It would also urge a reassessment of concepts and substantive rules of prevailing EU company law directives and regulations to allow a fresh view on the regulatory function and border zones between company and insolvency law. Taking another route may result in piling up or even cherry picking rules without assessing their ratio and effectiveness. Protection of associates, members and third parties should be based on contractual freedom to agree on the 'internal affairs' between them as associates, not as anonymous investors. General private law (contract and property) should be tested on their ability to cope with fraud and abuse of the corporate device, e.g. by distributing funds causing the company to become unable to pay its tax and other bills without recourse for creditors in bankruptcy. It urges to seek borderline solutions between strict company law and general private and insolvency law (like the *actio Pauliana*). Prevailing regulations should be meticulously assessed (e.g. asset and capital protection, disclosure of accounts, statutory audits, mandatory division of powers, general and specific (insolvency law) liability of directors and shadow directors, derivative or direct actions of creditors and other enforcement mechanisms. At least in the Netherlands case law reveals that receivers in bankruptcy did (successfully) attempt to construe directors' liability on alleged non-observance of *internal* company law rules.

IV. Basic issues to be addressed in the SPE Statute

Thinking bottom-up – like the ULLCA did – would cause the basis for the SPE Statute to be the freedom of enterprise and contract and the protection of propriety interests to enshrine the economic and legal organization of single-owned enterprises (incl. subsidiaries), quasi-partnership, firms financed with venture capital and family holdings with 'dispersed' ownership. The Statute should focus on minimum mandatory requirements and provide as well – in one form or another – off-the-peg models and solutions (default rules) for different, also more complicated firms like family holdings. It should allow partnership-like patterns for cooperation between business partners and tailor-made financing by venture capitalists and merchant banks. It should be apt to become a standard form in its own right. State concessions and similar requirements ('birth control') should be avoided and formal requirements (notarization) be minimized. Regulation of internal affairs (to protect shareholders) should be left to contractual freedom of promoters/partners and shareholders. In view of the many single-person companies and quasi-partnerships the statute should not be overloaded with superfluous rules that de facto address patterns with a multitude of 'outside' shareholders. The SPE should be recognized as a legal person the internal affairs of which are regulated by contract. The 'owners' of an SPE (shareholders) will have limited liability. Protection of employees, creditors and other interested third parties should be addressed primarily by non-corporate law rules, like contract and labour law, that can provide more effective and tailor-made tools for the protection of their interests. Tort victims are usually not specifically protected by the law on business organizations. (Future) Creditors should be more clearly confined to the principle of creditor self-help. Trust is indispensable in the business community, but should not be – at least not primarily and exclusively – be gained by a multitude of detailed and complicated statutory rules that later may and often do appear to be costly but ineffective.

A. The character of the SPE Statute

The choice for an SPE from the available menu(s) of business organizations should offer a reliable, cost effective business organization. The SPE Statute should therefore be drafted – in contrast to the SE Statute – as a real stand-alone statute. A Regulation would provide the proper instrument. It should be comprehensive and exhaustive, i.e. without references

to national law to fill gaps and without additional national requirements. Disputes are to be resolved by applying the rules of the statute in accordance with their ratio. Official comments should offer guidance. Ultimate interpretative questions will be submitted to the ECJ. Arbitration and mediation should be recognized as appropriate means which partners or shareholders can freely select to resolve their disputes. To prevent petrification of the Statute an official experts committee should be appointed to monitor practice and advise the EC on amendments or additions that may become necessary or desirable.

1. The character of the SPE

The focus on SMEs implies a bottom-up approach. Hence the SPE should be instrumental rather than institutional to enable and facilitate incorporation of small and medium-size sole ownerships, partnerships, family holdings and venture capital financed firms. The SPE should not be designed as a derivative of 'public' companies, but rather build on the contractual and proprietary concepts of partnership and sole ownership (see S. 202 ULLCA). Complicated internal governance and shareholder protection rules for public type companies should be avoided. The SPE should offer a simplified company form which is recognized as a separate legal entity (see S. 112, 201 and 501 ULLCA), grant limited liability to its owner(s)/shareholder(s) (see S. 303 ULLCA) and allows contractual freedom to organize its internal affairs. To prevent uncertainty and legal costs the Statute should provide for proper default rules and attach various off-the-peg models for the internal organization. Transfer of shares need not be excluded; the main rules can be adapted to those applicable in partnership law.

To enable the reality of SPE-patterns to be reflected the Statute should enable an SPE to be structured as '*shareholders managed*' or as '*management managed*' corporations.

2. Eligibility of an SPE

Perhaps the major advantage of an SPE in the enlarged and culturally diversified EU will be its European label, particularly in cross-border business activities developed from the home state. A requirement of being 'international' (or – like an SE – to be created by promoters from different member states) would unnecessarily limit the eligibility of the SPE. Promoters should not be forced to create artificial, 'formal' cross-border structures. An SPE should rather be eligible for every EU citizen-entrepreneur or firm, irrespective of the nature of their

activities: merchants (Kaufleute), providers of professional services (lawyers, auditors, docters), securities industry, farmers and others, including existing companies or other entities (also other than an SPE). A plurality of promoters will not be required (12th Directive). Limitations to the objects and operations like art. 3 of the EEIG Regulation should be avoided (S. 112 ULLCA).

B. The creation of an SPE

An SPE should be created by signing a memorandum of incorporation and filing that memorandum with the Commercial register (Registrar or similar national agency) which filing will vest legal personality (see S. 202 and 205–7 ULLCA and art. 1 EEIG). The Statute should – like the EEIG Statute – provide its own rules without reference to the 1st Directive. The creation will not be subject to any (form of) state consent or approval, nor quasi-public oversight like notarization of documents. Registration of the memorandum will inform and protect the business community and disclose its existence, scope, whether it is shareholder managed or management managed, the identity of the promoter(s), the power of managers – or in case of a shareholder-managed SPE, of shareholders to represent the SPE (see S. 202/203 and 301 ULLCA). The contractual internal organization and division of powers need not be disclosed. An SPE may also be created by conversion of existing corporate entities and partnerships without limitation to 'companies' as meant in art. 1 of the 1st Directive (as suggested in art. 5 EPC) and by a 'going concern' contribution in kind of a sole ownership (transfer by operation of law and therefore a quasi-conversion).

1. Capital and shares

The capital of the company will be divided in shares and the rights attached thereto will be laid down in the agreement between promoters. Shares may vary in terms of nominal value, control, income and value. Whether shares are transferable or may be pledged will depend on the operation agreement. The ULLCA takes another approach and explicitly provides that members are not co-owners of nor have a transferable interest in an LLC's property. It avoids the qualification 'share' and uses the term 'transferable interest' distinct from any (further) rights members in the organization of an LLC. Only that transferable interest may be transferred and the transferee consequently will not be a member (S. 501–3 ULLCA). That transferable interest may be pledged

or be the subject of a lien ordered by the court. In case of dissociation of a member in a continuing LLC only this interest will be purchased by the LLC against its value as agreed upon or fixed by the court (see 504, 602–3, 701 and 702 ULLCA).

2. Contribution

The SPE rules on contribution shall not be governed by the 2nd Directive and no minimum capital will be required. They should rather focus on partnership like rules and hence allow movable and immovable assets, money, but also services of any kind to be contributed (S. 401 ULLCA). The obligation to contribute will be governed by the agreement and be enforceable on behalf of the company (derivatively) by every shareholder-promoter and – in case he relied upon the obligation to contribute – a creditor (see S. 402 ULLCA). Since SMEs very often start as sole ownerships, contribution is in kind as a 'going concern' by operation of law and thus preserving its 'identity'.

C. Internal organization

The Statute's rules on internal organization should offer both the freedom to members to lay down such rules by (operating) agreement, off-the-peg choices and default rules. To reflect and follow the reality of single-owned companies, quasi-partnerships, subsidiaries and family-owned structures the Statute should follow the ULLCA example and allow SPEs to be organized both as a *shareholder-managed* SPE and as a *management-managed* SPE. The latter could serve cases with a wider circle of shareholders or delegated organizational structures. Mandatory provisions on the creation of and the division of powers between bodies corporate become obsolete; default rules on the consequences of such a choice do not. Because the choice directly affects the authority of members/managers to represent the SPE the choice should be disclosed in the memorandum of incorporation. An operating agreement regulates the affairs of the EPC and the conduct of its business and governs the relations among its members, managers and the company. It should include the following elements.

A *member-managed SPE* would effectively operate as a quasi partnership with each member having power to represent the SPE in its normal course of business, but also – as 'partner' – to be accountable to his fellow members and to observe duties of care and loyalty vis-à-vis the SPE (S. 103 and 404 ULLCA). Therefore the operating agreement cannot

unreasonably withhold information and inspection rights of members, duties of loyalty and care, eliminate obligations of good faith and fair dealing, vary the right to expel members in specified events or to wind up an SPE, as specified. It may specify the procedure to be observed in case of conflicts of interest (S. 103 ULLCA). Each member is agent of the SPE for the purpose of its business. He binds the SPE unless the third party with whom he was dealing knew or had notice of the lack of authority. In case of acts outside the ordinary course of business will be binding only if all other members did authorize such act. The SPE will be bound by wrongful acts in the ordinary course of the SPE's business (S. 301–302 ULLCA). Liability solely by reason of being or acting as member (or manager) is excluded. Members *may* by consent and disclosure assume liability for the debts of an EPC (S. 303 ULLCA).

With respect to the *management* each member would have equal rights and, unless otherwise provided, matters relating to the business of the SPE could be decided by majority vote (S. 404 ULLCA).

Each member shall properly account for his management to the company and its members. Each member has the right to be informed and access to the records of the company (S. 408 ULLCA). The 4th and 7th Directives would not be applicable to the SPE. Public disclosure would be limited to the memorandum of incorporation, irrespective specific information duties to tax authorities and other public agencies or contractual rights of financiers or other third parties.

Fiduciary duties of members in a member-managed SPE would be limited to the following duties of loyalty: to account to the SPE and hold as trustee assets and business opportunities; to refrain from self-dealing in case of a conflict of interest; refrain from competition with the SPE. Duties of care would be limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law. His assignment should be exercised with the obligation of good faith and fair dealing. These duties are not violated merely because the member's conduct furthers his own interest (S. 409 ULLCA).[8]

In a *management-managed SPE* managers will be elected by (a majority of) the members. The rules on binding the SPE would follow *mutatis mutandis* for a member-managed company and the same would be the case for the management-managed company. Management would exclusively decide on any matter related to the business; major matters

[8] See for the position of a member-non-manager in member-managed company: S. 409 (g) ULLLCA.

concerning the organization of the EPC would require approval by the members (S. 404 ULLCA).

Payments made by members made in the ordinary course of the business will be reimbursed and indemnified for any liability so incurred (S. 403 ULLCA). Accounting and information to the company and its members follow *mutatis mutandis* the rules for a member-managed SPE.

D. The limits of limited liability

The limits of limited liability are a delicate and heavily 'path dependent' topic since regulators – also at EU level – over time have designed a series of general and detailed rules to prevent and sanction abuse of limited liability (and non-liability of directors) by mandatory *company* and also private or insolvency law provisions. In drafting a 'light' SPE Statute a fresh analysis is needed of the relationship between recognition/grant of corporate personality as such, the conditions for limited liability, the allocation of the *per se* existing entrepreneurial risks between entrepreneur and third parties, the ability of the latter to protect their risks by contract (banks, suppliers/customers, tax collectors) and the entrepreneurial assignment of managers. Prevention of fraud and criminal use of the corporate device (e.g. for laundering) should be addressed separately in the context of crime prevention and penal sanctions.

The EU 2nd Directive for 'public' companies aims to protect the company's capital by a series of detailed and complicated rules (which were extended by some member states to 'close' companies). Non-observance of internal organization rules (often copied from public company statutes) have sometimes been interpreted as to cope with agency problems in close corporations as well and hence be extended (derivatively, by tort law or otherwise) to protection of third parties, thus blurring border lines between (internal) corporate and insolvency law. The 4th/7th Directives require 'private' companies to prepare and disclose audited single and consolidated accounts to enable (potential) creditors to assess their solvency.[9] As stated above an LLC is not subject at all to such duties

[9] Non-observance of these requirements under Netherlands law (art. 2:248 Civil Code) vest an assumption of causation in case of bankruptcy and hence liability of (shadow) directors for the company's deficit. This is far from rational and reality although these ongoing requirements are costly and burdensome. They tempt receivers to out-of-context interpretations. Starting from the inherent risk of any business venture, the crucial test should rather be whether shareholders in the face of insolvency risks divert assets from the company or managers knowing/intending to induce new creditors to find recourse.

of drafting, auditing and disclosure of its accounts. The directives in their 'institutional' approach thus deviate from the mere traditional accounting to members who evidently can design their own rules for accounting and inspection of records (with proper default rules). Since the ultimate test materializes in insolvency the variety of specific insolvency rules[10] developed in various member states have to be taken into account as well and preferably the SPE Statute should provide exhaustive rules.[11]

The focus should be (again) on the basic issue of withdrawing (by whatever technique) assets from the SPE's patrimony causing the SPE to be or become unable to pay its debts as becoming due in the ordinary course of its business or the SPE just becoming insolvent. This is the core of many existing rules and it should preferably be the core provision in the Statute as well. Its application would involve directors' liability vis-à-vis the SPE to be also enforceable derivatively.

For the LLC the following rules have been established. S. 406/407 ULLCA prohibit distributions to shareholders if (a) the company would be unable to pay its debts as they become due in the ordinary course of business. be made and liability for unlawful distributions or – in summary – (b) total assets would be less than total liabilities upon dissolution of the company. Members/managers failing to meet the standards of conduct and vote for or assent to unlawful distributions will be personally liable for the portion of the distribution that exceeds the maximum amount that could have been lawfully distributed. The recovery remedy extends to the company only, not to creditors.

E. Dissociation and expulsion of members

Regulation of dissociation and expulsion of members in SPE's with more than one member would be primarily subject to the operating agreement between the members. For quasi-partnerships and joint ventures members should envisage that the basis of personal cooperation and commitment (*affectio societatis*) may disappear and result in frustration of the operations of the company or even a deadlock in its management and strategy. Members may provide for dispute resolution but if unsuccessful dissociation should be allowed. They therefore should explicitly provide for – like in a partnership – the terms and conditions for expulsion and for voluntary dissociation and, equally important, for the

[10] E.g. wrongful trading and thin capitalization.

[11] S. 807–8 ULCCA: procedures to settle claims against dissolved LLC.

settlement of the exit price. In view of possible incomplete contracts or a change of the shareholders base, the Statute should provide for default rules to be applied in such case. Although continuity of the SPE's business should be the guiding principle, complete dissolution of the SPE will follow upon occurrence of an event or consent of (number/percentage of) members as specified in the operating agreement, inability to pursue the business or on a substantiated application of a member or transferee of a member's interest (S. 801 ULLCA).

The default rules providing the reasons and grounds for dissociation should include a (lawful)[12] notice of a member to withdraw, agreed upon event, expulsion according to the operating agreement or by unanimous vote under substantiated circumstances, dissolution of a corporate member or partnership, judicial expulsion, bankruptcy, death or appointment of a guardian or conservator (cf. S. 601 ULLCA).

The effect of dissociation of a member is that his 'organizational' rights as most of his fiduciary duties ceases to exist and that he becomes entitled to a purchase by the LLC of his transferable interest against the agreed-upon value or – upon application – as being fixed by the court (S 603, 701–2 ULCCA).

F. Corporate reorganizations

Corporate reorganizations are important for SPEs as they are for other business forms. The 3rd, 6th and 10th Directives harmonized (cross) border mergers and splits and the SEVIC decision of the ECJ extended the reach of facilitating national rules, like German Umwandlungsgesetz to 'foreign' firms wishing to use these. Seat transfer, conversion and cross-border merger are also addressed in the SE Statute.

The dynamics of SMEs equally require a flexible regime for corporate reorganizations which should be addressed separately in the SPE Statute by extending the existing facilities to include SPEs. In view of the very nature of the LLC, allowing contractual cooperation between its members as quasi-partnership, it would be important to also allow for conversion of partnerships into an LLC and vice versa as well as to convert an LLC in other forms, including a 'public' company, e.g. in view of going public of a successful start-up of a firm financed with venture capital. Apart from the existing EU rules reference is made to the flexible rules as provided by Article 9 ULLCA on conversions of partnerships

[12] S. 602 ULLCA.

into an LLC and merger of entities with or resulting in an LLC. For completeness sake it should be noticed that an amendment of an SPE from a member-managed into a management-managed SPE does not constitute a conversion of business form in the strict sense.

V. Concluding remarks

The main purpose of this article in honour of Eddy Wymeersch was to address the possibility of combining corporate and contractual (partnership-like) notions into one and the same statutory business organizations. Faced with the intention of the European Commission to come up with an innovative design of an SPE to facilitate SMEs and taking notice of the desires as expressed in the consultation, the danger should be faced and addressed that the project will stand on the dogmatic resistance of combining what according to some scholars can simply not be combined: contract and corporation. This idea seems to be definitely outdated but continues its life as 'unveiled assumption'. Since my 1976 PhD thesis on joint ventures I have been fascinated with the question whether one can be a partnership *inter sese* and a corporation to the rest of the world. The question was positively resolved in the US at the beginning of the last century and the LLC, the highly successful offshoot of this development, provides us with a statutory example how to combine contract and corporation. I sincerely hope that Eddy Wymeersch will continue to enrich the academic debate as he did so devotedly for so long!

Post scriptum

After completion of this article the European Commission published a draft Statute for a European Private Company (SEC/2008/2098/2099). Time and space only allow a very brief overview. The Statute largely follows the 'standard' form for private companies in the EU. Its formation is free and includes transformation/conversion of an existing business as well as merger/division (art. 5). Registered office and real seat may be in different states (art. 7). Articles of association shall be published, not only a memorandum of incorporation; legal personality will be acquired upon registration (art. 8–11). Capital divided in shares, no minimum capital required, contribution in kind allowed (art. 14–15, 19–21). Transfer regulated by articles; expulsion and withdrawal of shareholder envisaged (art. 16–17). Solvency certificate required before

distributions to shareholders (art. 21). Preparation, filing, auditing and publication of accounts according to art. 25 follow applicable national law, i.e. essentially the 4th and 7th Directives. The Statute does not envisage a shareholder-managed EPC and sticks to the model of centralized management acting in the interest of the EPC (art. 30/31) albeit with broad collective powers for the AGM (art. 27). Individual (group) rights of information and calling a meeting are covered by art. 29/29. Transfer of registered office is regulated separately (incl. employee participation). Transformation, merger, division and dissolution follow national law (art. 39–40). The Statute should be in force by July 1, 2010.

The draft takes an important step towards a stand-alone 'federal' business form for all member states. In view of its focus on SMEs and its use as cross-border subsidiary further simplifications as allowed by ULLCA should be considered.