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LL.M. MINI-THESIS

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The Societas Privata Europaea - A European Private Limited Company in the Making

including a comparative look at the process of company law reform in South Africa

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Declaration

I, Pablo Rüdiger S. de Erice, hereby declare that this mini-thesis, “The Societas Privata Europaea - a European Private Limited Company in the Making”, is my own original work and that it has not been submitted for examination for the award of any degree at any other university.

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The Societas Privata Europaea -
A European Private Limited Company in the Making

including a comparative look at the process of company law reform in South Africa

I. Introduction

European as well as South African company law is in flux. This mini-thesis analyses a particular European legislative project, the Statute on a pan-European private limited liability company. In addition to that, it provides an overview of the ongoing reform of company law in South Africa and more briefly seeks to relate these findings to the European project.

A. The European Private Company project

European company law has been experiencing rapid development in recent years. On 8 October 2004 a controversial European legislation entered into force that laid the legal foundations for a European public limited liability company, the so called Societas Europaea (SE). The SE, designed to enhance the global competitiveness and business of large European enterprises and groups of companies, was a necessary and important step towards the modernization and harmonization of European company law. It is widely agreed that European small and medium-sized businesses (SMEs)¹ conducting cross-border business are likewise in need of a legal company form designed to match their specific requirements. The SE will therefore not be the last company type to be regulated on a European level.

Since the late 1990's a European private limited liability company has been a topic of discussion and deliberation among academics, legal practitioners and the business community alike. The European private limited company is deemed to be of high relevance for the further development of the European Internal market and of what is generally considered its backbone: the small

¹ In French: petites et moyennes entreprises (PME); in German: kleine und mittlere Unternehmen (KMU)

and medium-sized enterprises conducting cross-border business within it. The fact that small businesses generally make an important contribution to overall economic growth and regional development is widely and generally acknowledged, in South Africa² as well as in Europe.

However, European small and medium-sized enterprises still face significant problems with regards to their cross-border business in the Internal Market. Their difficulties are mostly related to high entry thresholds to other European countries. Costs, legal barriers and complex bureaucracy are only a few of the difficulties small and medium-sized enterprises face in setting up and running business in European Union Member States other than their own. The diversity and complexity of company law frameworks and regimes in the European Union are generally perceived to be the most significant sources of legal and practical uncertainty for businesses.³ The existing pan-European public limited European Company (SE), designed for large companies, does not constitute a viable option for small and medium-sized businesses, in particular because of its minimum capital requirement of 120.000 Euros.

In 2004, the European Commission therefore financed and published a “Feasibility Study for a European Statute of SMEs”⁴ essentially referring to a new and uniform type of European private limited liability company, the European Private Company (EPC). Similar to the already existing public limited liability company (SE), the future European Private Company is also referred to by its Latin name: Societas Privata Europaea (SPE). The Commission’s feasibility study paved the way for a legislative process regarding the future Statute for a European Private Company (EPC Statute).

In 2005 the EPC was officially included as a discussion topic in the European Commission’s “Consultation and Hearing on Future Priorities for the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union”.⁵ At about the same time, in 2006, the European

² Henning, *Journal for Juridical Science*, 28(2), p. 2

³ Schunk, Presentation at the European Commission’s 2008 Conference

⁴ For a summarized overview of the study: European Commission, 2005 Feasibility Study, Executive Summary

⁵ European Commission, 2005 Consultation Document

Parliament's Committee on Legal Affairs held a public hearing⁶ on the EPC's necessity, advantages and drawbacks. On the basis of this, the European Parliament adopted a Resolution in February 2007⁷ requesting the European Commission to draw up a draft EPC Statute during that same year. Detailed recommendations on the possible content of such Statute were annexed to the resolution.

Starting in July 2007 the European Commission held another more specific public consultation among small and medium-sized businesses ("Consultation on a possible statute for a European Private Company (EPC)")⁸ in order to assess the necessary practical and legal scope of a possible Statute. The 2007 Consultation was based on a detailed questionnaire developed for this purpose and forms part of the ongoing hands-on legislative impact assessment process which aims to verify the cost-benefit relation of the envisioned project. Its results were published in December 2007⁹ and could not be misread: the majority of small and medium-sized businesses shared the majority view of academics and legal practitioners and considered that the EPC statute was a necessary step to take.

B. South African corporate law developments

Similar to European corporate law, South African corporate law is in a state of development and restructuring. In May 2004, the South African Department of Trade and Industry (DTI) published a study entitled "South African Company Law for the 21st Century - Guidelines for Corporate Law Reform".¹⁰ The paper suggested a series of amendments to the South African regulatory framework for companies, notably the Companies Act 61 of 1973 (still largely based on English law) and the Close Corporation Act 69 of 1984. The overall aim is to simplify the law in order to enhance the growth of South African enterprises. In February 2007, a Draft Companies Bill was issued. It was announced that it would be passed in Parliament during 2008. Among the overall issues contemplated by the Companies Bill 2007 are the director's duties, the board

⁶ European Parliament, 2006 Hearing

⁷ European Parliament, 2007 Resolution

⁸ European Commission, 2007 Consultation, Questionnaire

⁹ European Commission, 2007 Consultation, Summary Report

¹⁰ South African Government Gazette 26493, notice 1183, 23 June 2004

structure, the introduction of a so-called closely held company, the single business entity, capital maintenance, shareholder and investor protection, as well as mergers and takeovers. This list of issues reveals certain parallels and overlapping with the European efforts.



II. Motivation, method and structure of the investigation

A. Problem statement / motivation of the investigation

It is by now widely acknowledged that there is a need for the European Private Company. However, although the European Parliament had requested the European Commission to put forward a draft Statute during 2007,¹¹ the Commission is currently (May 2008) only at the beginning of the drafting process and thus far behind schedule. European lawmakers, legal practitioners, lobbyists and academics are still busy collecting and discussing thoughts on what the EPC Statute should ideally look like. The discussion and consequently the potential content of such Statute are still very fragmented and in a remarkably underdeveloped state. Neither the teleological requirements, nor the content of the legal framework to be developed have been identified clearly and comprehensively¹². Questions, such as the overall aim and structure of the EPC, its uniform rules and respectively applicable national laws as well as all the details of its content remain unanswered. The EPC Statute, therefore, is still a vague idea, a first collection of issues, rather than a clear legal project.

This mini-thesis aims to contribute to the debate around the legislative process by summarizing and analysing it comprehensively. It will, without being exhaustive, seek to identify the most important legal requirements that the future Statute needs to meet in order to facilitate cross-border business of small and medium-sized businesses. It seeks to systematise and comment on the most important legal Key Issues and therefore clarify and enrich the debate. The mini-thesis will not, however, question the necessity of the EPC itself, or examine whether the legislation of a Statute at this point in time is premature or whether other ways would be more feasible to enhance the cross-border business of small and medium-sized businesses in Europe.¹³ It

¹¹ European Parliament, 2007 Resolution, lit. H.1

¹² See also: German Association of Notaries, Response to the European Commission's 2007 Consultation

¹³ For an overview of doubts and alternative approaches see: de Kluiver, Presentation at the European Commission's 2008 Conference

simply acknowledges the fact that the EPC is necessary and that the EPC Statute will be legislated. The research problem can be formulated as follows:

“What is the necessary legal content of the Statute for a European Private Company in order for it to facilitate the conduct of business in the European Internal Market for small and medium-sized enterprises?”

B. The method of the investigation

1. European perspective

In order to provide a solution to the research problem, the mini-thesis will firstly investigate the EPC Statute's teleology and define its main purpose and objectives from a purely European perspective. On those grounds it will identify and systematize the most important legal issues regarding the scope, structure and content of the future Statute. The legal cornerstones to be regulated by the EPC Statute will be called “Key Issues” for the purpose of this investigation. The Key Issues will be grouped topically in different Key Issue groups (e.g.: legal issues regarding the EPC's share capital will be grouped under the title “Share Capital” as follows: minimum legal capital, shareholder contributions, shares and share classes, share transfer, transfer restrictions and pre-emption rights).

This mini-thesis will subsequently discuss and assess the EPC Statute's necessary scope and content regarding each Key Issue. It will explore some of the important Key Issues in more detail, again without being exhaustive. Other Key Issues of less importance will be touched upon briefly. The assessment will take into account not only the Statute's identified teleology and positions from the different players involved in the public debate, but also generally applicable concepts of company law, economical and practical business factors. It will further seek to take into account any potentially reciprocal effects of any Key Issue on other Key Issues.

The investigation will be carried out by analysing legal literature and official policy documents on the matter. This notably includes the European

Commission's findings in its two public consultations regarding the EPC¹⁴ as well as the numerous responses to those consultations as provided by lobbying groups and small and medium-sized enterprises. Another important source of information will be the first draft for an EPC Statute by the Paris Chamber of Commerce and Industry from 1997.¹⁵ The reviewed literature will form the basis for developing an appropriate solution to the research problem. The amount of available literature is, however, somewhat limited. The assessment of necessary solutions will therefore be partly based on general legal reasoning and the author's limited practical experience. The expected findings of this mini-thesis should serve as a possible indication for the drafting of the EPC Statute.

2. South African perspective

In addition to the European investigation, the mini-thesis includes a brief examination of the parallels between the European and South African debates regarding corporate law reform legislation. Thereby it seeks to broaden the investigation's perspective and give a different connotation and fresh ideas to both, the European and South African debates.

C. Structure and basic outline of the investigation

This mini-thesis is essentially structured in the following way:

- Topical and historical overviews
In Chapter III. the mini-thesis will provide overviews of the most important topical and historical facts regarding pan-European and South African company law and respective legislative projects. This will include:
 - a short introduction to the existing company law framework on European Community level, including notably the European Court of Justice's jurisdiction and the existing Statute on a *Societas Europaea* (SE),
 - a historical overview of the legislative process regarding the EPC Statute, from its origins in 1954 up to the European Commission's latest announcement to put forward a first draft of the EPC Statute in 2008,
 - a brief topical overview of South African company law

¹⁴ European Commission, 2005 Consultation and 2007 Consultation

¹⁵ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Explanatory Memorandum and Draft Articles

- a summary of the envisioned overhaul of South African company law
- In depth analysis of the European project
 - Teleology of the EPC Statute
In Chapter IV. the investigation will identify the EPC's teleology. The result will be an overview of reasons and deliberations why the EPC Statute is after all deemed a necessary legislation and what social benefits and policies it is supposed to serve.
 - Discussion of the European Key Issues
Chapter V. will, in light of the EPC Statute's teleology, discuss and assess alternative solutions to the Key Issues. It will identify and suggest an appropriate solution for each of the Key Issues in each of the Key Issue Groups.
- Relations between the projects in Europe and in South Africa
In Chapter VI., the mini-thesis will seek to answer the question: what can European lawmakers learn from the South African reform project when drafting the EPC Statute. It will relate the planned South African reform project to the European project.
- Conclusion
In Chapter VII. the overall and most basic conclusions of the investigation will be summarized.

III. Topical and historical overviews

This Chapter provides an overview of the most important topical and historical facts regarding pan-European and South African company law against the background of the respective legislative projects. This includes a summary of the envisioned South African company law reform. The information in this Chapter is the basis for an in-depth analysis of the European project to be conducted in Chapters IV. and V. and the subsequent relation of the findings to the South African project in Chapter VI.

A. Overview of the European Community corporate law framework

1. Current structure

A large number of forms of companies are trading in the European Union all of which are subject to very different national regulations. European Law tries to cope with the diversity of national company laws on three levels. Firstly, Articles 43 and 48 of the Treaty on the European Community (EC-Treaty) together with the jurisdiction of the European Court of Justice provide for mutual recognition and corporate mobility (see below a)). Secondly, European lawmakers are permanently busy harmonizing the most important fields of national corporate law, notably by means of Directives that have to be implemented in the Member States (see below b)). Thirdly, European lawmakers work on the establishment of pan-European company forms, such as the European Company (SE) and the European Private Company (see below c)).

a) Mutual recognition and European mobility of companies

A particular company from one Member State of the European Union that plans to conduct business in another Member State is depending on recognition of its legal form in the foreign host Member State. As a rule according to the Treaty on the European Community (EC-Treaty), there should be mutual recognition of all kinds of types of companies throughout the Union, resulting in complete corporate freedom of movement and establishment. The cornerstones of the legal framework for that can be described as follows:

i) The freedom of establishment of Articles 43 and 48 EC-Treaty

In order to establish the European Internal Market and the freedom of movement of natural and legal persons as well as companies, Articles 43 and 48 of the EC-Treaty provide for general and multilateral recognition of national company forms in all other Member States:

“Article 43

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State. Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital.

[...]

Article 48

Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States. "Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making."

The freedom of establishment of companies and the application and interpretation of these provisions in the Member States of the European Union gave rise to a number of legal problems that were brought in front of the European Court of Justice. There are three landmark cases decided by the European Court of Justice which thereby actively got involved in the development of European company law: the Centros case, the Überseering case, and the Inspire Art case:

ii) The problem of the pseudo-foreign company (Centros case)

In 1998 the Court ruled on the problem of the so-called pseudo-foreign company (as opposed to a real foreign company).¹⁶ A real foreign company is incorporated and conducting business in one Member State (its home jurisdiction) and at the same conducts business (with or without a registered branch) in another Member State (the host jurisdiction) on grounds of Articles 43 and 48 of the EC-Treaty. A pseudo-foreign company is a company incorporated in one Member State without conducting business there, but instead trading exclusively in another Member State. Pseudo-foreign companies are usually used to avoid strict company law requirements in the host country by fulfilling the more relaxed requirements of the home jurisdiction. For example an English Private Limited Company requires no minimum capital even if it conducts business in Germany, whereas the domestic German private limited (GmbH) would currently require a minimum legal capital of € 25.000.

Until 1998 there was significant uncertainty in and dispute over the question of whether such “legal-form-tourism” was an abuse of Articles 43 and 48 of the EC-Treaty. The European Court of Justice ruled in the Centros case and later on several occasions with different legal connotations that pseudo-foreign companies were perfectly consistent with European Law. In essence the Court had to decide the case of the English Limited “Centros” that had been refused incorporation in Denmark on grounds of the argument that the use of the UK Limited, which required no minimum capital, was not meeting the Danish regime for creditor protection. The Court refused the Danish position arguing that establishing a pseudo-foreign company meant not abusing but using the freedom of establishment.

¹⁶ European Court of Justice, Centros Case, C-212/97

iii) The problem of the real seat (Überseering case)

In 2002, the European Court of Justice decided on a case regarding the transfer of seat of foreign companies, the so-called Überseering case.¹⁷ A German court had ruled that the sale of shares in the Dutch company Überseering B.V. to new owners living and managing the company in Germany had led to a transfer of its real seat to Germany. The court concluded in application of the so-called seat doctrine that the company had legally collapsed the moment its real seat was transferred and had therefore no capacity to sue. The German Federal Supreme Court referred the case to the European Court of Justice which decided that any company established under the laws of a Member State must be accepted by all other Member States as such, regardless of its real set. The Court thereby essentially discarded the real seat doctrine.

iv) The problem of defence legislation (Inspire Art case)

The next significant case regarding the establishment of foreign companies, the so-called Inspire Art case, was decided in 2003.¹⁸ In this case the Court clarified that no national legal requirements must be superimposed on foreign and pseudo-foreign companies.¹⁹ The case concerned Dutch defence legislation meant to defend the requirement of a minimum legal capital in the Netherlands against circumvention, by means of an obligation to disclose a company's pseudo-foreign character. The Court decided that the Dutch defence legislation was inconsistent with the Eleventh European Company Law Directive dealing with disclosure requirements for branches.

b) Legislative harmonization efforts

The legislative harmonization of national company laws on a European level is being achieved by means of a series of Directives.

¹⁷ European Court of Justice, Überseering Case, C-208/00

¹⁸ European Court of Justice, Inspire Art Case C-167/01

¹⁹ Schall, p. 9

Apart from rare exceptions the process of harmonisation only concerns public limited companies.²⁰ The most important harmonizing Company Law Directives are:

- the First Directive (enacted in 1968)²¹ harmonized the mandatory disclosures of company data, such as the disclosure of the articles, the board members and their power to bind the company, the disclosure of the annual accounts etc.;
- the Second Directive (1976)²² introduced capital raising and maintenance provisions for public companies;
- the Third Directive (1978)²³ provided for standard rules for the merger of public companies;
- the Fourth Directive (1978)²⁴ regulated common rules for the annual accounts of companies and was modified in 2001;
- the Fifth Directive, which was going to harmonize company structures failed for political reasons;
- the Sixth Directive (1982)²⁵ regulated the division of public companies;
- the Seventh Directive (1983)²⁶ brought rules for the consolidation of group accounts and was modified in 2001;
- the Eighth Directive (1984)²⁷ harmonized the qualification and liability of auditors;
- the IAS Regulation (2002)²⁸ obliged all listed companies to submit their annual accounts according to the International Accounting Standards (IAS/IFRS);
- the Tenth Directive (2003)²⁹ provided for a regime on cross-border mergers of companies with limited liability (public and private);
- the Eleventh Directive (1989)³⁰ stipulated common disclosure requirements for branches of foreign companies;
- the Twelfth Directive (1989)³¹ obliged all Member States to recognize single-member companies;
- the so-called Thirteenth Directive (2004)³² provided for common requirements for takeover bids;

²⁰ Braun, p. 1394; Schall, p. 11; Drury, "The European Private Company", p. 1

²¹ First Council Directive 68/151/EEC

²² Second Council Directive 77/91/EEC

²³ Third Council Directive 78/855/EEC

²⁴ Fourth Council Directive 78/660/EEC

²⁵ Sixth Council Directive 82/891/EEC

²⁶ Seventh Council Directive 83/349/EEC

²⁷ Eighth Council Directive 84/253/EEC

²⁸ EC-Regulation 1606/2002

²⁹ Directive COM (2003) 703(01)

³⁰ Eleventh Council Directive 89/666/EEC

³¹ Twelfth Council Directive 89/667/EEC

³² Directive 2004/25/EC (the Thirteenth Directive is not officially named the Thirteenth)

- the European Insolvency Regulation (2002)³³ provided for a very limited harmonization of the cornerstones of company insolvency;
- moreover, a Fourteenth Company Law Directive on cross-border seat transfers is in the making.³⁴

This list of Directives illustrates that European harmonization legislation is still an incomplete patchwork of a minimum of harmonizing regulations.³⁵

c) Pan-European company forms

i) Overview

There are essentially three existing pan-European structures available to business ventures in the European Union:

- the European Economic Interest Group (EEIG),
- the European Cooperative Society (SCE),
- and the European Company or Societas Europaea (SE).

Only the European Company (SE) is of significant practical relevance and shall be described in more detail:

ii) The European Company or Societas Europaea (SE)

The European Regulation on the Statute for a European Company³⁶ entered into force on 8 March 2004. The Societas Europaea (SE) was designed, just like the European Private Company will be, as a uniform legal form to minimize the adverse effect that 27 different company law systems have on cross-border business.³⁷ Just like the EPC is going to be, the SE is governed by a more or less uniform set of rules throughout the European Union. Unlike the EPC, which is going to be a private limited company addressing the needs of small and medium-sized businesses, the SE is a public limited company addressing the needs of larger companies and groups of companies. The

³³ EC-Regulation 1346/2000

³⁴ see: http://ec.europa.eu/internal_market/company/seat-transfer/index_en.htm

³⁵ For an overview of remaining gaps see: Schall, p. 22

³⁶ EC-Regulation 2157/2001

³⁷ For an in-depth overview of the law governing the SE see: van Gerven / Storm, "The European Company"

SE's legal key features and its practical relevance can be described as follows:

(a) The SE's basic legal features

The SE cannot be set up by a natural person, but only by one or more public and/or private limited companies according to a very limited catalogue of possible ways of formation, including mergers and transformations. An SE must have its registered office and its administrative head office, but not necessarily all its commercial activities, in a single Member State. The SE will be allowed to operate in other Member States than its own in a way comparable to a branch but without the necessity to register as such. The minimum subscribed capital is € 120.000, subject to possible stricter requirements in certain Member States. The founding members can opt for a one-tier management system (administrative board only) or a two-tier system (supervisory and management boards). The tax law of the Member State where the SE is registered, tax resident or in which it has a taxable presence applies.

(b) The SE in practice

As of March 2007 about 70 SEs have been incorporated and another 20 were in the phase of incorporation, some of them mere "shell-companies".³⁸ Among the few incorporated SEs are some very large groups of companies, such as the German "Allianz SE".³⁹

2. History and status quo of the EPC project

The following is an overview of the EPC's historical developments. The early beginnings are obviously intertwined with the history of the SE, as public and private limited liability companies were discussed under the common umbrella term of "pan-European company":

³⁸ a company that is incorporated, but has no significant assets or operations.

³⁹ Lenoir, p. 87; also see Lenoir's in-depth analysis of practical experiences regarding the SE dated July 2007

a) Origins

The idea of a pan-European company originated among French notaries as early as 1959. Initially proposed on political level by the European Commission in 1970, and amended in 1989 – 1991, the European Company, private as well as public, was discussed over and over again with varying intensity for more than 30 years, without any significant results.

b) MEDEF / Paris Chamber of Commerce 1997 Study

The first in-depth investigation of the possibility of an EPC was conducted by the Mouvement des Entreprises de France (MEDEF, the French Business Confederation) and the Chambre de Commerce et d'Industrie de Paris (CCIP, the Paris Chamber of Commerce and Industry) in 1997.⁴⁰ MEDEF and the Chamber published a study entitled "The European Private Company" on a company statute for small and medium-sized enterprises and suggested a pan-European business structure appropriate for the latter. The study already included an early draft proposal for the statute (the only one up until today) and intensified the current academic as well as legal policy debate on the matter.⁴¹

c) European Charter for Small Enterprises 2000

The European Charter for Small Enterprises, adopted by the General Affairs Council in Lisbon on 13 June 2000 and endorsed at the Feira European Council Meeting on 19-20 June 2000, pointed out that small businesses form the "backbone" of Europe's economy and are the key to its competitiveness especially in the drive to make Europe a competitive and dynamic knowledge-based economy.⁴²

d) European Statute on the European Company (SE)

After a lengthy legislative process the statute for the first pan-European company, the public limited SE aiming at large companies

⁴⁰ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Explanatory Memorandum and Draft Articles

⁴¹ e.g. Dejmek, NZG, 2001, p. 878, and Steinberger, BB 2006, Vol. 37 (Beilage)

⁴² European Council, European Charter for Small Businesses

and groups of companies, was adopted in October 2001 (see above for details). The statute entered into force on 8 March 2004.

e) The European Commission's 2003 Action Plan

The further development of the idea of a European Private Company was slow. On 21 May 2003, the European Commission published an Action Plan entitled "Communication from the Commission to the Council and the European Parliament: Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward"⁴³. This Action Plan, to be implemented successively over the next years, was not focussed on the EPC at all, but it included first official comments on the matter of a European private limited. It is important to note that it was not a piece of legislation, but a mere policy paper pointing in a certain direction and giving new impetus. The Action Plan 2003 Report reads:⁴⁴

"[...] the Societas Europaea (SE), adopted in October 2001, may not meet all expectations of the business community, in particular SMEs [...]"

and referred to the development,

"[...] of a "European Private Company" (EPC) which, as a new legal form at EU level, would primarily serve the needs of SMEs which are active in more than one Member State. [...] The Commission will therefore launch a feasibility study in the short term, with a view to presenting a proposal for an EPC statute (if the feasibility study confirms the need for such an initiative) in the medium term. The aim of this feasibility study is to evaluate the advantages and the problems generated by a possible European legal statute for small and medium enterprises in order to facilitate their internationalisation. To this end, the study should conduct an in-depth analysis of the legal, tax and social policy regimes relevant to SMEs in the [then still] 25 Member States of the enlarged Union."

f) The European Commission's 2004 Feasibility Study

In 2004 / 2005, the European Commission launched, financed and published the said "Feasibility Study for a European Statute of

⁴³ European Commission, 2003 Action Plan

⁴⁴ European Commission, 2003 Action Plan, p. 20 / 21

SMEs”⁴⁵. The results were presented on 13 December 2005. The executive summary points out the following:

“The enterprises wish for a legal medium which will enable them to carry out ambitious projects, at both national and inter-European level: to grow and to secure their position. The SMEs questioned in the context of this study express to equal extents their points of view on the nature and importance of the legal, administrative and tax problems, as well as their concerns concerning the obstacles to their establishment abroad. It appears that the need for a new statute, where it exists, is justified above all by the will to have a flexible legal medium, independent of the European dimension or tendency of the SMEs.”

g) The European Commission’s 2005 Consultation

From December 2005 to 31 March 2006, as the first phase of implementation of the 2003 Action Plan was coming to an end, the European Commission held a public consultation⁴⁶ on the future of the Company Law and Corporate Governance Action Plan 2003. The addressees’ backgrounds were diverse with 30% industry, 11% investors, 18% public authorities, 8% financial intermediaries, 7% trade-unions, 5% academics, 21% others. The consultation included a question number 12 on the necessity for an EPC:⁴⁷

“Do you see value in developing an EPC Statute in addition to the existing European (e.g. Societas Europaea, European Interest Grouping) and national legal forms? Please give your reasons. If so, are there, in your view, specific elements which any such statute should cover?”

The results of the consultation regarding the EPC were not multifaceted⁴⁸ and reflected the respondents’ different backgrounds. Nevertheless, overall the new approach received considerable support. The Summary Report found:

“Whilst underlining the current ‘regulatory fatigue’ and calling for a ‘digestion/stabilisation period’, a number of respondents pleaded for the adoption of enabling legislation (i.e. a proposal

⁴⁵ See European Commission, 2005 Feasibility Study, Executive Summary

⁴⁶ European Commission, 2005 Consultation Document

⁴⁷ European Commission, 2005 Consultation Document, question 12

⁴⁸ See European Commission, 2005 Consultation, Summary Report

for a Directive on the transfer of registered office, a European Private Company Statute)⁴⁹. [...] A strong majority of the respondents (63,9%) was in favour of a possible proposal for a European Company Statute (EPC) as a tool providing advantages especially to the private companies, which may not be able to benefit of the European Company Statute. [...] An EPC Statute would ensure legal certainty by providing a uniform legal framework for a European corporate form and guarantee that the same set of rules would apply to companies operating cross-border. This would significantly reduce compliance costs and, therefore, enhance the mobility and competitiveness of the European SMEs. A number of respondents stressed the importance of the Statute for the companies aiming to set up joint ventures or operate a network of subsidiaries in different Member States. The possibility to do business across EU under one 'European label' was also mentioned as an important advantage for the marketing reasons and integration in the internal market, especially of the companies with less known legal forms (e.g. from the new Member States). A minority of the opponents (25,2%) mentioned the lack of interest in the industry in such corporate form."⁵⁰

h) The European Parliament's 2006 Hearing

On 22 June 2006 the European Parliament's Committee of Legal Affairs held a public expert hearing on a possible EPC.⁵¹ The experts included a member of the legal committee of the Union of Industrial and Employers' Confederation of Europe (UNICE), several academics from Queen Mary University in London, the University of Bologna, the University of Heidelberg, as well as in-house and private practice corporate lawyers and a representative of the Dutch Trade Unions' Confederation. The Hearing underscored the need for a European Private Company as a legal form for small and medium-sized undertakings engaged in cross-border business.

i) The European Parliament's 2006 Report

On grounds of these findings, the Parliament's Committee of Legal Affairs drafted an own-initiative report⁵² and a resolution on the issue together with recommendations on the possible content of the EPC Statute. The report was published on 29 November 2006.

⁴⁹ European Commission, 2005 Consultation, Summary Report, p. 7

⁵⁰ European Commission, 2005 Consultation, Summary Report, p. 24 /25

⁵¹ European Parliament, 2006 Hearing

⁵² European Parliament, 2006 Report

j) The European Parliament's 2007 Resolution

It was only in 2007, however, when plans seriously picked up pace. On 1 February 2007, the European Parliament held another hearing on the EPC and subsequently adopted the aforementioned resolution⁵³ including an annex with detailed recommendations, requesting that the European Commission draw up a uniform statute for the new company type to submit to Parliament on the basis of Article 308 of the EC-Treaty during 2007.⁵⁴ It must be pointed out that with regard to the European Parliament's very peculiar standing among European institutions⁵⁵ this resolution on the EPC has no legislative effect but is rather to be considered as a mere political statement or initiative of no binding effect.

k) The European Commission's 2007 Consultation

The European Commission analysed the Parliament's report and recommendations and defined several topics that needed to be tested with the market in order to collect the facts and evidence needed for a legislative proposal regarding the EPC Statute. Therefore, in July 2007, the European Commission launched another public consultation, this time specifically designed with regards to the EPC, including a questionnaire on the problems small and medium-sized businesses face in their cross-border and activities.⁵⁶ The Commission asked notably entrepreneurs and policy-making groups for their opinions on what the EPC Statute should ideally look like. Among the 75 respondents from 11 Member States were 26% business associations (each representing large groups of businesses), 23% groups of companies, 23% professional service providers (lawyers, notaries, accountants), 19% individual small and medium-sized businesses, 3% trade unions, 3% public authorities and 3% others. The vast majority of responses came from France (22), Germany (13) and Austria (10). The results of the Consultation were

⁵³ European Parliament, 2007 Resolution

⁵⁴ European Parliament, 2007 Resolution, lit. H.1

⁵⁵ For details see: Peterson / Schackleton, p. 95

⁵⁶ European Commission, 2007 Consultation Questionnaire

published in December 2007⁵⁷. Regarding the obstacles business face in cross-border activities the Commission summarises:

“A majority of respondents consider that they face obstacles related to the legal form of companies when doing business in other Member States. The diversity of company law forms and regimes in the EU is perceived as a significant source of costs and legal uncertainty. Respondents also consider the existing legal framework as insufficient for cross-border activity and would welcome a statute for a European private company (SPE). In addition to providing a European label which many respondents would find helpful as a marketing tool in a global environment, the SPE would allow significant cost savings by enabling the use of the same legal form in several Member States. As a matter of fact, a majority of respondents would prefer setting up a new business as a SPE rather than use a national company legal form.”⁵⁸

l) The European Commission’s October 2007 announcement

At the European Parliament’s Legal Affairs Committee on 3 October 2007, Internal Markets and Services Commissioner Charlie McCreevy announced his intention to present a proposal on the EPC Statute by mid-2008 at the latest.⁵⁹ As of 6 May 2008 no proposal has been published.

m) The European Business Test Panel Survey 2007

Parallel to the official institutional procedures, a survey by the so-called the European Business Test Panel among European companies entitled “European Survey on European Private Company” was available in all official EU languages from 3 October 2007 until 5 November 2007. It received 517 responses from diverse industries. The majority of respondents deemed the EPC necessary for their activities.⁶⁰

n) The European Commission’s conference on 10 March 2008

On 10 March 2008, the European Commission held a high-profile conference on how to best pave the way towards a Commission

⁵⁷ European Commission, 2007 Consultation, Summary Report

⁵⁸ European Commission, 2007 Consultation, Summary Report, p. 4

⁵⁹ McCreevy, Speech at the European Parliament’s Legal Affairs Committee on 3 October 2007

⁶⁰ European Business Test Panel (EBTP), “Report on the European survey on a European Private Company”

proposal on a statute for the EPC.⁶¹ The conference's goal was to sound out expert opinion on the subject. Approximately 120 participants from 24 Member States and from all kinds of stakeholding backgrounds (including entrepreneurs, public officials, policy-makers and academics) attended the conference. The list of expert panel speakers, whose opinions this mini-thesis partly draws upon, reads as follows:

- Brane Matjasec, Director General for the Internal Market, Government of Slovenia,
- Kristina Schunk, Company Lawyer, Schunk GmbH & Co., Germany,
- José Furtado, Portuguese Institute for SMEs and Innovation (IAPMEI),
- Joëlle Simon, Director for Legal Affairs, French Business Confederation (MEDEF),
- Leena Linnainmaa, Central Chamber of Commerce, Finland
- Christoph Teichmann, Professor of Company and Commercial Law, University of Würzburg, Germany,
- Harm-Jan de Kluiver, Professor of Corporate Law, University of Amsterdam, Netherlands,
- Robert Drury, Senior Lecturer in Law, University of Exeter, UK,
- András Hanák, Attorney-at-Law, Budapest, Hungary
- Janet Dine, Professor in Commercial Law Studies, University of London, UK,
- Theodor Baums, Director of the Institute for Banking Law, Goethe University, Frankfurt am Main, Germany,
- Mirosław Cejmer, Attorney at Law, Cracow, Poland,
- Ioan Dumitrascu, Attorney-at-Law, Bucharest, Rumania,
- Vanessa Knapp, Private Practice Lawyer, Freshfields Bruckhaus Deringer
- Guido Ferrarini, Professor in Business and Capital Markets Law, University of Genoa, Italy,
- Reiner Hoffmann, European Trade Union Confederation,
- Jörgen Holmquist, Director-General for the Internal Market and Services, European Commission.

The results of the conference held on 10 March 2008 are currently being analysed by the European Commission and will be taken into account in the preparation of a draft proposal for the EPC Statute.

o) Outlook

As said before, a first draft proposal is announced for mid-2008.

⁶¹ See European Commission, 2008 Conference, Programme

B. South African corporate law and reform overview

This part of the mini-thesis seeks to give a basic overview of existing corporate law regulation in South Africa and it will explain the ongoing reform process.

1. Basics of South African company law

South African companies have the typical structure of common-law corporations: legal personality, perpetual succession and limited liability. They are essentially partnerships of which the shareholders are partners, although their juristic nature is very different⁶². Companies are legal persons entirely distinct from the shareholders who own and compose it (legal personality). The company can acquire rights and duties in its own name. Unlike in a partnership, in a company a change in the membership does not have the effect of terminating the entity (perpetual succession). As a rule, the liability of shareholders of a company is limited to either the amount unpaid on shares held by them, or to such amount as the members agreed to pay in case the company needs to be wound up (limited liability). A member's interest in the company is equivalent to the number of shares the particular member owns in the company. Generally, the share capital of a company may be divided into shares with a par value (with an indicator of its value) or shares with no par value (no indicator of its value)⁶³. As a rule, members of a company may freely transfer their shares, except where the transfer is restricted by the articles.

The founding of a company has to be registered with the Registrar of Companies in Pretoria, comprising two documents: the memorandum of incorporation (governing the company's external affairs) and the articles of association (governing the company's internal affairs). The most important organs of a company are the general meeting of members, and the directorate (board of directors). A company acts through its directors who in turn act on grounds of the respective memorandum and articles of association.

⁶² Gibson, p. 259

⁶³ For details on the recurring debate about merits of par-value and no-par-value-shares see: van der Linde, (2007) 19 SA Merc LJ, p. 473-486

2. Types of companies and corporations in South Africa

The most common and important corporate structures currently provided by South African corporate law for business ventures are the limited company and, to a less significant extent, the close corporation. The most important sources of corporate law are, therefore, the South African Companies Act 61 of 1973, still largely based on English law, and the Close Corporations Act 69 of 1984, both as amended. However, in some areas, notably in the area of directors' duties, common law is still a significant source.⁶⁴ With regard to this mini-thesis' limited comparative scope, further discussion is restricted to the abovementioned forms and will not look at non-corporate forms, such as the sole proprietorship or the partnership, or at less common corporate forms, such as the business trust or the co-operative society.

a) Companies under the Companies Act 61 of 1973

The Companies Act 61 of 1973 allows for the incorporation of two basic types of companies: a company with a share capital, and a company limited by guarantee (s 19 (1)). Companies with a share capital may be either public or private in nature (s 19 (2)).

i) Companies with a share capital

The liability of shareholders of a company with a share capital is restricted to the respective member's unpaid (if any) share in the company's share capital. There are currently public companies with a share capital and private companies with a share capital:

(a) Public companies with a share capital

The public company with a share capital is the basic corporate structure provided by the Companies Act 61 of 1973. It must have at least seven members with the shares usually freely transferable. Shares may be (but are not necessarily) listed on a stock exchange. The name of a public company with a share capital always includes the word "Limited" (Ltd). Public companies must have a

⁶⁴ Havenga, General Principles of Commercial Law, p. 293

company secretary, responsible, amongst other things, for guiding the directors with regard to their duties and ensuring proper documentation of the company's conduct of business as well as other housekeeping duties.

(b) Private companies with a share capital

A private company with a share capital is a company which by its articles restricts the right to transfer its shares. It limits the number of its members to fifty and prohibits any offer to the public for the subscription of any shares or debentures of the company (s 20 (1)). Private companies are exempt from many legal provisions governing public companies, making the private company a simpler and more easily manageable type of business structure. The name of a private company with a share capital always includes the words "Proprietary Limited" ((Pty) Ltd). It is possible to stipulate in the company's memorandum of association that the directors and past directors of a private company would be liable jointly and severally with the company for debts incurred during their activity. In that case the name of the private company includes the word "Incorporated" (Inc), instead of "Proprietary Limited".

ii) Companies limited by guarantee

A company limited by guarantee does not have a share capital, but its memorandum of association limits the shareholders' liability to a certain amount of money which each shareholder must contribute in the event of winding up (s 52 (3)). All Companies limited by guarantee are public companies by definition. The official name of such company always includes the words "Limited by Guarantee".

b) Close corporations

In addition to the said companies, the South African Close Corporations Act 69 of 1984 provides for the Close Corporation as

another form of corporate body with limited liability. The Close Corporation is very similar to the private company under the Companies Act.⁶⁵ However, its legal structure is even simpler, it is governed by more relaxed legal provisions and it is less rigidly controlled.⁶⁶ The Close Corporations Act 69 of 1984 was legislated in order to enhance the business of small and medium-sized enterprises in South Africa by providing a less expensive and more flexible legal form.⁶⁷ A close corporation has characteristics of both a partnership and a company.⁶⁸ The close corporation has legal personality and the principle of perpetual succession applies. The number of members of a close corporation may not exceed ten and the members may exclusively be natural persons, not legal persons. In connection with incorporation, every founding member must make an initial contribution of money, property or services rendered. In turn, the member receives a certificate signed by or on behalf of every member confirming the percentage of that particular member's interest in the corporation. Apart from their contribution, the members are not liable for the corporation's liabilities. As a rule, every member has the right to participate in the management of the corporation and equal rights in the power to represent. The power to bind the corporation is governed by the law of agency and the doctrine of *ultra vires*⁶⁹ is not applicable. The official name of a close corporation always includes the acronym "CC".

3. In particular: powers and duties of company directors

The current regime of directors' fiduciary duties in South Africa is under particular scrutiny in the process of reform of South African corporate law (see below for details of the reform process). The current law can be summarized as follows:

⁶⁵ Gibson, p. 423

⁶⁶ Gibson, p. 442

⁶⁷ Henning, *Journal for Juridical Science*, 28(2), p. 3 et seqq.

⁶⁸ Havenga, *General Principles of Commercial Law*, p. 297; Henning, *Journal for Juridical Science*, 28(2), p. 3

⁶⁹ In corporate law, *ultra vires* describes acts attempted by a corporation that are beyond the scope of powers granted by the corporation's articles of association or similar founding documents.

a) Basics

The powers and duties of directors are governed by the Companies Act 61 of 1973, by common law principles,⁷⁰ by the director's contracts with the company, and finally by the company's constitution. Public companies must have at least two directors, and private companies at least one director (s 208 (1)). The directors collectively form the board of directors. According to common-law practice directors owe fiduciary duties and obligations of care and skill to the company.

b) Appointment and qualification

Directors are appointed by the subscribers of the memorandum of association (s 209), unless the articles of association provide otherwise. The Companies Act 61 of 1973 stipulates a number of reasons disqualifying a person from being appointed a director (s 218). The acts of a director are valid notwithstanding any legal defect that may possibly be found in his appointment or qualification (s 214).

c) Powers and agents

Usually the articles of association authorize the directors to exercise all powers of the company, unless certain powers are explicitly required to be exercised by the general meeting. As a rule, the board of directors is the company's agent. Generally, the powers of the directors must be exercised by all appointed directors acting together in a board meeting, unless the articles provide otherwise, notably for the possibility of delegating certain powers to one or more directors. The articles can also provide for a managing director with authority to perform all or any of the powers of the board; third parties dealing with the managing director are then entitled to believe he has the authorities he would normally have to bind the company. The managing director or any other individual director appointed with authority to act on behalf of the company is an agent governed by the law of agency.

⁷⁰ Havenga, General Principles of Commercial Law, p. 293

d) Good faith and liability

Any agent of the company, i.e. notably the board or one or more individual directors, stands in a fiduciary relationship to it and has the typical common-law duties of agents, including the duty to act in utmost good faith.⁷¹ The essence of this fiduciary obligation is that the agent should act bona fide in the interests of the company. This entails amongst other things that the director should avoid any conflict of interests with the company. Moreover, he must exercise his powers for the purpose for which they were conferred upon him. Furthermore, the director must not exceed the limits of his powers, i.e. he must not conclude transactions which do not fall in the scope of the company's business (ultra vires doctrine) or the director's own authority. The director's fiduciary duties are binding and any contractual provision (notably but not exclusively in the articles) to exempt any director from his duties or respective liabilities arising from negligence, default, breach of duty or trust, would be void (s 247). This includes provisions to indemnify the director against any such liability (s 247).

e) Directors' dealings

An important example of the directors' duty to act in good faith is that an agent cannot, as a rule, enter into transactions that would cause his interests and duty to conflict. According to the Companies Act 61 of 1973 any director who is in any way, directly or indirectly, materially interested in contracts or proposed contracts of the company is obliged to declare his interest and give full details (ss 234 (1), and 237 (1), (2)).

4. The reform of South African Company Law

South African company law is under scrutiny and a comprehensive reform is currently on its way.

a) Expectations of the reform

The reform's "overall aim is to streamline the Companies Act, to bring it into line with 21st century legal thinking and practice, thereby

⁷¹ Gibson, p. 351

ensuring a regulatory framework that will promote growth, innovation, stability, good governance, confidence and international competitiveness.”⁷² South African corporate law is expected to “undergo a quantum leap, moving to a more sophisticated and modern regulatory regime”⁷³ that will be “in line with international standards”.⁷⁴

b) History, objectives and status quo of the reform

The reform process was heralded in May 2004 by the South African Department of Trade and Industry (DTI) publishing a study entitled “South African Company Law for the 21st Century - Guidelines for Corporate Law Reform”.⁷⁵ The paper, suggesting several significant changes to the South African corporate law framework, promised “clear, facilitating, predictable and consistently enforced law” and to develop a “legal framework based on the principles reflected in the Companies Act, 1973, the Close Corporations Act, 1984, and the common law.”⁷⁶ Eventually this approach led to the issuing of a Draft Companies Bill⁷⁷ which has been open to public comment since early 2007. The Companies Bill of 2007 will presumably replace the more than 34 year-old Companies Act. The draft bill is still subject to change, it is, however, envisioned for adoption in Parliament during 2008. Its main objectives are: simplification, flexibility, corporate efficiency, transparency, and predictable regulation.

c) The reform issues

The main cornerstones of the proposed Companies Bill 2007 can, according to the Department of Trade and Industry’s Explanatory Memorandum,⁷⁸ be summarized as follows:

⁷²; Brink, *Managing Partner Magazine*, Vol. 8, Issue 9; for details see: South African Government Gazette 29630, notice 166, 12 February 2007

⁷³ Fleiser, *STAR* 22 February 2008, p. 8

⁷⁴ Temkin, *Business Day*, 14 February 2007, 13

⁷⁵ South African Government Gazette 26493, notice 1183, 23 June 2004

⁷⁶ *Ibid.*

⁷⁷ Companies Bill 2007, Draft Documents; see also the Notice of Intention to introduce the Bill into Parliament, South African Government Gazette 29630, notice 166, 12 February 2007

⁷⁸ South African Government Gazette 29630, notice 166

i) Overall structure of the reform

The suggested Companies Bill 2007 would replace the Companies Act 61 of 1973. Many of the Companies Act's provisions, which proved to be functional legislation over the last years, would, however, be retained in the new framework. For example, the current Companies Act's provisions on dealing with and winding up of insolvent companies would remain unchanged for the time being.⁷⁹ One of the most important aims of the reform, according to the Explanatory Memorandum, is the promotion of high standards of corporate governance.⁸⁰ The Bill would, moreover, provide for a new simplified regime for forming and managing small companies or "closely held companies" which was inspired by the provisions in the Close Corporations Act 69 of 1984. In the long run the Department of Trade and Industry plans to repeal the (redundant) Close Corporation Act, which will, however, remain effective as an alternative regime for a 10-year experimental period. Only after that period it will be decided whether the Close Corporation Act will indeed be repealed or needs to be retained indefinitely.⁸¹

ii) Institutional reform

The Companies Bill 2007 proposes to rearrange regulatory and administrative responsibilities of South African state institutions regarding all kinds of company law matters.⁸² The Bill envisions the establishment of one new institution, a so-called Companies Ombud, as well as the transformation of three existing institutions. Under the current Companies Act the responsibilities are shared between the Minister of the Department of Trade and Industry, the Registrar, the Securities Regulation Panel (SRP),⁸³ and the Financial Reporting Standards Council (FRSC) as well

⁷⁹ South African Government Gazette 29630, notice 166, p. 7

⁸⁰ South African Government Gazette 29630, notice 166, p. 4

⁸¹ South African Government Gazette 29630, notice 166, p. 7

⁸² Ibid.

⁸³ For details on the new SRP see: Sher, *The Quarterly Law Review for People in Business* Vol. 14, part 2, p. 87-90

as the Companies Intellectual Property Registration Office (CIPRO, an entity within the Department of Trade and Industry). The Companies Bill 2007 proposes to rearrange the responsibilities, including some of the Minister's functions, and form an advisory committee to the Minister, a Companies and Intellectual Property Commission as well as a Takeover Regulation Panel. The Financial Reporting Standards Council and the Companies Intellectual Property Registration Office shall no longer exist under the draft act. The new Companies Ombud is supposed to serve as a forum for alternative dispute resolution and shall review certain administrative decisions.

iii) Scope and categorization of companies

The Companies Bill 2007 proposes to create three different basic types of companies:⁸⁴

- not for profit companies
- widely held for profit companies
- closely held for profit companies

In addition to that there would be a so-called "public interest company" label (s 9)⁸⁵ governed by rules that overlay the three other categories. Public interest companies, as opposed to "limited interest companies", have greater responsibility with regards to public interests and are subject to stricter regulation regarding disclosure and transparency.⁸⁶ Furthermore, the Companies Bill 2007 suggests facilitations for companies that are run under certain circumstances, e.g. companies in which all shareholders are related, resulting in less necessity for minority shareholder protection, or companies whose shareholders are all directors, resulting in less need for shareholder participation (see below for details).

⁸⁴ South African Government Gazette 29630, notice 166, p. 8/9

⁸⁵ For the text of the Bill see the actual Companies Bill 2007, Draft Documents

⁸⁶ For further details see: Sher, The Quarterly Law Review for People in Business Vol. 14, part 2, p. 87-90

iv) Formation, naming and dissolution

According to the Department of Trade and Industry's Explanatory Memorandum, the Companies Bill 2007

“places minimal requirements on the act of incorporation, allows for maximum flexibility in the design and structure of the company, and significantly restricts the ambit of regulatory oversight on matters relating to company formation and design.”⁸⁷

The Companies Bill would make it easier to incorporate companies⁸⁸, e.g. by allowing the memorandum of incorporation to be the sole governing document of the company. The Bill also proposes to annex a standard form memorandum of association to the act, which would provide for the simplest possible form of incorporation for companies ready to accept the required default provisions without alteration.⁸⁹ The current Company Act's regulations on how a company must use its name and what words must be subjoined to the name remain essentially unchanged.⁹⁰ Names registered under the current act would remain registered under the new act. The Bill also proposes to amend the regulations on pre-incorporation of contracts in section 35 of the Companies Act.⁹¹

v) Company finance

Company law would “shift from a capital maintenance regime based on par value, to one based on solvency and liquidity”⁹² under the Companies Bill 2007. The Bill proposes changes related to the capital maintenance rule and the requirements that must be met before profits or capital can be distributed to the shareholders.⁹³ Minority shareholder protection remains

⁸⁷ South African Government Gazette 29630, notice 166, p. 10

⁸⁸ For details see also: du Plessis, SA STAR, 14 December 2007, p. 8

⁸⁹ South African Government Gazette 29630, notice 166, p. 10

⁹⁰ du Plessis, SA STAR, 14 December 2007, p. 8

⁹¹ For details see: Cassim SA Law Journal, (2007) 124(2) SA Law Journal, p. 364-399

⁹² South African Government Gazette 29630, notice 166, p. 5; for details on the debate, see: van der Linde, (2007) 19 SA Merc LJ 473-486

⁹³ For details see: Jooste, (2007) 124 SA Law Journal 710-733; Cassim (2007) 122(2) SA Law Journal 283-293; Brincker, SA Business Day, 10 April 2007, p. 2

essentially unchanged, with the requirement of shareholder approval for share and option issues and financial assistance for share purchase.⁹⁴ The Companies Bill 2007 also provides for a revised scheme regarding the primary and secondary offering of securities to the public.

vi) Company governance

The Companies Bill 2007 introduces changes to all kinds of matters related to company governance. It would modernise the form of shareholder meetings, including the proxy rights and the adoption of resolutions.⁹⁵ The draft makes only minor amendments to the existing qualifications and disqualifications for directors, in particular regarding very small entities where the only shareholder is also its single director (s89 (8) (a) / (b)). Regarding directors delinquent or under probation, the draft innovates a regime allowing for a court, on application by shareholders and other stakeholders, to remove those directors from office. Furthermore, the draft proposes a statutory codification of a regime of directors' duties (ss 84 et seqq.), including both a fiduciary duty, and a duty of reasonable care, which shall complement the existing common law duties.⁹⁶ The regime on directors' duties would be supplemented by new provisions on conflict of interest as well as directors' liability, indemnities and insurance (ss 92 et seqq.).

The relevant part of the draft provision on directors' duties in the Companies Bill 2007 reads as follows:

“91. Standards of director's conduct

- (1) Each director of a company, when acting in that capacity, or as a member of a committee of directors, or when gathering information or similarly

⁹⁴ For details on financial assistance for share purchase, see: Sher, *The Quarterly Law Review for People in Business*, Vol. 14(2), p. 87-90

⁹⁵ South African Government Gazette 29630, notice 166, p. 12

⁹⁶ For details see Esser / du Plessis (2007) 19 SA Merc LJ, p. 346-363, Havenga (2006) 18 SA Merc LJ, p. 229-237; Havenga, *Obiter* 2005, p. 609; Jones, (2007) 19 SA Merc LJ, p. 326-336

preparing to act in either of those capacities, is subject to –

(a) a duty to exercise the degree of care, skill and diligence that would be exercised by a reasonably diligent individual who had both – (i) the general knowledge, skill and experience that may reasonably be expected of an individual carrying out the same functions as are carried out by that director in relation to the company; and (ii) the general knowledge, skill and experience of that director; and

(b) a second, fiduciary, duty to act honestly and in good faith, and in a manner the director reasonably believes to be in the best interests of, and for the benefit of, the company. [...]"

vii) Takeovers and fundamental transactions

The Companies Bill 2007 introduces the concept of amalgamation to South African company law.⁹⁷ It further proposes significant amendments to the law governing takeovers and fundamental transactions essentially altering a company, e.g. mergers, the said amalgamation, or the disposal of substantially all its assets. As a rule, court approval for such transactions would be required if a minority of 15% of the shareholders opposed the transaction.⁹⁸ The Bill proposes new regimes governing the notification of share purchase and remedies for compulsory acquisition of minority shares in takeover situations. Furthermore, as indicated before, the Companies Bill 2007 envisions the transformation of the existing Securities Regulation Panel into an independent organ of state, the Takeover Regulation Panel. This institution would remain the main public regulator of any fundamental transactions.

viii) Business rescue

The Companies Bill 2007 suggests replacing the judicial administration of insolvent companies with a modernized regime of self-administration and the development of a business rescue

⁹⁷ South African Government Gazette 29630, notice 166, p. 13

⁹⁸ Ibid.

plan under independent supervision and subject to court intervention.⁹⁹ The regime is particularly meant to take into account the rights of shareholders, creditors and employees.

ix) Remedies

The South African High Court remains the main judicial forum for remedies under the Companies Bill 2007. However, the act introduces certain new general principles. These include: a new declaratory order as to a shareholder's rights, a right to have a director declared delinquent, and possibilities to enhance and protect the work of so-called "whistle blowers" who report irregularities in the company to the authorities.¹⁰⁰ Moreover, the act proposes to strengthen the judicial rights of dissenting shareholders in fundamental transactions to have their shares appraised and purchased.¹⁰¹

x) Enforcement

Firstly, the Companies Bill 2007 proposes to decriminalize South African company law. Criminal provisions in company law would be restricted to very few significant offences, such as refusal to respond to a summons, give evidence, perjury, and similar matters with respect to the administration of justice. Notably, the draft proposes that it would be an offence, "punishable by a fine or up to 10 years imprisonment, for a director to sign or agree to a false or misleading financial statement or prospectus, or to be reckless in the conduct of a company's business".¹⁰² Instead of a broad range of criminal provisions, the draft act suggests using a system of administrative enforcement through the various state institutions responsible for the administration of company law.

⁹⁹ Ibid.

¹⁰⁰ South African Government Gazette 29630, notice 166, p. 14

¹⁰¹ Ibid.

¹⁰² South African Government Gazette 29630, notice 166, p. 15

xi) Transitional period

There are transitional provisions in the Companies Bill 2007 (s 6). Those would allow existing companies under the current Companies Act, which would in the future be governed by the new proposed Bill, a transitional period in order to adapt their articles of association. The Bill also includes proposed regulations on the voluntary conversion of existing or newly created close corporations into companies under the new act.¹⁰³

xii) Details on the new “closely held company”

This mini-thesis essentially analyses ways of enhancing small and medium-sized businesses through company law legislation. The Companies Bill 2007 envisions a new regime for closely held companies, with a bespoke solution for typically small and medium-sized businesses. As said before, the closely held company of the Companies Bill 2007 would compete with the Close Corporation for an experimental 10-year period.

(a) Definition of a closely held company

According to the Companies Bill 2007 the term “closely held company” encompasses all for profit companies that are not widely held companies. Section 8 (2) of the Bill defines that a for profit company is a widely held company if -

- “(a) the company’s Memorandum of Incorporation –
 - (i) permits it to offer any of its shares to the public, within the meaning of sections 60 and 61;
 - (ii) limits, negates or restricts the pre-emptive right of every shareholder set out in section 36 (1); or
 - (iii) provides for the unrestricted transferability of any of its shares; or
- (b) a majority of its shares are held by another widely held company, or collectively by two or more related or inter-related persons, any one of which is a widely held company.”

All remaining for profit companies would consequently be closely held companies. It becomes apparent that closely

¹⁰³ South African Government Gazette 29630, notice 166, p. 9

held companies would characteristically be owned neither by an indefinite circle of “public” shareholders, nor by a widely held company. The shares of a closely held company would not be transferable without restrictions. The closely held company would adjoin the words “CHC Limited” or “CHC Ltd” to its name (ss 16 (2) and 19 (2) (b) (iii)). Provisions on special treatment of closely held companies are found throughout the Companies Bill 2007. The most significant of these provisions are:

(b) Exemption from certain provisions

According to section 7 (3) of the Companies Bill 2007, the closely held company would be exempt from application of sections 97 to 103 and 116 to 118 of the bill if all of the shares of that company are owned by one person, or by two or more related or inter-related persons. Those sections regulate the following matters:

- In s95 to s99 (Financial year, records and reporting)
 - s97: Annual financial statements
 - s98: Disclosure of directors’ remuneration and benefits
 - s99: Right to copies of financial statements and reports
- In s100 to s103 (Financial accountability)
 - s100: Audit committees
 - s101: Appointment and rotation of auditors
 - s102: Rights, duties and functions of auditors
 - s103: Resignation of auditors and filling of casual vacancies
- In s112 to s120 (Regulation and implementation of certain transactions)
 - s116: Proposals to dispose of substantially all assets of undertaking
 - s117: Proposals for merger or amalgamation
 - s118: Proposals for scheme of arrangement

According to section 112(2) of the Companies Bill 2007 all closely held companies are exempt from application of sections 113 to 115 of the bill:

- In s112 to s120 (Regulation and implementation of certain transactions)
 - s113:Required disclosure concerning certain share transactions
 - s114: Mandatory offers
 - s115:Compulsory acquisitions and squeeze out

Moreover, according to section 112(3)(b) and (c) of the Companies Bill 2007, sections 116, 117 (2) to (5), 118 (2) and (3) and 119 do not apply with respect to a closely held company if all of its shares are held by persons who are related or inter-related; to all other closely held companies they only apply if the memorandum of incorporation of the company expressly provides that the sections apply to the company.¹⁰⁴

- In s112 to s120 (Regulation and implementation of certain transactions)
 - s116:Proposals to dispose of substantially all assets of undertaking
 - s117:Proposals for merger or amalgamation
 - s118:Proposals for scheme of arrangement
 - s119:Required approval for transactions contemplated in this part

(c) Filing of memorandum of incorporation

According to s 15 (1) of the Companies Bill 2007 the closely held company would not be required to file its memorandum of incorporation for registration.

(d) Shareholder approval for issuing shares

If every shareholder of a closely held company is also a director of that company, the company is exempt from

¹⁰⁴ There seems to be a structural redundancy, if not a contradiction, in the Companies Bill 2007: section 7(3) regulates that sections 116, 117, 118 and 119 are not applicable to closely held companies if all of the shares of that company are owned by one person, or two or more related or inter-related persons. Section 7(3) is therefore not consistent with the redundant section 112(3)(b) which states that sections 116, 117 (2) to (5), 118 (2) and (3) and 119 do not apply with respect to a closely held company if all of its shares are held by persons who are related or inter-related. The following section 112(3)(c) contradicts section 7(3) insofar as it states that sections 116, 117 (2) to (5), 118 (2) and (3) and 119 apply with respect to a closely held company not contemplated in section 112(b) only if the memorandum of incorporation of the company expressly provides that this Part will apply to the company.

s 38 of the Companies Bill 2007 which stipulates the requirement of shareholder approval for issuing shares in certain cases.

(e) Options for purchase of shares

According to s 39 (6) of the Bill, s 39 (4) is not applicable to closely held companies, if every shareholder of the company is also a director of that company. Section 39 (4) of the Companies Bill 2007 stipulates certain legal requirements for options for the purchase of shares granted directly or indirectly to a director or future director, including authorization in terms of a special resolution.

(f) Financial assistance for the purchase of shares

Financial assistance by a closely held company to a person for the purchase of shares or options issued or to be issued can, according to the Companies Bill 2007, amongst other requirements only be given pursuant to a certain authorization set out in the company's memorandum of incorporation (s 40 (1) (b) (iii) (cc)).

(g) Time frame for board authorized distributions

Regarding closely held companies, section 48 (2) (a) (ii) of the Companies Bill 2007 sets a maximum time frame of 120 days after the first distribution payment to a shareholder in accordance with the authorizing board resolution, after which the board must reconsider a liquidity and solvency test before further distribution. In a widely held company the time frame of 120 days starts earlier, namely on the date on which the company announces the resolution authorizing the distribution (s 48 (2) (a) (i)).

(h) Shareholder meetings and notice of meetings

According to s 79 of the Companies Bill 2007, the closely held company must hold meetings of shareholders as required by the company's memorandum of incorporation. Widely held companies must give notice of the meetings to the shareholders 15 business days before the meeting (s 80 (1) (c)). For the closely held company this period is only 10 days as a rule (s 80 (1) (b)), and only 5 days if all the shares are owned by persons who are related or inter-related (s 80 (1) (a)).

(i) Directors

Same as the Close Corporation, the closely held corporation which does not qualify as public interest company needs to have only one director (s 84 (1) (b)), instead of three like the widely held corporation (s 84 (1) (a)). Section 89 (8) (a) / (b) of the Companies Bills makes certain significant exceptions for the closely held company from the rules on the disqualification of directors.

(j) Financial assistance to directors

According to s 92A (1) (d) (iii) of the Companies Bill 2007, financial assistance by the company to a director can only be given pursuant to a certain authorization set out in the company's memorandum of incorporation.

(k) Register of directors, auditors and secretaries

A closely held company that is not a public interest company and the shares of which are all owned by persons who are related or inter-related is not obliged to keep a register of directors, auditors and secretaries (s 94 (1) (a)).

(l) Conclusion

The Companies Bill 2007 offers a variety of provisions, forming a detailed and bespoke system of facilitations for

closely held companies in order to specifically enhance the growth of typically small and medium-sized businesses.



IV. Teleology of a Statute for the European Private Company

In order to assess the necessary scope, structure and content of a future statute for the EPC, its teleological backgrounds and aims need to be identified:

A. General

The overall aim of the EPC Statute is to free enterprises, notably small and medium-sized businesses, from the legal and practical constraints resulting from their operations under up to 27 separate national legal systems in the 27 Member States of the European Union. It is important to note that national company laws and their diverse legal would forms remain untouched by the Statute and the EPC would exist with those forms side by side¹⁰⁵.

B. Definition of the term “small and medium-sized business”

99,8% of all companies in the European Union are categorized as small and medium-sized businesses which account for about 30% of all employment positions.¹⁰⁶ The European Commission defines small and medium-sized businesses as follows.¹⁰⁷ Medium-sized enterprises have less than 250 employees and their annual turnover does not exceed € 50 million¹⁰⁸ or their annual balance-sheet total is less than € 43 million. Small enterprises have between 10 and 49 employees and they have an annual turnover not exceeding € 10 million and/or an annual balance-sheet total not exceeding € 10 million. Micro-enterprises are enterprises, which have less than 10 employees and they have an annual turnover not exceeding € 2 million and/or an annual balance-sheet total not exceeding € 2 million. Furthermore, one distinguishes two kinds of small and medium-sized businesses: firstly, the very small owner-managed business formed by a small number of members, possibly all related or inter-related, operating the company in a way comparable to partnership, and secondly the slightly larger enterprise with a larger and more diverse group of members, of whom one or more are usually

¹⁰⁵ Teichmann, Presentation at the European Commission's 2008 Conference

¹⁰⁶ Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech; see also the European Commission's SME web portal http://ec.europa.eu/enterprise/smes/facts_figures_de.htm;

¹⁰⁷ European Commission, Recommendation 96/280/EC of 1 January 2005 concerning the definition of micro, small and medium-sized enterprises

¹⁰⁸ The amount of € 50 million converts to approximately R591 million as of 1 May 2008 (€1≈ R11,82)

financial investors contributing to the capital but not participating actively in the management of the business.

C. Constraints on small and medium-sized businesses

The problems small and medium-sized businesses face in their European cross-border activities are mainly related to the diversity and complexity of national company laws in the European Union (market fragmentation).¹⁰⁹ The current pan-European company law framework, which is supposed to harmonize the laws and overcome the difficulties, is so far insufficient.

1. Diversity and complexity of national company laws

Small and medium-sized businesses with cross-border activity in the European Union face significant obstacles related to the diverse legal forms of companies and the complexity of national company laws when conducting business in other Member States.

a) The difficulty of choice

An entrepreneur or an existing company planning to conduct business in another Member State need to familiarize themselves with the national frameworks of up to 27 host countries and take a decision with regards to the legal form they would operate with in each of them. There are four basic options for conducting cross-border business in foreign Member States:¹¹⁰

- A subsidiary abroad:
 - registration of the existing home company with the foreign register of the host country (so-called “European passport”), or
 - formation and registration of a new foreign legal entity in the host country on grounds of host legislation,
- A branch abroad
 - opening a registered branch in the host country, or
 - running a branch without any formal organisation or registration (de facto branch) in the host country.¹¹¹

¹⁰⁹ See the report by Schunk, Presentation at the European Commission’s 2008 Conference

¹¹⁰ for details see Steinberger, BB 2006, Vol. 37 (Beilage), p. 27.29

¹¹¹ European Commission, 2007 Consultation, Summary Report, p. 8

The choice is difficult and obviously tends to become increasingly complex with each additional Member State the business seeks to expand into. It is not unlikely that it would make sense for a particular entrepreneur to choose a different strategy for each single country he plans to go to. For example in one country a newly founded subsidiary company might be more favourably taxed than a branch. In another country the minimum legal capital of a certain type of company might be too high and a branch would be the only feasible alternative although maybe unattractively taxed. The range and complexity of legal and financial parameters to be taken into account is extraordinary. Different tax regimes, legal capital requirements as well as formation and registration procedures are only some factors of many to be taken into account, and not the trickiest ones. Another typical constraint is that potential liability risks for shareholders and company directors in foreign jurisdictions are not easy to evaluate properly. For example the legal possibility of “piercing the corporate veil”¹¹² of limited liability in certain cases of abuse is regulated in 27 very different ways throughout the Union.

b) Significant costs of establishing business abroad

The difficulty of choice corresponds to another highly adverse effect. In order to assess options and identify a strategy for cross-border business the entrepreneur is dependant on costly professional advisors, notably lawyers and tax advisors. He needs bespoke advice regarding the ideal and most cost- and time-efficient way to act for his particular enterprise in each of the potential target Member States. The diversity and complexity of national company laws, and the legal uncertainty they result in, are therefore also major cost-driving factors for European businesses establishing business abroad. In addition to advisor fees there are the costs of formation and registration of up to 27 different subsidiaries or branches, including possibly the notarisation of documents which is mandatory in certain Member

¹¹² The piercing or (lifting) of the corporate veil describes a legal concept whereby a shareholder of a corporation is held liable for the debts or liabilities of the corporation despite the general principle that shareholders are immune from suits in contract or tort that otherwise would hold only the corporation liable.

States (e.g. Germany). The more Member States the business seeks to expand into, the more costs the operation is likely to incur.

c) Significant costs of conducting day-to-day business abroad

The diversity and complexity of national laws also affect the day-to-day operations in cross-border business and increase costs. Due to the different national legal requirements concerning the legal structure and the organisation of a subsidiary or a branch, the daily business management and coordination is usually more difficult and more costly in comparison to the management of the mother company at home,¹¹³ this regard amongst other things the accounting and the documentation of general assemblies.

d) Difficulties in cross-border capital raising

Cross-border capital raising is one of the preconditions for successfully setting up and expanding business in a European and globalized market. The free movement of capital is one of the fundamental EC-Treaty freedoms and an important vehicle for integration. Market fragmentation regarding company law in the 27 Member States poses a serious constraint on the supply of capital for European companies. Investors, including large venture capital funds, are dissuaded by high transaction costs and legal uncertainty.¹¹⁴ Facilitating cross-border operations could help to increase the overall supply of capital.

2. Current pan-European framework insufficient

Small and medium-sized businesses consider the existing legal framework on a European level insufficient for their cross-border activities.¹¹⁵ About 60% of respondents to the European Commission's 2007 Consultation agree "that there is no existing legal company form suitable to conduct business throughout the European Union."¹¹⁶ Notably the conduct of business of the existing mother company under its own name and legal

¹¹³ Schunk, Presentation at the European Commission's 2008 Conference

¹¹⁴ Furtado, Presentation at the European Commission's 2008 Conference

¹¹⁵ European Commission, 2007 Consultation, Summary Report, p. 4, 5

¹¹⁶ European Commission, 2007 Consultation, Summary Report, p. 8

form in another Member State suffers from the widespread lack of trust in foreign legal forms abroad, irrespective of their origin. This lack of trust is considered as a major barrier to cross-border activity.¹¹⁷ One could argue that the option to operate with the existing home company abroad by registering it in the host country (European passport) has been facilitated significantly by the European Court of Justice's recent case law on corporate mobility in Europe, notably in the so-called Centros case.¹¹⁸ This development could potentially give rise to doubts regarding the need for an EPC Statute. Drury replies to such concerns:¹¹⁹

“[...] there are many reasons to doubt whether this particular [juridical] ‘climate change’ is as profound as appears at first sight. While some of these developments may have marginalized some of the advantages sought by the European Private Company project, they do not actually touch the core issues that lie behind the case for a transnational corporate vehicle designed essentially to be friendly to small businesses.”

I agree that the range of possible options for the entrepreneurs is still highly complex and up until today results in significant legal uncertainty and costs that need to be reduced.

Moreover, the existing pan-European public limited company (SE) is not regarded as a suitable option for small and medium-sized businesses¹²⁰ because its legal structure and management is too complicated and its establishment with a minimum legal capital of € 120.000 too expensive. A statute for a pan-European company should help overcome all the abovementioned difficulties.

3. Other obstacles to cross-border business

The European Commission 2007 Consultation report points out that diverging company laws and the insufficiency of the current framework are not the only obstacle to cross-border business and names tax, social and commercial provisions, including a fragmented intellectual property (IP)

¹¹⁷ European Commission, 2007 Consultation, Summary Report, p. 5

¹¹⁸ European Court of Justice, Centros Case, C-212/97

¹¹⁹ Drury, “The European Private Company”, p. 3

¹²⁰ Drury, “The European Private Company”, p. 1; Dejmek, NZG 2001, p. 882; Braun German Law Journal 2004, Vol. 5, No. 11, p. 1394; European Commission, 2007 Consultation, Summary Report, p.5

protection as well as cultural and language barriers as further sources of difficulties.¹²¹

D. Advantages of an EPC Statute

The following are considered to be the most significant advantages of a uniform EPC Statute throughout the European Union:

1. Simple operation in several Member States

The most significant advantage of a uniform EPC Statute will be that it enables companies to opt for the same internal organisation, no matter where in Europe they conduct business, and that they will no longer have to deal with 27 different legal systems. Instead, there will be standardized rules across the European Union. This regards both, the establishment of a company in a foreign European country and its day-to-day management. The more countries a business is active in, the higher the level of advantage it can draw from an EPC as legal form. As a matter of fact, more than 80% of respondents to the European Commission's 2007 Consultation would prefer to register a company in another Member State as an EPC,¹²² instead of registering their home company, and consider that the EPC would be "an attractive form of subsidiary for groups of Companies".

2. Cost reduction

It is a core principle of the European Internal Market that crossing borders must not cause additional costs.¹²³ If properly developed and legislated, the EPC Statute could significantly reduce the costs that cross-border businesses face in relation to the diversity of national legal forms. This also regards both, the establishment of a company in a foreign European country as well as its day-to-day management and it is particularly true for enterprises which conduct business in more than two or up to 27 Member States.

¹²¹ European Commission, 2007 Consultation, Summary Report, p. 5

¹²² European Commission, 2007 Consultation, Summary Report, p. 8

¹²³ Teichmann, Presentation at the European Commission's 2008 Conference

3. European Label

Moreover, the so-called European label “EPC” could turn out to be a helpful marketing tool in pan-European and global business. Three quarters of respondents to the European Commission’s 2007 Consultation considered the European label as an added-value and believe that it would enhance their company’s “image, visibility, competitiveness and dynamism”.¹²⁴ The added-value would be highest for companies from countries whose legal forms are not as widely known and recognized. For example it will be easier for a Romanian entrepreneur to build up a business relationship with French or German clients, lenders or suppliers if he uses an EPC as a vehicle, instead of a national legal form the structure of which is most likely unclear to them.

4. Advantages summarized

Schunk, a German medium-sized entrepreneur and company lawyer with an active cross-border business in several European countries and speaker at the European Commission’s 2008 Conference, summarizes the advantages from a practical point of view:¹²⁵

“Of a European Private Company we expect significant simplifications of the founding process and of the day-to-day administration of our subsidiaries. Because:

- We would not have to deal with foreign company law any longer
- We would have less consultancy fees regarding the formation and the drafting of a company statute
- We could use standardised European-wide model articles
- We could evaluate liability risks more easily
- We could establish uniform structures e.g. regarding all management bodies of the various companies
- We would have a European label.”

¹²⁴ European Commission, 2007 Consultation, Summary Report, p. 6; see also Steinberger, BB 2006, Vol. 37 (Beilage), p. 29

¹²⁵ Schunk, Presentation at the European Commission’s 2008 Conference

E. Constraints of the European Private Company

1. Possible disadvantages of regulating an EPC Statute

There are, in my view, no disadvantages of an EPC Statute conceivable. Every European entrepreneur will be perfectly free to choose whether the EPC is a suitable legal form for his business, or whether he prefers one of the traditional options for cross-border business. There will be no obligation to act under the new European label.¹²⁶ This means that the EPC Statute will not result in any new practical constraints or additional difficulties and costs for entrepreneurs. The range of possibilities for European small and medium-sized businesses is simply broadened.

2. Limits of the European Private Company

The EPC Statute will regulate the applicable company law for the EPC. Several other, related legal matters that would also urgently require harmonization simply cannot be addressed by the EPC Statute, but must remain regulated under national law. The legal matters that need to remain outside the EPC Statute will also remain outside the scope of this mini-thesis. They concern notably tax and accounting matters as well as social, labour and criminal legislation with regards to the EPC.

a) Tax matters

Diverging domestic tax legislations significantly hamper cross-border business in Europe. One of the major problems of legislating the EPC Statute at this point in time is the fact that tax issues will have to remain outside the new legal framework.¹²⁷ Although the majority of respondents to the European Commission's 2007 Consultation would like to see tax matters addressed in the EPC Statute,¹²⁸ such an approach is out of the question. The general taxation laws of the Member State in which the EPC will be registered, tax resident and/or in which it will have a taxable presence will therefore apply to it. European domestic tax laws are currently too diverse, too complicated and not ready for harmonization at this point in time at all. Also the

¹²⁶ See also: Matjasek, Presentation at the European Commission's 2008 Conference

¹²⁷ For details regarding the taxation of the pan-European SE and the future EPC see: Cerioni, p. 201

¹²⁸ European Commission, 2007 Consultation, Summary Report, p. 10

interests at stake are too powerful.¹²⁹ Tax aspects therefore remain outside the scope of the EPC Statute. The EPC Statute will unfortunately have to simplify the regulatory environment by concentrating on company law and without addressing tax matters. This mini-thesis therefore exclusively refers to the Statute as one that does not address tax issues.

b) Other matters

The same essentially applies to some other branches of law that are not company law, such as national labour, social and criminal legislation, requirements with regard to audit and the format and publication of accounts as well as procedures for insolvency. They will also remain outside the scope of the EPC Statute.¹³⁰ In such matters, submitting the EPC to each national law seems to be the only possible solution. Here the Statute will not touch on the matter itself, but it will have to establish functional links to the respective national laws without interfering in the national laws as such, i.e. the Statute must determine reasonable boundaries of that field of law. It is understood that for this purpose there should at least be an annex to the Statute listing the form of company to which the EPC shall be considered equivalent in each Member State, in particular in respect of the application of the said legislations.

The aforementioned fields of law will consequently not be addressed in this mini-thesis, with the exception of a couple of insolvency related matters that are very closely intertwined with the field of company law and hardly separable from it, and therefore have to be dealt with in the EPC Statute itself¹³¹ (notably director's duties regarding capital maintenance).

¹²⁹ Teichmann, Presentation at the European Commission's 2008 Conference

¹³⁰ This seems to have been clear from the very beginnings of the discussions around the EPC with the Paris Chamber of Commerce stating in its Explanatory Memorandum to its 1997 Study: "Naturally, the European private company will remain subject, like other companies, to the general rules of the Member States: employment, accountancy, and tax legislation, procedures for insolvency and cessation of payments, and criminal law."; see also: European Parliament, 2007 Resolution, Annex, Recommendation 8

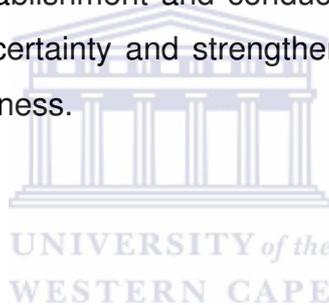
¹³¹ Teichmann, Presentation at the European Commission's 2008 Conference

c) National regulatory matters

Moreover, it goes without saying that where a business requires regulatory approval in a Member State either to carry on business or to sell a particular product, the establishment of an EPC will not, of itself, enable an approval in one Member State automatically to apply to other Member States.

F. Teleology summary

It is the aim of the EPC Statute to facilitate the conduct of cross-border business for European small and medium-sized enterprises in the European Internal Market. This is going to be achieved by providing them with a European uniform and flexible legal company form throughout the Member States. The availability of uniform corporate rules should significantly reduce costs related to the establishment and conduct in a foreign Member State. It should reduce legal uncertainty and strengthen the businesses' cross-border mobility and competitiveness.



V. Discussion of the European Key Issues

The following chapter is providing an in-depth discussion of the most important legal Key Issues regarding the scope, content and structure of the future EPC Statute. It is undisputed that the EPC shall be a private limited company.¹³² It shall possess legal personality and its liability for debts to creditors shall be limited to its assets.¹³³ It shall offer companies an additional, voluntary option, alongside national company forms, in terms of how they may constitute themselves.¹³⁴ Apart from that, almost everything about the EPC's future scope, structure and content is yet to be defined. As said before, certain matters such as labour, social and penal legislation, requirements with regard to audit, and the format and publication of accounts and procedures for insolvency as well as all tax matters will remain outside the scope of the EPC Statute and this mini-thesis, or will only be touched briefly. The following is a short overview of the Key Issue Groups and Key Issues to be discussed in this mini-thesis:

- Key Issue Group A: Overall Uniformity of the Statute (see below A.)
 - Key Issue 1: Statutory Uniformity
 - Key Issue 2: Contractual Uniformity
- Key Issue Group B: Formation and Registration (see below B.)
 - Key Issue 1: Formation
 - Key Issue 2: Registration
- Key Issue Group C: Shareholders (see below C.)
 - Key Issue 1: Shareholder Structure
 - Key Issue 2: General meeting, resolutions, voting
- Key Issue Group D: Share Capital (see below D.)
 - Key Issue 1: Minimum Legal Capital
 - Key Issue 2: Shareholder Contributions
 - Key Issue 3: Shares and Share Classes
 - Key issue 4: Share Transfer, Restrictions and Pre-emption Rights
- Key Issue Group E: Management (see below E.)
 - Key Issue 1: Overall Management Structure
 - Key Issue 2: Nomination and Eligibility of Directors
 - Key Issue 3: Powers of Directors

¹³² For an analysis of historical and legal roots of the concept of limited liability see: Rojo, Angel, "The typology of companies"

¹³³ See e.g. European Parliament, 2007 Resolution, lit. D

¹³⁴ See e.g. European Parliament, 2007 Resolution, lit. E

- Key Issue 4: Duties of Directors
- Key Issue 5: Directors' Liabilities
- Key Issue 6: Employee Participation at Board Level
- Key Issue Group F: Creditor Protection (see below F.)
 - Key Issue 1: Transparency and Public Disclosures
 - Key Issue 2: Specific Directors' Duties
 - Key Issue 3: Distribution Limits
 - Key Issue 4: Subordination of Shareholder Loans to the Company
- Key Issue Group G: Duration, Termination, Dissolution (see below G.)

A. Key Issue Group: Overall uniformity of the statute

Uniformity of the EPC and the EPC Statute throughout the European Union is an important aim in order to make the EPC a widely accepted and truly European legal form. However, in a legal environment as diverse as the European Union, lawmakers need to determine to which extent the EPC Statute must and can actually be uniform in 27 different Member States. Overall uniformity of the Statute has two recurring structural aspects: a statutory aspect (see below 1.) and a contractual aspect (see below 2.). In addition to the following general discussion, the question of uniformity will be addressed specifically with regards to each of the Key Issues, if necessary.

1. Statutory uniformity of the statute

a) The problem

It needs to be determined to what extent the EPC Statute shall be uniform throughout the European Union in terms of references to domestic statutory law. Should the Statute, instead of regulating certain matters, just refer to national law or should it be comprehensive and stand-alone? There are essentially two positions: either the EPC Statute is designed more or less exempt of references to national laws and therefore very detailed but essentially uniform. Or the Statute, in place of regulating every possible matter in detail, refers to national statutes and their very diverse regulations regarding certain legal matters. In that latter case, an EPC would be partly governed by the domestic laws of the Member State in which it is registered. Such a Statute would, to a certain extent, be shorter and

simpler, but not statutorily uniform. It would be intertwined with all kinds of national legal systems in the Member States. Consequently, the EPCs that will be registered on grounds of the EPC Statute and the domestic laws they respectively refer to, will not be uniform but diversified across the Union.

b) The European Parliament's opinion

The European Parliament takes the view that an EPC Statute "should be based as far as possible on rules of Community law and should thus dispense with references to national law: it should therefore be conceived as a uniform and definitive statute."¹³⁵ It names an extensive list of legal matters to be regulated in the EPC Statute.¹³⁶ "In other areas", according to the European Parliament "the Statute should in principle apply, and any rules going beyond it should apply only in a subsidiary manner, in the following order of precedence: other rules of Community law; provisions governing comparable types of company in the Member State in which the company has its registered office."¹³⁷ To avoid legal uncertainty, according to the European Parliament, the EPC Statute should have an annex listing the types of national legal forms the EPC is equated with in respect of areas not covered by the regulation.¹³⁸

c) The European Commission's 2007 Consultation

In the European Commission's 2007 Consultation numerous respondents insisted "that the SPE will only be useful and provide added-value if its statute is uniform throughout the European Union".¹³⁹ The majority clearly favoured a Statute completely exempt from references to national law: "References to national law are likely to lead to as many kinds of SPEs as there are Member States, thus depriving the SPE of much of its attractiveness"¹⁴⁰ and a comment frequently made was that "to bring real added-value, the SPE statute

¹³⁵ European Parliament, 2007 Resolution, Annex, Recommendation 1

¹³⁶ For details see: European Parliament, 2007 Resolution, Annex, Recommendation 1

¹³⁷ European Parliament, 2007 Resolution, Annex, Recommendation 1

¹³⁸ European Parliament, 2007 Resolution, Annex, Recommendation 8

¹³⁹ European Commission, 2007 Consultation, Summary Report, p. 4

¹⁴⁰ Ibid.

should be simple and clear and, most importantly, as autonomous and as free as possible from national rules.”

d) Preferable solution

In light of the problems businesses face in their cross-border activities and the EPC Statute’s aim to enhance their overall growth, it seems indeed vital that the Statute provides for a legal framework as uniform as possible throughout the European Union. The importance of statutory uniformity can hardly be overrated. The EPC Statute should be exempt from references to national law as far as possible, and it should be mainly withdrawn from the jurisdictions of the Member States. With every reference to national law in the EPC Statute the legal structure of the EPC threatens to become more complicated and unmanageable. This would result in even more legal uncertainty instead of less and would turn the Statute’s teleology upside-down. A mixture of European and national regulations beyond the indispensable is likely to increase, rather than reduce the costly need for legal advice on establishing and running businesses in foreign Member States.¹⁴¹ Without a maximum of uniformity, the chances that the EPC turns out as a simple and inexpensive instrument for conducting cross-border business drop considerably. In particular, the notion of a European label would not work in an EPC that has 27 different faces. Preferably nothing should be left to national laws,¹⁴² with the exception of certain fields in which harmonization is impossible at the moment (e.g. tax as mentioned before). The discussion of the following Key Issues will be made in light of this finding (see each relevant Key Issue below for details).

e) The further problem of regulatory gaps

A further problem related to statutory uniformity is what happens if regulatory gaps are found in the legal framework. Teichmann offers three thoughts on that risk:¹⁴³ Firstly, it must be ensured during the

¹⁴¹ Schunk, Presentation at the European Commission’s 2008 Conference

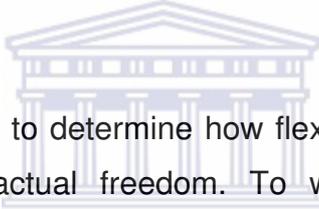
¹⁴² Teichmann, Presentation at the European Commission’s 2008 Conference; Steinberger, BB 2006, Vol. 37 (Beilage), 27-29

¹⁴³ Teichmann, Presentation at the European Commission’s 2008 Conference

legislative process that few regulatory gaps can possibly arise by providing a well drafted Statute that is tailored to the needs of small and medium-sized businesses. Secondly, the Statute should provide for model articles of association with default provisions in order to avoid gaps in the actual articles of association (for details on model articles see below). Thirdly, according to Teichmann, not every single possible case can be legislated for in the Statute or the articles of association. Here the legislative technique of using general clauses in the Statute should help. Those general clauses shall be interpreted by the national courts with a common point of reference in European Law and the possibility of referring a particular case to the European Court of Justice, if necessary.

2. Contractual uniformity of the statute

a) The problem



There is a need to determine how flexible the EPC Statute can be in terms of contractual freedom. To what extent must the Statute regulate certain matters and to what extent can it be silent on other matters and leave them to the company's articles of association? A related question is whether or not there should be model articles of association.

b) The European Commission's 2007 Consultation

Most respondents of the European Commission's 2007 Consultation considered that the Statute should be as open as possible offering maximum flexibility¹⁴⁴ and leaving as much regulation as possible to the company's constitution or articles of association. Many respondents thought that contractual freedom could be greater in a single shareholder company as opposed to a multiple shareholder company¹⁴⁵ because there are no potential conflicts of interest between shareholders. Others thought that a broad margin of contractual freedom could hamper the EPC's uniformity throughout

¹⁴⁴ European Commission, 2007 Consultation, Summary Report, p. 4

¹⁴⁵ Ibid.

the European Union and that the Statute should rather provide for definitive and binding, instead of soft legal provisions.

c) Preferable solution

In my view, a maximum of uniformity is desirable but at the same time there needs to be a high degree of flexibility for entrepreneurs and their ventures.¹⁴⁶ These conflicting objectives need to be balanced. The EPC Statute should therefore provide for a sound and comprehensive set of standard rules regulating the most basic and important legal cornerstones of the EPC.¹⁴⁷ The details could be left to contractual freedom and should be regulated in the respective articles of association in order to ensure flexibility for businesses to regulate their own affairs. De Kluiver agrees and considers that the EPC Statute should be more principle based than rule based.¹⁴⁸ This will ensure a sufficient level of uniformity throughout the Union. Teichmann points out that

“it is precisely contractual freedom which offers the founders the possibility to tailor provisions for themselves which apply Europe-wide. The parent company in state A can provide its subsidiaries in states B, C and D with the same articles of association. This simplifies cross-border corporate governance and saves considerable costs compared with the administration of subsidiaries all of which have to follow different legal regulations.”¹⁴⁹

As a rule, most issues related to the company’s external relations, including e.g. creditor protection, must be catered for in the EPC Statute. On the other hand, uniformity is essentially only required regarding the external relations so that many of the internal relations can be left to contractual freedom. The in-depth question whether a particular point should be left to the articles of association must be analyzed separately for each legal Key Issue in question and will therefore be dealt with as part of the further discussion (see each relevant Key Issue below for details).

¹⁴⁶ See also Schunk, Presentation at the European Commission’s 2008 Conference

¹⁴⁷ See also Dejmek, NZG 2001, p. 881

¹⁴⁸ de Kluiver, Presentation at the European Commission’s 2008 Conference

¹⁴⁹ Teichmann, Presentation at the European Commission’s 2008 Conference

d) Model articles of association

The flexibility reached by a Statute leaving certain matters to contractual freedom comes at a price: there will be legal issues left to be decided or designed by the founders. This in turn incurs costs for legal advisors that the EPC Statute is meant to reduce. Particularly small businesses in most cases cannot afford legal advice from law-firms specialized in European corporate law. Model articles of association are therefore a tool to bring a flexible Statute in line with its overall objective of enhancing the growth and prosperity of small businesses.¹⁵⁰ Smaller companies, instead of hiring expensive lawyers, can simply pattern their articles of association on model articles of association.¹⁵¹ If, after all, a large part of the EPC's structure will be left to contractual freedom, there must, in my view, be official model articles of association annexed to the EPC Statute. These model articles could possibly have two different functions, a so-called residual function, a pure model function or a hybrid function.

i) Residual function

One function of the model articles of association could be that they apply by default where the company's actual articles are silent on a certain point (default or residual function). One prominent example of model articles with a residual function is Table A of the British Companies Act of 1985. A residual function would mean that the model articles have a quasi-regulatory scope because the founders would have to opt-out of certain provisions of the model articles, either by expressly excluding their application or by regulating certain matters differently in the actual articles of association. Particularly Teichmann strongly promotes model articles with a residual function and points out that the model articles are necessary to fill all kinds of gaps in the regulatory and contractual framework of the EPC.¹⁵²

¹⁵⁰ See also the Explanatory Memorandum to the South African Companies Bill 2007 suggesting a standard form memorandum of association, South African Government Gazette 29630, notice 166, p. 10

¹⁵¹ See for more details: Drury, Presentation at the European Commission's 2008 Conference

¹⁵² Teichmann, Presentation at the European Commission's 2008 Conference

ii) Model function

Model articles of association with only a model function, not a residual function, are only meant to be a source of inspiration for founders of EPCs without the legal effect of filling any contractual gaps by default. Draftsmen can voluntarily draw upon the “tool-box” of model articles when drafting the actual articles.

iii) Hybrid function

Ideally, model articles have both, a model as well as residual function. However, Holmquist points out that a mixed residual / model approach would hardly be viable: if the model articles have a residual function, there would only be very limited room left for a model function¹⁵³ because the residual model articles would apply by default and can therefore not offer several alternative solutions to a certain matter. Residual model articles have to be unambiguous and cannot provide alternative options catering for diverse needs of entrepreneurs.

iv) Comment

The EPC Statute will leave a large number of legal issues to be regulated by the articles of association (see the Key Issue discussion below for details). It would therefore be highly recommendable to make use of official model articles of association annexed to the Statute. These model articles must, in my view, have a residual function. This is necessary because practical experience shows that the actual articles of association of many EPCs will be faulty or incomplete and in some cases even dysfunctional. Such contractual and regulatory gaps could not only potentially damage the EPC's standing in the public eye but also lead to all kinds of internal disputes between the shareholders. If the articles of association fail to regulate a matter left to contractual freedom, there must be a default provision of some kind in order to ensure the proper working of the company.

¹⁵³ Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech

This function can only be catered for by the model articles of association.

However, in my opinion, the model articles of association should and could not only have a residual function, but a model function as well. In the light of Holmquist's critique of hybrid model articles, the only viable option to achieve both functions would be to offer two alternative versions of the model articles:¹⁵⁴ one model text serving as a standard of minimum requirements with a residual function and the other text, a diversified version serving as inspiration and a tool-box for founders including various alternatives for diverse needs of entrepreneurs.

B. Key Issue Group: Formation and registration

1. Formation

The EPC Statute will have to determine according to which rules the formation of an EPC will be possible.

a) Statute or contractual freedom

The majority of respondents to the European Commission's 2007 Consultation considered the formation of an EPC an issue which should be dealt with in the EPC Statute comprehensively and could not be left to the articles of association.¹⁵⁵ Provisions on formation in the Statute are indeed necessary because the formation concerns the very essence of the EPC's existence, the root of the corporate structure, and defines its overall shape. The standards regarding formation must be included in the Statute. Regarding the company's formation, uniformity is not only one of several possible policy objectives, but an absolute must and the Statute is the only way to ensure it.

¹⁵⁴ Linnainmaa, Presentation at the European Commission's 2008 Conference

¹⁵⁵ European Commission, 2007 Consultation, Summary Report, p. 12

b) Methods of formation

In order to achieve high practical flexibility, there should be different possible ways of forming an EPC. First of all, it should be possible to newly create an EPC by founding it *ex nihilo*. Furthermore, it should be possible for existing national companies, no matter if private or public, to be converted or to merge into a European Private Company. This would make the legal form of an EPC as attractive as possible for all kinds of medium-sized groups of companies dealing with permanently evolving and complex structures of numerous subsidiaries. Accordingly, the European Parliament suggests that there should be different options regarding the formation¹⁵⁶ including conversions. It summarizes the relevant topics to be regulated relating to possible conversions: the EPC must be able to merge with other companies,¹⁵⁷ split and change into, for example a European Company (SE),¹⁵⁸ as far as possible in accordance with Community law which has already been harmonised. Moreover, according to the Parliament, it must in turn be possible for national companies to convert into an EPC and to re-convert from an EPC into a national legal form.¹⁵⁹ The Statute should allow for named conversions. Some aspects of the legal issues arising out of such conversions can be dealt with by reference to the already existing Third European Company Directive (merger directive).

c) Form

In many European jurisdictions the incorporation documents can exclusively be set up by way of a notarial deed. This is to make sure that the documents are properly set up, authentic and complete in terms of necessary or mandatory legal content. The EPC is meant to become a flexible and cost-effective legal form. It would therefore be best to allow for the formation by means of simply written documents,

¹⁵⁶ European Parliament, 2007 Resolution, Annex, Recommendation 2

¹⁵⁷ Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross border mergers of limited liability companies (OJ L 310, 25.11.2005, p. 1).

¹⁵⁸ Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) (OJ L 294, 10.11.2001, p. 1). Regulation as last amended by Regulation (EC) No 1791/2006 (OJ L 363, 20.12.2006, p. 1).

¹⁵⁹ European Parliament, 2007 Resolution, Annex, Recommendation 10

without the necessity of involving a public notary. In that case it must be regulated that the public registration authorities have to test and confirm the authenticity of submitted incorporation documents, instead of the notary (see below for details).

d) Name and objects of Company

The majority of respondents to the European Commission's 2007 Consultation considered the name and the objects of the EPC issues which should be dealt with in the EPC Statute and could not be left to the articles of association.¹⁶⁰ Holmquist on the other hand suggests to leave the determination of name and objects to the model articles of association.¹⁶¹

Essentially, I agree that the model articles, and not the Statute, should provide for all kinds of voluntary stipulations regarding name and object of the EPC. However, in my view, the most basic foundations with regards to the company's trade name need to be withdrawn from the disposition of the founders and by means of regulation in the Statute. This is necessary to ensure a minimum of uniformity of the EPC's "face". After all, one of the envisioned advantages of the EPC is its European label function. The Paris Chamber of Commerce made a convincing suggestion of the following wording (Article 7):¹⁶²

"The EPC shall select a corporate name which may include the object of the company, the name of one or more shareholders, or be entirely imaginary, provided that it must not be misleading or liable to cause confusion. The company's name shall be preceded or followed immediately by the words "European Private Company" or the acronym "EPC".

Such stipulation in the EPC Statute would be a sufficient to avoid a myriad of different EPC labels without any kind of cross-border "brand recognition effect."

¹⁶⁰ European Commission, 2007 Consultation, Summary Report, p. 12

¹⁶¹ Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech

¹⁶² Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

2. Registration

The EPC's incorporation and constitutional documents will have to be submitted to a public register. As usual, the EPC will acquire status as an independent legal person with registration. The formalities and procedures regarding the registration of an EPC need to be determined by the European lawmakers drafting the EPC Statute. They are of particular importance for the success of the EPC as a legal form.

a) Overview of issues regarding national registration

The different national registration procedures for European limited liability companies are very diverse and not at all harmonized. For example, in some countries, such as Germany, the registration of a private limited company is only possible if the deed of formation is notarized (see also above). Other countries accept corporate documents in simple written form. The institutional structure of the competent registrar authorities ranges from registers administered by judicial courts to private bodies. The length of the registration processes vary from a few days to several months. The cost of registration is equally eclectic throughout the Union. The registration usually has to be filed in the official language of the country the company is registered in¹⁶³ and English is not always an option. The European country with the most efficient and inexpensive company registration procedures seems to be Denmark where online registration is possible and takes about 20 minutes. No registration fees are charged in Denmark.¹⁶⁴

b) Positions

The majority of respondents to the 2007 Consultation considered registration an issue which should be dealt with in the EPC Statute and could not be left to the articles of association.¹⁶⁵ The Law Society of England and Wales summarizes the essential point:¹⁶⁶

¹⁶³ Linnainmaa, Presentation at Presentation at the European Commission's 2008 Conference

¹⁶⁴ Gesell / Flaßhoff / Krömker, p. 29/30

¹⁶⁵ European Commission, 2007 Consultation, Summary Report, p. 12

¹⁶⁶ Law Society of England and Wales, Response to the European Commission's 2007 Consultation

“Whichever approach is adopted, it is important that the time taken to register the relevant company is not too long and that the information can be provided electronically and without the costs of having to notarise and translate documents. If there is certain basic information which it is felt must be available in the language of the host Member State in the local language, we would like to see this standardised and kept to a minimum.”

The Commission has received similar comments in its 2007 Consultation and points out that “administrative requirements should be kept a minimum. There should be no need for the notarisation of documents, to save costs. Registration should be able to be done electronically.”¹⁶⁷ Schunk agrees: “the requirements for the incorporation must not be too strict.”¹⁶⁸ The European Parliament considers: the EPC “should be registered [...] taking into account mechanisms for verifying the substantive correctness and authenticity of the constitutive instrument.”¹⁶⁹ The draft Statute of the Paris Chamber of Commerce of 1997¹⁷⁰ suggests the following wording: (Article 8) which seems overall acceptable:

”1. The EPC shall be registered in the State of its registered office, in the register specified by the legislation in that State [...]
2. The registration formalities may be carried out by any person authorized by the founders for such purpose or appointed by the articles of association to represent the company in relation to third parties. For registration purposes, the following information shall be provided: the company's form and name, its duration if determined, the objects of the company, the address of the company's registered office, the amount of subscribed capital and the body or bodies having authority to enter into commitments to third parties for the company and to represent it before the Courts. The names and particulars of the persons appointed to such governing body or bodies shall also be specified.”

c) Details of a preferable solution

In my view, the EPC Statute should put a strong emphasis on promoting the flexibility, affordability and overall attractiveness of the EPC in particular by providing for a regime of formalities and

¹⁶⁷ European Commission, 2007 Consultation, Summary Report, p. 14

¹⁶⁸ Schunk, Presentation at Presentation at the European Commission's 2008 Conference

¹⁶⁹ European Parliament, 2007 Resolution, lit. G

¹⁷⁰ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

procedures of registration as simple, inexpensive and uniform as possible. The following seem to be the most important cornerstones:

i) Administrative authority

The existing national public authorities for the registration of companies and the administration of company registers, i.e. for example the English Registrar or the German *Handelsregister*, should also handle the registration of European Private Companies in their respective Member States. This avoids the establishment of new bureaucracy in the form of a new European registrar authority.

ii) Uniform set of rules, documents and forms

The Statute must regulate a standard set of rules governing the registration process in detail and in a uniform way throughout the European Union. This includes model documents and forms for the registration procedure. In addition to the Statute, standard written instructions for the formation and registration procedure should be provided.¹⁷¹

iii) Form of registration and submission

All relevant documents and forms shall be submitted in original form. There should be no requirement for any kind of notarization of documents; this is absolutely necessary for cost and time efficiency reasons. Instead, registration in written form should be acceptable as long as the standard forms have been properly used. It must then, however, be regulated that the respective national registrar authorities have to review and confirm the authenticity of submitted incorporation documents. Procedural details of this could be left to respective national legislation. Another medium term aim should be to allow for online submission of registration documents, although for the time being the technical requirements for proper online identification of persons are still under way. Furthermore: if it will be decided that the Statute's model articles will exclusively have a model

¹⁷¹ Linnainmaa, Presentation at Presentation at the European Commission's 2008 Conference

function, not a residual function to fill contractual gaps (see above for details), then there has to be some kind of checklist for registration in order to ensure that the articles cover for all kind of mandatory matters.

iv) Language, cost and time issues

It is essential that the EPC Statute obliges all Member States to take the necessary steps to enable the respective national registrar authorities to accept registration documents and forms in English language. This would facilitate cross-border registrations significantly and save time and money of founders. Moreover, I believe the Statute should set a maximum time and a maximum fee for registration with the public registrar authority. Two weeks or one month after the documents have been submitted seems to be the longest sensible period of time.¹⁷² The costs of registration should not exceed € 500.

C. Key Issue Group: Shareholders

The following discussions regard the EPC's shareholder structure, general meetings, resolutions and voting, minority shareholder protection and finally shareholders' liability.

1. Shareholder structure

a) The problem

It is discussed whether the EPC should be open to both, legal persons and natural persons, and if it should be open to single shareholders only, or equally to a group of multiple shareholders. The practical consideration behind these questions is essentially whether the EPC shall be established only by existing companies or groups of companies wishing to establish a subsidiary abroad, or whether it should be open to individual entrepreneurs as well. On the one hand, the EPC Statute would be shorter and simpler catering for a single, legal person shareholder only. This in turn would ensure a high degree of uniformity of the EPC in the Union. On the other hand, a

¹⁷² Ibid.

Statute not restricting the shareholder structure to single shareholders and legal persons would ensure a higher degree of flexibility as it would be open to all kinds of businesses. It must be pointed out that the multiple shareholder approach will clearly face greater political difficulties during the negotiation process regarding the EPC Statute.

b) Positions

The majority of respondents to the European Commission's 2007 Consultation support a single shareholder EPC, although according to most of them the company should be open to single and multiple shareholders, legal and natural persons alike.¹⁷³ The European Parliament stated in its 2007 Resolution: "it should be possible for one or more natural or legal persons who do not necessarily reside in a Member State to establish a European Private Company (EPC) on Community territory."¹⁷⁴

c) Comment

I agree with the open approach, allowing one or more natural persons as shareholders, as well as legal persons. European small and medium-sized businesses are very diverse in structure, including notably a large number of businesses owned by single individuals, groups of individuals or partnerships. It is this group which, in my view, would make particularly frequent use of and would profit most from the possibility of establishing an EPC to conduct their cross-border business. This group is economically less powerful than the large groups of companies and can usually not afford the necessary armada of legal and tax advisors in order to design an appropriate cross-border strategy. In addition to that, allowing for only a single shareholder could easily be circumvented in practice anyway.¹⁷⁵ The draft Statute of the Paris Chamber of Commerce of 1997¹⁷⁶ suggests the following appropriate wording: "A European Private Company ("EPC") may be incorporated by one or more individuals or legal

¹⁷³ European Commission, 2007 Consultation, Summary Report, p. 4, 8, 9, 10

¹⁷⁴ European Parliament, 2007 Resolution, lit. C

¹⁷⁵ Law Society of England and Wales, Response to the European Commission's 2007 Consultation

¹⁷⁶ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

entities, nationals of a Member-State or not, in the conditions and in the manner provided for under this Regulation.”

2. General meeting, resolutions, voting

The procedures of assembly and decision-making among the shareholders are important issues for any company including the EPC.

a) The problem

Examples of the main questions regarding shareholder assembly and decision-making are: How often shall regular general meetings take place? Who shall be extraordinarily allowed to summon the shareholders to assemble? What is the number of members that must be present in order to constitute valid meeting (quorum)? Which questions should require collective decisions of the shareholders? In what way can shareholder resolutions be taken, and what are the relevant voting procedures including the majorities for certain resolutions?

b) Positions

Holmquist suggests leaving all those questions to the model articles of association.¹⁷⁷ The idea behind that seems to be that the meetings, resolutions and voting form exclusively part of the internal working of the company, as opposed to its external relations towards third parties. The majority of respondents to the European Commission’s 2007 Consultation thinks differently and considered that the procedures for resolutions and voting must be dealt with in the EPC Statute and could not be left to the articles of association.¹⁷⁸ The draft Statute of the Paris Chamber of Commerce of 1997¹⁷⁹ leaves space for the articles of association and suggests the following provisions of the Statute regarding voting rights: (Article 15)

”[...] the number of votes granted, for decisions taken collectively by the shareholders, to each share to which a voting right attaches [shall be determined]. Such number may vary according

¹⁷⁷ Holmquist, Presentation at the European Commission’s 2008 Conference, Closing Speech

¹⁷⁸ European Commission, 2007 Consultation, Summary Report, p. 12

¹⁷⁹ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

to the nature of the decisions. [...]The articles of association shall determine the decisions which must be taken collectively by the shareholders. They shall also provide for the required procedures and requirements, in particular as to the manner of consultation and requirements as to quorum and majority. [...]"

c) Preferable solution

In my view, it needs to be differentiated between purely procedural issues and substantial matters that could possibly infringe the rights of minority shareholders or third parties, notably the company's creditors. On the one hand, the formal and procedural issues, such as the form and dates of the regular meetings, the general quorum and other voting procedures should be left to contractual freedom as a rule. A comprehensive exemplary wording in the model articles with a residual function would be an appropriate solution here. This includes the overall decision on how powerful the general meeting shall be in a particular company, which questions should require collective decisions of shareholders and if shareholders could also use other means of communication in decision-making (mail, telephone, internet, email). On the other hand, shareholder resolutions that could potentially infringe the rights of minority shareholders or creditors must be regulated in the EPC Statute and not in the model articles. Ideally the Statute includes a catalogue of sensitive shareholder resolutions that require a mandatory qualified majority (for details on creditor protection and minority shareholder protection see below).

3. Minority shareholder protection

It has to be determined whether and how the rights of minority shareholders shall be protected by the EPC Statute. The options are the following.

a) Contractual freedom

One option could be to leave all matters related to minority shareholder protection to contractual freedom. This extremely liberal approach would, however, leave too much space for all kinds of abuses of a majority against the minority of shareholders. It would also potentially result in a wave of disputes between shareholders brought

in front of the national courts, a prospect that should be avoided against the background of the general overwork of judicial organs in the European Union. The protection of shareholder rights is essential to the proper working of every company because all shareholders, not only the majority, put their capital at risk, no matter how small the amount, and are entitled to protection against abuse.

b) Comprehensive regulation

A converse possibility would be to regulate the minority rights as exhaustively as possible. The majority of respondents to the European Commission's 2007 Consultation considered minority rights an issue which should be dealt with solely in the Statute and could not be left to the articles of association.¹⁸⁰ For the purpose of regulating minority rights one could take advantage of the fact that statutory laws and case laws of all Member States are so well developed and detailed on that matter. It could therefore be an option to draw upon those national laws and formulate a complete regime for the protection of minority shareholders in the EPC Statute as comprehensive as possible in order to avoid conflicts between shareholders from the very beginning of every company. However, this approach is hardly feasible. Firstly because the Statute will never be complete anyway, there will always be gaps which will lead to new problems. Secondly, a Statute trying to be comprehensive on that matter would be inconsistent with the objective to keep the Statute as simple and concise as possible. Moreover, the Statute would hardly be flexible anymore.

c) Preferable solution

An alternative for the Statute would be to be more limited in scope regarding minority rights of shareholders, but still regulate the essential cornerstones. De Kluiver convincingly suggested in his speech at the European Commission's 2008 conference that the Statute "should lay down principles for a fair treatment of shareholders, without unduly restricting freedom to adopt structure

¹⁸⁰ European Commission, 2007 Consultation, Summary Report, p. 12

they deem fit, and a buy-out mechanism if they are unfairly prejudiced.”¹⁸¹ I agree with this approach and believe there should ideally be a general catalogue of protected minority rights. Dumitrascu summarizes a sensibly short list of the most important minority rights as follows:¹⁸²

- pre-emption rights of (minority) shareholders in case of capital increase or sale of shares,
- shareholders’ right to call meetings or put items on agenda,
- shareholders’ right to be informed on the company’s affairs,
- shareholders’ right to challenge the board resolution,
- right to impose legal action against directors,
- sell-out rights.

All those rights should be dealt with in the EPC Statute as a minimum standard. Further details could be left to contractual freedom and the model articles of association. An additional important issue to be regulated in the Statute is the protection of minority shareholders against an abusive behaviour of the majority by means of so-called minority blocking rights:

d) Blocking rights

The essential question is: Should there be a right for a minority of shareholders to block particularly sensitive decisions favoured by the majority? If so, in which cases should such blocking rights apply and what are their limits in order to in turn avoid abusive blocking by the minority?

In my view, the issue of minority blocking rights is an example of an essential issue that needs to be regulated in the EPC Statute. The predominant reason for stipulating rules on blocking rights is to ensure the internal functioning of the company and avoid disputes and respective court action.

¹⁸¹ de Kluiver, Presentation at the European Commission’s 2008 Conference

¹⁸² Dumitrascu, Presentation at the European Commission’s 2008 Conference; the term sell-out rights actually seems to refer to so-called buy-out rights of the majority to buy-out minority shareholders

An extreme possibility would be to simply regulate a unanimity vote requirement for all resolutions adopted by the shareholders. Nowadays this approach is not frequently seen in private limited company laws; it is highly inflexible and favours the minority shareholders in an unjustified and inappropriate way and easily leads to a voting abuse by the minority. An adequate solution needs to balance the risk of majority abuse against the converse risk of minority abuse.

A more balanced solution in which a certain qualified majority vote is required for a catalogue of certain shareholder resolutions would be favourable. Ideally the Statute itself provides for a catalogue of mandatory situations in which a 2/3 or 3/4 majority is required. Such an approach would provide for a sensible minority protection. At the same time it provides for a substantial minimum threshold of minority voters to block decisions, thus preventing minority abuse. According to Dumitrascu the list of sensitive resolutions requiring for a certain majority vote could read as follows:¹⁸³

- important amendments to the articles of association (e.g. the main business object, headquarters, change of legal form),
- share capital increase/decrease,
- corporate restructuring,
- winding up / liquidation.

All other situations could be left to contractual freedom, i.e. the model articles. Moreover, Holmquist suggests that the model articles of association should include a default requirement of a three-quarter majority to alter those provisions of the articles which do not expressly require unanimity.¹⁸⁴

4. Shareholders' liability

Shareholders of a limited liability company are, as a rule, only liable for the company's actions to the extent of their unpaid contributions. This principle is a vital element of the limited liability company's success as a legal form

¹⁸³ Dumitrascu, Presentation at the European Commission's 2008 Conference

¹⁸⁴ Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech

and its attractiveness to purely financial investors that are not ready to assume liabilities. However, throughout European jurisdictions there are statutory or case laws on the piercing of the corporate veil of non-liability in case of fraudulent or abusive behaviour on the side of the shareholders. It should be considered to include a selective and concise catalogue of piercing-of-the-veil cases patterned on the national laws regarding particularly severe cases. This could include certain cases of abusive undercapitalisation or cases in which a parent company as a majority shareholder exercises its powers to the detriment of the company.

D. Key Issue Group: Share Capital of the EPC

The question of the EPC's share capital offers a whole range of legislative issues to be analysed and determined: minimum legal capital, shareholder contributions, shares and share classes, share transfer and restrictions. A few respondents to the European Commission's 2007 Consultation thought that share capital issues could be left to the articles of association, at least in a single shareholder company.¹⁸⁵ Unfortunately things are more difficult than that. The following aspects illustrate the complexness of this particular Key Issue.

1. Minimum Legal Capital

The minimum legal capital a private limited company disposes of is supposed to offer a minimum of protection to the company's creditors in case of insolvency. It is also regarded as a token of seriousness and soundness of the investing founding members. It has to be determined by the EPC Statute whether the EPC should be obliged to have a certain minimum legal capital or not.

a) Overview of national solutions

Laws of the Member States of the European Union are very diverse in terms of the minimum capital of their private limited companies. The EU-wide average is about € 9000.¹⁸⁶ Notably, the UK and Irish version, Private Limited Company (Ltd), does not require any

¹⁸⁵ European Commission, 2007 Consultation, Summary Report, p. 4

¹⁸⁶ Gesell / Flaßhoff / Krömker, p. 40

minimum legal capital at all. The German version, Gesellschaft mit beschränkter Haftung (GmbH), has been requiring € 25.000 for the last decades. However, the necessity of a legal minimum capital has been increasingly disputed over the last years, with Germany currently reducing the minimum legal capital to € 10.000. Similar to the United States (Delaware Effect),¹⁸⁷ European jurisdictions seem to be in a competition to attract investors by offering a low legal capital requirement. Must the EPC participate in this competition and would a symbolic capital amount of 1€ be sufficient, or is there a need for a higher minimum legal capital for the EPC?

b) Positions

The majority of respondents to the European Commission's 2007 Consultation considered the minimum legal capital a topic which should be dealt with in the EPC Statute and could not be left to the articles of association.¹⁸⁸ Apart from that, the Commission has received comments that the minimum legal capital should be kept low, some respondents considered € 10.000 as a minimum¹⁸⁹, other respondents thought that this amount was too high.¹⁹⁰ Schunk considers: "The share capital must not be fixed at an amount that is unacceptable for SMEs. As a guideline a share capital of 25.000 Euro would seem appropriate."¹⁹¹

The European Parliament suggests a minimum capital of € 10.000 at the time of registration although this amount would not necessarily have to be paid up.¹⁹² The draft Statute of the Paris Chamber of Commerce of 1997¹⁹³ proposes a minimum capital of € 25.000 which shall be subscribed for and paid in full at the time of registration.

¹⁸⁷ The absence of a federal corporate law in the United States resulted in a rivalry among the States for the most liberal and flexible corporate regulations (so-called Delaware Effect). Statistically, the State of Delaware seems to have won this race by attracting the majority of US-American corporate entities. As a side effect, Delaware courts developed highly specialized expertise in the field of corporate law and are among the most distinguished of the country.

¹⁸⁸ European Commission, 2007 Consultation, Summary Report, p. 12

¹⁸⁹ Also: Steinberger, BB 2006, Vol. 37 (Beilage), p. 37

¹⁹⁰ European Commission, 2007 Consultation, Summary Report, p. 14

¹⁹¹ Schunk, Presentation at the European Commission's 2008 Conference

¹⁹² European Parliament, 2007 Resolution, Annex, Recommendation 3

¹⁹³ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

Others suggest the EPC to require no minimum capital at all or a symbolic amount of € 1.¹⁹⁴

c) Comment

It is the EPC Statute's overall aim to enhance the growth of small and medium-sized businesses by providing for a sound and functional pan-European legal form. I believe, however, that the overall positive effects of a minimum legal capital in terms of creditor protection and evidence of soundness are overrated. Notably the effect of creditor protection is easily and frequently circumvented by withdrawing or otherwise annihilating the minimum capital after registration. Therefore, I do not see the necessity of a large amount of legal minimum capital, such as € 25.000. An effective creditor protection regime should rather be achieved, amongst other things, by provisions on the amount of permissible distribution (see below for details). An amount of € 25.000 is likely to hamper the emergence and the business of small and medium-sized enterprises rather than enhance it. The minimum capital needs to allow for all kinds of entrepreneurs, including founders of micro businesses, to establish a company with a very small amount of capital. This is particularly true for entrepreneurs in the new, formerly socialist Member States whose economic development is still weaker than in the rest of Europe.

I take the view that the Statute should stipulate a minimum capital of €10.000. On the other hand, I believe that it would be counterproductive to require no minimum capital at all because one important benefit of a minimum capital is indeed the psychological threshold for entrepreneurs to prove an absolute minimum of soundness and seriousness. Also it prevents dysfunctional companies with no financial means from acting in the market. Investing a sum of € 10.000 would be an appropriate proof of purpose.

¹⁹⁴ Andras, Presentation at the European Commission's 2008 Conference

2. Shareholder contributions

There are several open questions with regards to shareholder contributions to the EPC. Should contributions be regulated in the Statute itself? What types of contributions shall be allowed? How should contributions be valued?

a) Statute or contractual freedom

First of all, in my view, the issue of shareholder contributions as such cannot be left to contractual freedom. There should be provisions in the EPC Statute itself, not only in the model articles of association, on the kinds of contributions permitted and their valuation. The main reason for this is that the field of contributions is particularly sensitive with regards to the shareholders' financial interests as well as creditor protection. A clear and comprehensive regime of shareholder contributions can prevent all kinds of long-term disputes between shareholders. It also mitigates the risk of manipulations regarding balance-sheet positions. Contributions are one of the areas in which corporate soundness and transparency are vital to the working of the entity. Of particular importance is the process of valuation of contributed assets which, in my view, should be regulated comprehensively by the Statute.

b) Contribution methods allowed

To keep the Statute as flexible as possible, contribution of money or in kind (property) should be generally allowed. The latter, however should require express permission by the articles of association. Beyond that, I do not believe a shareholder's obligation to render services would be a suitable contribution. Contributions of services are simply very hard to value, their scope and quality are highly subjective and they are likely to produce disputes as well as legal problems in case of failure to perform. Therefore, the draft Statute of the Paris Chamber of Commerce of 1997¹⁹⁵ convincingly suggests: "Share capital may be contributed in cash or in kind, but not in work or services."

¹⁹⁵ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

c) Time of contributions

In order to enhance financial flexibility of the EPC and attract financial investors, the EPC Statute should not oblige shareholders to make their full contributions upon incorporation. On the other hand, a minimum amount of a quarter or a third of the contribution should be payable within a certain period of time upon express request by the company in order to facilitate its early business. The details of that could be left to the model articles of association.

d) Valuation of contributions in kind

As said before, the process of valuation of contributions in kind is of particular importance to avoid disputes between shareholders and achieve transparency for the company's creditors. The EPC Statute should stipulate that the valuation of the property contributed must be made on the basis of an independent expert's report. The draft Statute of the Paris Chamber of Commerce of 1997 on that issue suggests:

“1. The articles of association shall contain a valuation of each contribution in kind. 2. Such valuation shall be performed on the basis of a report appended to the articles of association and drafted subject to his, her or its own responsibility by an expert authorized to perform the statutory review of accounts according to the legislation of each Member-State, [...]”

This seems to be an acceptable solution. Baums points out that he would not recommend to solve the problem of contributions in kind just by referring to the second Company Law Directive on capital raising and maintenance provisions for public companies, which he alleges to have certain flaws in terms of legal structure.¹⁹⁶ He considers that it should be enough to hold the respective director responsible for the valuation liable in case of faulty valuations of contributions in kind.

e) The problem of hidden contributions in kind

So-called hidden contributions in kind are a widespread practice among founders and shareholders of companies in order to

¹⁹⁶ Baums, Presentation at the European Commission's 2008 Conference: "The SPE statute should not adopt Art. 10 Second CLD with its mandatory expert report on contributions in kind. Whether the assets which have been overvalued have been contributed on the stated capital or whether they have been sold by the shareholder or a by third party does not matter from a creditor's perspective."

circumvent the legal rules on shareholder contributions and capital maintenance. The procedure is as follows: at the stage of registration, a founder makes a properly valued and audited contribution in kind, for example a car. At a later stage the founder, then shareholder, buys the car back from the company at a price lower than the market price without having audited the value of the car. Hidden contributions in kind should be treated as invalid contributions by the EPC Statute and the respective shareholder shall remain obliged to render his contribution.

3. Shares and share classes

Should the EPC Statute address the issue of shares, classes of shares and different rights attaching to shares or should there be complete contractual freedom for founders and shareholders in this respect? The majority of respondents to the European Commission's 2007 Consultation considered these issues should be dealt with in the EPC Statute and could not be left to the articles of association.¹⁹⁷ The European Parliament suggests in the Third Recommendation of its 2007 Resolution that "the capital stock of the EPC should be divided into shares with a specific nominal value; that members' shares should be rounded off to the nearest Euro."¹⁹⁸ This would be a concise and sufficient provision, in my view. I agree that the EPC Statute should only supply for the basic structure of EPC shares in order to ensure a minimum of standard uniformity as well as clarity for third parties.

Beyond that, the Statute should leave contractual freedom regarding notably personal rights attached to certain classes of shares. These issues are at the very core of the internal structure of the company and can therefore be left to the discretion of the shareholders in order to make the EPC as flexible a legal form as possible. The risk of dysfunctional articles of association that do not provide for essential provisions can be prevented by including a comprehensive regime on classes of shares and different rights attaching to shares in the model articles. These model

¹⁹⁷ European Commission, 2007 Consultation, Summary Report, p. 12

¹⁹⁸ European Parliament, 2007 Resolution, Annex, Recommendation 3

articles would have a residual function and close any contractual gaps. They should also include provisions on alteration and cancellation of the rights related to the preferred shares and preferential rights of each individual shareholder creation of new classes of preferred shares and preferential rights. Moreover, the model articles need to elaborate on the options of certificated or dematerialised, register or bearer shares (or a combination thereof).

4. Share transfer, transfer restrictions and pre-emption rights

a) Governing law regarding the general transfer of shares

First of all it must be pointed out that the law governing the day-to-day transfer of shares in the EPC will have to be the domestic civil law (or in some cases company law) regarding the transfer of securities and shares of companies in the Member State where the particular EPC is registered. The same applies to related issues, such as lien and usufruct that are similarly deeply rooted in the national civil law frameworks. Any conflicts of laws in these areas must be dealt with on grounds of International Private Law. This includes all kinds of potential restrictions on transfer that the national laws possibly provide for. Full uniformity regarding the transfer of shares is therefore not a feasible option. It is not the EPC Statute's aim, nor would the EPC Statute be able to establish a new civil law or modify national civil laws or International Private Law on that matter. There is, however, one very important exception. The EPC Statute would be incomplete without a provision regulating that the transfer of shares in the EPC does not need to be notarized, but can be achieved by means of a written agreement. This is necessary to achieve the necessary degree of flexibility regarding the transfer of shares.

b) Restrictions on transfer and pre-emption rights

Restrictions on share transfer and pre-emption rights with regard to the corporate structure of a company are usually contractual instruments in order to allocate certain rights and duties corresponding to different underlying financial and political interests of

the shareholders. They can also be useful as a means to prevent a shareholder from selling his shares to an outside third party which could in certain cases be prejudicial to the joint corporate success. For example shareholders can ensure a certain long-term strategy regarding shareholder structure by a system of transfer approval requirements and pre-emption rights as well as drag-along and tag-along agreements.

Just as with different share classes, the question of share transferability lies at the very core of internal shareholder organisation and should be left to their discretion. It is therefore not quite comprehensible, why half of the respondents to the European Commission's 2007 Consultation considered this an issue which should be dealt with in the EPC Statute and only the other half thought this could be left to the articles of association.¹⁹⁹ Holmquist proposes to leave all kinds of transfer restrictions (if any) to the model articles of association.²⁰⁰ I agree that the model articles with their residual function should propose a certain default regime regarding restricted transferability of shares. This includes notably a general provision on whether shares can only be transferred with the consent of the other shareholders as well as provisions on a right of first refusal, a right of first offer and put and call options. Moreover, the model articles should oblige a transferring shareholder to notify the company of the transfer. Furthermore, it would be favourable, if the model articles provided remedies for the event of refusal of a transfer.

E. Key Issue Group: Management of the EPC

The numerous issues related to the management of the future EPC are probably among the most important in terms of protection of shareholder value as well as creditor protection.

¹⁹⁹ European Commission, 2007 Consultation, Summary Report, p. 12

²⁰⁰ Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech

1. Overall management structure of the EPC

a) National approaches

Management structures of national private limited companies in the European Union vary significantly. They range from shareholder-manager approaches where one or more shareholders themselves manage the company, to open shareholder and/or external manager structures (e.g. the French Société à Responsabilité Limitée (SARL) or the German GmbH) where external or shareholder-managers are responsible for the day-to-day management and only certain matters are reserved to the shareholder assembly, and finally a one tier administrative board system like in the UK/Irish Ltd.

b) Positions

The draft Statute of the Paris Chamber of Commerce of 1997²⁰¹ suggests the following open wording leaving the issue to contractual freedom (Article 14): "The articles of association shall determine the company's organization. In particular, they shall determine the manner of appointment, powers and terms of operation of the company's governing bodies, and the relationship between them." Article 16 suggests: "The company shall be represented in relation to third parties by one or more individuals or legal entities having full powers to act in all circumstances in the company's name.[...]" The European Parliament's Resolution considers that the EPC Statute should require at least one responsible executive director, the rest could be left to contractual freedom.²⁰² Holmquist agrees and suggests providing for a standard management structure in the model articles of association²⁰³

c) Comment

I take the view that there should be complete freedom as to the kind of management structure the shareholders would like to choose for their company with the exception of two necessary cornerstones that need to be regulated in the EPC-Statute. Firstly, as the European

²⁰¹ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

²⁰² European Parliament, 2007 Resolution, Annex, Recommendation 5

²⁰³ Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech

Parliament points out, there must be at least one formal executive director responsible for the company's business towards third parties and authorities. Secondly, only natural persons may be appointed directors, not legal persons which in turn would be able to claim the privilege of limited liability for themselves. The latter could inflict significant damage on the EPC's public standing because it would result in an unacceptable intransparency of responsibilities and a doubling of limited liabilities. For a legal person acting as director with limited liability there would be no deterrent from acting recklessly.

Apart from those two points there should be contractual freedom regarding the management structure. This would ensure a maximum of flexibility for the business. For example it should be possible for the EPC not to have a board but a single director. The Statute should also be flexible on the number of directors on a possible board. The potential lack of uniformity resulting from such contractual freedom is acceptable because the management structure as such is an issue predominantly concerning the internal working of the firm with only a few potential external effects. The model articles of association should propose a standard management structure that works as a default in case the actual articles fail to regulate the point properly.

2. Nomination and eligibility of directors

Moreover, the procedure of nomination of directors should be left to contractual freedom. This also reflects the majority view of respondents to the European Commission's 2007 Consultation.²⁰⁴ The European Parliament points out that "the first executive directors should be appointed by decision of the members or in the articles of association."²⁰⁵

The eligibility of directors is a more sensitive point. In order to raise public confidence in certain legal forms company laws often prescribe a catalogue of disqualifying criteria for directors' eligibility. On these grounds, courts are usually enabled to prohibit a person from running

²⁰⁴ European Commission, 2007 Consultation, Summary Report, p. 12

²⁰⁵ European Parliament, 2007 Resolution, Annex, Recommendation 4

companies. The majority of respondents to the European Commission's 2007 Consultation (and I agree) considered such prohibitive provisions necessary in the EPC Statute.²⁰⁶ The European Parliament summarizes the mandatory legislation which should provide "that no person who has been prohibited by decision of a court or administrative authority of a Member State from occupying a position comparable to that of executive director should assume or occupy that position."²⁰⁷

3. Powers of directors

Most respondents to the European Commission's 2007 Consultation thought that the powers of directors are an issue which should be dealt with in the EPC-Statute and could not be left to contractual freedom.²⁰⁸ It is indeed absolutely necessary to regulate the powers, notably the representative powers of directors towards third parties in the EPC-Statute. Otherwise third parties dealing with the EPC would have to cope with uncertainty as to a particular director's powers and regarding the effectiveness of a certain director's acts. This in turn could significantly damage the EPC's public standing and cause a serious risk to it becoming a suitable and widespread instrument for cross-border business. But again, the Statute should only stipulate a minimum standard, notably the necessity of one or more executive directors to be registered with the company registrar and the scope of the director's power to act.

4. Duties of directors

There is a wide range of duties the directors of national private limited companies in the European Union have to cope with. A common principle seems to be that the directors have to act with the diligence of a prudent businessman and in the best interest of the company.²⁰⁹ But what should the duties and liabilities of directors of an EPC be and what would be the most effective liability regime? Should the EPC Statute refer to national company laws or could the regime be left to contractual freedom?

²⁰⁶ European Commission, 2007 Consultation, Summary Report, p. 12

²⁰⁷ European Parliament, 2007 Resolution, Annex, Recommendation 4

²⁰⁸ European Commission, 2007 Consultation, Summary Report, p. 12

²⁰⁹ Gesell / Flaßhoff / Krömker, p. 35

a) Uniformity regarding directors' duties

The first question is whether directors' duties should be regulated by the Statute, possibly including references to national company laws, or whether they can be left to the articles of association.

i) Positions

Half of the respondents to the European Commission's 2007 Consultation answered that directors' duties are an issue which should be dealt with in the EPC-Statute, the other half considered this could be left to the articles of association.²¹⁰ The European Parliament simply pledges for minimum standards concerning the duties of management *vis-à-vis* the company.²¹¹ Holmquist suggests that the fiduciary duties of directors should be left to contractual freedom and that only minimum standards should be covered by the model articles of association annexed to the Statute.²¹² The draft Statute of the Paris Chamber of Commerce of 1997²¹³ suggests the following hands-on wording (Article 16): "[The directors] shall exercise such powers within the limits of the objects of the company, and subject to those matters in respect of which the Regulation or the articles of association require collective decisions by the shareholders."

ii) Comment

(a) Contractual freedom

Director's duties are at the very core of corporate activity and governance. Directors essentially define the companies they represent by acting on their behalf. Any reckless or fraudulent act of a director can directly damage the company's assets and standing and even third parties, notably creditors. Therefore, in my view, the regulation of directors' duties cannot be left to the contractual freedom

²¹⁰ European Commission, 2007 Consultation, Summary Report, p. 12

²¹¹ European Parliament, 2007 Resolution, Annex, Recommendation 1

²¹² Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech

²¹³ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

of the founders, but must be governed by provisions in the EPC Statute. The founders are simply not the only ones holding a stake in sound corporate governance. Other shareholders' and creditors' rights can only effectively be protected by means of mandatory provisions. And even the directors themselves will want to know exactly and without any room for uncertainty what their duties (and possible liabilities) are.²¹⁴

(b) Reference to national law

Moreover, I do not believe that the EPC-Statute should refer to existing national laws on directors' duties, however evolved and refined those national laws may be.²¹⁵ The significant national differences would result in a high diversity of types of EPCs regarding director's duties and an unacceptable lack of uniformity in a highly sensitive field. Particularly in terms of directors' duties and powers the EPC needs a uniform face. Apart from that leaving the duties to national law would bring about considerable doubt and potential dispute regarding the question whether the applicable law shall be the law of the country in which the EPC has its registered office or its real seat and headquarters. These uncertainties are exactly what the EPC Statute is meant to prevent.

b) Duties to be regulated

There are essentially two different types of directors' duties to be distinguished.²¹⁶ Firstly, there are general or fiduciary duties regarding principles of running a company, e.g. the duty to act in the best interest of the company. And secondly, there are specific duties, e.g. to file certain company data with the registrar.

i) General and fiduciary duties in the EPC Statute

²¹⁴ Knapp, Presentation at the European Commission's 2008 Conference

²¹⁵ For an overview of the national rules see: Gesell / Flaßhoff / Krömker, p. 35

²¹⁶ Knapp, Presentation at the European Commission's 2008 Conference

The future EPC Statute must contain a definition of the directors' fiduciary duties. I suggest basing that definition on the wording of the British Act on directors' duties of 2006 obliging the directors to act "in the way most likely to promote the success of the company for the benefit of the shareholders". In addition to that the EPC Statute should also adopt the concept of "enlightened shareholder value" and expect the directors to take other stakeholders' interests, such as employees, customers and suppliers and even public interests, such as environmental protection, into account in their decisions. However, those stakeholder interests shall only be acknowledged by the law; the directors should nevertheless only be accountable to their shareholders, not to third parties.

Furthermore, directors should have an obligation to act in accordance with the company's articles of association. As to the applicable standard of care the Directors should be expected to be reasonable in the way that they carry out their duties. A principle of good faith should be enough when looking at all relevant pieces of information available and deciding what is best for the company. Moreover, directors with special qualification, e.g. in accounting, should be obliged to use their specific faculties when exercising their duties as director.²¹⁷

ii) Specific duties

The following two specific duties should be considered for regulation as part of a catalogue in the EPC Statute in order to ensure a minimum standard:

(a) Conflicts of interest

Directors of a company should not accept any benefits from third parties that could potentially affect their independence and integrity towards the company. Furthermore, there are certain transactions between the

²¹⁷ Ibid.

company and a director that typically result in a conflict of interests. Ideally the EPC Statute provides for a catalogue of typical conflicts of interest that the directors need to avoid and provide for exact instructions on what is permissible and under what circumstances, e.g. which specific transactions between a director and the company need to be disclosed to the other directors and which conflicts the shareholders need to approve of.

(b) Capital protection and wrongful trading

Directors should be expressly obliged to take the objective of capital maintenance into account in their work; such a duty becomes even more important if the minimum legal capital for the EPC will be set at a symbolic € 1. As said before, the EPC Statute should also contain provisions on capital protection and wrongful trading as well as a duty to apply for insolvency proceedings according to the applicable national insolvency laws (see below for details).

5. Directors' liability for breach of duty

a) General: regulation in the EPC Statute

In my view, both, directors' duties as well as directors' liabilities in case of breach of duty must be coherently regulated in the EPC Statute as one inter-related matter and cannot be left to contractual freedom. This also reflects the majority view of respondents to the European Commission's 2007 Consultation.²¹⁸ Moreover, because of the mentioned differences in the Member States' laws regarding directors' liabilities, a reference to the national laws would result in an unacceptable lack of uniformity of the EPC. Ferrarini points out that a uniform regulation is also necessary in order to provide sufficient clarity for directors on the consequences of a potential breach of duty.²¹⁹ For the mentioned reasons, the EPC Statute should be exempt of references to national laws. Ferrarini is furthermore a

²¹⁸ European Commission, 2007 Consultation, Summary Report, p. 12

²¹⁹ Ferrarini, Presentation at the European Commission's 2008 Conference

supporter of a comprehensive regulation on directors' liabilities taking the view that a simple listing of principle guidelines would not be enough. At the same time, he acknowledges that even the most comprehensive Statute will not be complete and there will be conflicts with national law and disputes brought in front of the courts.²²⁰

b) Other positions regarding directors' liabilities

i) The Paris Chamber of Commerce draft

The draft Statute of the Paris Chamber of Commerce of 1997²²¹ suggests the following wording: (Article 17):

"1. The officer or officers of the EPC, appointed in accordance with Article 14, shall be liable, individually or jointly, to the company for actions in breach of the rules applicable to the company by virtue of Article 12 of this Regulation. They shall be liable, in the same manner, for breach of their duties and the standard of diligence reasonably required in the conduct of business. [...] 3. De facto officers shall be treated as de jure officers as regards all obligations and liability to which the latter are subject."

ii) The European Parliament

According to the European Parliament's sixth Recommendation in its 2007 Resolution,²²²

"the executive director or directors of the EPC must be liable either individually or jointly and severally vis-à-vis the company for all acts committed contrary to any provisions of civil and criminal law which are applicable to the company."

c) Comments regarding details of directors' liabilities

The most important issues regarding directors' liabilities are, in my view, the question of joint and several liability, the limits of liability, the enforcement of negligence claims, and finally insurance matters.

²²⁰ Ibid.

²²¹ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

²²² European Parliament, 2007 Resolution, Annex, Recommendation 6

i) Joint and several liability

In most Member States of the European Union directors are jointly and severally liable for breach of an individual director's duties, regardless of which of the individual directors actually caused the breach.²²³ One of the predominant reasons given for such joint and several liability is the fact that it causes each director to supervise his co-directors which leads to a system of monitoring or checks and balances among directors. Obviously the psychological disadvantage of that is a possible atmosphere of distrust. Legally it is arguable whether a director who acted in full accordance with his individual duties should be held responsible for other directors' breach of duty. In my view, the EPC Statute should ideally find a well-balanced compromise on this. One appropriate solution seems to be to stipulate joint and several liability as a rule, but at the same time supply for a number of legal limits to liability:

ii) Limits of liability

(a) Business judgement rule / standard of review

The primary instrument to limit liability should be the stipulation of a business judgement rule as a defence against negligence claims. The business judgement rule is a US-American case-law-derived concept whereby the directors of a company enjoy the privilege of the general presumption of being motivated in their conduct by a bona fide regard for the interest of the company. On those grounds a court will refrain from reviewing the directors' acts in managing the company unless there is an allegation of breach of duty in bad faith. Holmquist asserts that it would be sufficient if the model articles of association annexed to the Statute included a business judgement rule.²²⁴ According to Ferrarini, and I agree, a

²²³ Gesell / Flaßhoff / Krömker, p. 35

²²⁴ Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech

comprehensive EPC Statute would be incomplete without such business judgement rule.²²⁵

(b) Ratification of breaches

Another possibility that could be considered is the ratification of breaches by means of a shareholder resolution. I, however, take the view that this would not be an appropriate way of limiting liability. As said before, there are other stakeholders (employees, creditors) who have an interest in directors' duties and liabilities and potential claims on those grounds should not be decided over solely by the company's shareholders ratifying a breach.

(c) Allocation of duties among directors

Another exculpatory instrument to limit liability would be a provision in the Statute that a director is released from joint and several liability if the particular director has not committed the breach himself and at the same time the director, which has acted, has done so according to a prior allocation of duties between several directors.

(d) Statute of limitations

The EPC Statute should also stipulate an appropriate statute of limitations. Negligence claims would ideally become time-barred after five years, starting on the day the breach of duty is committed.

iii) Enforcement

The question of who shall be allowed to enforce claims on grounds of managerial misconduct must also be dealt with by the EPC Statute. In my view, apart from the company itself, the shareholders should be allowed to become involved under certain conditions. The draft Statute of the Paris Chamber of

²²⁵ Ferrarini, Presentation at the European Commission's 2008 Conference

Commerce of 1997²²⁶ suggests a convincing conditionality regarding a minimum percentage of shareholders (Article 18): "Shareholders holding ten per cent at least of the capital or votes may, individually or together, bring action for reparation on behalf of the company against the officers." Beyond that, I do not believe that creditors should be allowed to directly sue the directors. Creditors' claims should be addressed solely to the company in order to keep the liability regime simple, concise and structured.

iv) Insurance matters regarding directors' liability

The EPC should be legally permitted to reimburse directors for the cost of liability insurance (so-called D&O insurance) against any damages incurred from managerial misconduct. Furthermore, it is strongly advisable that the European Commission discusses the matter of directors' liabilities with the insurance industry in order to make sure that the future EPC Statute does provide a regime that is practically insurable at a reasonable price.

6. Employee participation at board level

Laws on the extent of employee participation in companies' management at board level are very diverse and not at all harmonized throughout the European Union. There are countries with a strong tradition of employee participation (e.g. Germany) and other countries where employee participation is more limited (e.g. the UK). In Germany, a number of employee representatives are granted membership at board level with all duties and liabilities of an ordinary board member, giving the employees significant influence in the corporate decision-making process.²²⁷

According to Hoffmann, a European trade unionist, the main problem to be solved by the EPC Statute is how to prevent the undermining of national

²²⁶ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

²²⁷ Gesell / Flaßhoff / Krömker, p. 52

employee rights regimes.²²⁸ The European Parliament expects that: “pre-existing employee participation rights [...] should be fully preserved, and whereas consequently the conversion of a company with employee co-determination, information and consultation rights into an EPC should not result in the loss of those existing rights.”²²⁹

The issue and its strong social connotation were already highly contentious in the lengthy negotiations on the European public limited company (SE). The political compromise achieved for the SE provides for a complex standard mechanism, through mutual agreement, information, consultation and sometimes participation, by which employees can influence management decisions in SEs with a certain size and under certain conditions. This regime is, however, not applicable to all kinds of SEs; particularly in cases where a national company is transformed into an SE, the existing employee participation rules in the relevant Member State retain their full applicability in order to prevent circumvention.

The EPC Statute’s regulations on employee participation should essentially be patterned on the well-balanced SE model and ideally provide for additional differentiation regarding the size of business and the number of employees. Any other model is, in my view, politically inconceivable or would at least take considerably more time to negotiate.

F. Key Issue Group: Creditor protection

It goes without saying that creditors of companies are ideally entitled to protection from certain kinds of abusive corporate behaviour that could potentially put their claims at risk. Unlike the shareholders, the creditors have no direct means to exert influence on the company and its financial situation. The protection of creditors by company law encompasses a variety of aspects. The national rules on creditor protection in the Member States of the European Union vary significantly. Most continental European jurisdictions put the emphasis on a strict regime governing the maintenance of the registered share capital, while common law jurisdictions rather stress the protection of the

²²⁸ Hoffmann, Presentation at the European Commission’s 2008 Conference

²²⁹ European Parliament, 2007 Resolution, lit. H

company's liquidity by a regime of directors' duties and liabilities towards the creditors.²³⁰ The majority of respondents to the European Commission's 2007 Consultation considered creditor protection an issue which should be dealt with in the EPC Statute and could not be left to the articles of association.²³¹

I agree that the EPC Statute should regulate creditor protection and cannot leave this issue as such to contractual freedom. However, the EPC Statute needs not offer a comprehensive and exhaustive regime of creditor protection. In my view, for designing the EPC a legal form as flexible as possible, the Statute should confine itself to selected sensitive issues where harmonization seems indispensable.²³² The essential questions regarding creditor protection to be taken into account on European level seem to be the following.

1. Headquarters and registered office

An important point which the EPC Statute will have to determine with regards to creditor protection is whether an EPC shall be prohibited to have its headquarters and registered office in different Member States. In addition to creditor protection the reasons given for such a strict prescription are the need for a minimum of corporate transparency and the prevention of all kinds of abuses. It is also alleged that with headquarters and registered seat in different countries it could become difficult to determine the applicable company, insolvency or tax legislation. The (pre Überseering case) draft Statute of the Paris Chamber of Commerce of 1997²³³ therefore suggests the following wording (Article 6): "The registered office of the EPC shall be located within the Union. It shall correspond to the location of its central administration."

The European Parliament takes a similar stance in its 2007 Resolution: the "EPC should be registered in the country in which its seat is located, in the appropriate register, [...] with a business address at which service may be validly effected [...]"²³⁴The majority of respondents to the European

²³⁰ Gesell / Flaßhoff / Krömker, p. 53

²³¹ European Commission, 2007 Consultation, Summary Report, p. 12

²³² See also: Baums, Presentation at the European Commission's 2008 Conference

²³³ Paris Chamber of Commerce and Industry (CCIP), 1997 Study on the EPC, Draft Articles

²³⁴ European Parliament, 2007 Resolution, lit. G

Commission's 2007 Consultation disagreed and considered that the EPC should be able to have its headquarters and registered office in different Member States.²³⁵

Drury correctly points out that after the European Court of Justice's *Überseering* decision it is no longer legally mandatory for the EPC Statute to stipulate that the entity's registered office must correspond to the location of its central administration.²³⁶ Registered office and head office can now be located wherever commercial advantage dictates, although if there is a common set of rules governing the EPC throughout the Union there should be no real need to have these in different locations.

I agree with the view that the EPC should be allowed to have its headquarters and registered office in different Member States in order to make it a truly European legal form. The European Union's integration is advancing fast and unstoppable, particularly regarding the legal framework for any kind of commercial cross-border activity. It would therefore be an anachronistic move to re-establish long discarded borders in European corporate law. For the sake of future integration it must not make a difference if an EPC has its headquarters in Germany and its registered seat in Italy. Corporate transparency, the protection of creditors and the prevention of abuses are admittedly important policy aims, but those aims have to be achieved on other levels of European regulation.

Notably the protection of creditors must be enhanced through other stipulations in the EPC Statute (see below for details) and an effective, supra-national cooperation in the field of justice, notably the cooperation of domestic courts and law enforcers on a European level. Any possible difficulties in determining the applicable legislation regarding an EPC can be avoided by approaching it formally and simply regulating that the legislation of the country in which the company is registered shall be applicable. It is argued that the free choice of location for headquarters will possibly lead to forum shopping, with a risk that companies opt for the

²³⁵ European Commission, 2007 Consultation, Summary Report, p. 4, 9

²³⁶ Drury, "The European Private Company", p. 3

legal framework which is least protective of workers or creditors. However, this is another issue that needs to be addressed on a different level of legislation: the harmonisation of European domestic insolvency and worker protection law to a minimum standard. Forum shopping is simply a symbol of improper or lack of necessary integration.

2. Transparency and public disclosures

Public disclosure obligations are designed to promote corporate transparency and provide third parties, notably potential and actual creditors, with an insight into the company's financial strength. It seems undisputed that the obligation to disclose important company related information needs to be catered for in the EPC Statute as a minimum standard for the protection of creditors and cannot be left to contractual freedom.²³⁷ Most respondents to the European Commission's 2007 Consultation agreed.²³⁸ The First, Fourth and Seventh European Company Law Directives harmonizing European company law already deal with a large number of relevant disclosure issues. A declaratory provision to the effect that the same Directives apply to the EPC as apply to other companies under the Directive, will therefore be adequate and sufficient on this issue. Among other things, the Directives include disclosure obligations as to the constitutional documents, the appointment and termination of directors, the amount of share capital subscribed, the balance sheet and profit and loss accounts.

3. Specific directors' duties

As indicated before, capital maintenance and effective creditor protection also require for certain specific duties for company directors in the EPC Statute. These duties are nearly exclusively related to the potential risk of an insolvency which would pose a significant threat to the company's assets and consequently to creditors' claims. Methodologically the respective legal rules would be located on the borderline of company law and insolvency law. The following provisions, hand in hand with respective liability sanctions (see above), would be the minimum to discipline the

²³⁷ Teichmann, Presentation at the European Commission's 2008 Conference

²³⁸ European Commission, 2007 Consultation, Summary Report, p. 12

directors of an EPC in case of severe financial problems or an imminent insolvency. They should be included in the catalogue of directors' duties:

a) Director's duty to file for insolvency procedures

The most important and widespread concept to safeguard that in case of an insolvency early measures of creditor protection can be taken is the directors' duty to file for insolvency procedures when insolvency is imminent.

b) Wrongful trading regulation

Wrongful trading regulations are traditional in common law jurisdictions. They provide for a directors' duty to discontinue trading which will be triggered at the point at which the directors ought to know that there was no sensible reason to believe the company would avoid insolvency procedures.

c) Shareholders' meeting

Moreover, the directors should be obliged to call a shareholders' meeting in case the share capital is reduced to 50% of its original value. The shareholders must then decide on the appropriate measures to take.

4. Distribution limits

An effective creditor protection regime in the EPC Statute needs to include rules on the amount of permissible distribution. In general, distributions are only permissible as either dividends, or proceeds from capital reduction, or finally liquidation proceeds.

a) Dividends

The EPC Statute must provide for adequate legal requirements regarding distributions in the form of dividends. Apart from rules regarding the necessary majority of shareholder votes for the distribution, this includes rules on the financial permissibility of dividends. In my view, those rules should essentially refer to the Second Company Law Directive which stipulates that assets can only be distributed if the respective balance sheet test is positive, i.e.

dividends can only be paid out of the net profits or reserves after deduction of losses carried forward. In other words, after payment of the dividend, the company's assets must still fully cover its liabilities. In addition to the balance sheet test a solvency test should be considered, determining if the company has enough liquid assets to pay a dividend. Furthermore, Dine suggests²³⁹ to oblige directors to issue a so-called "solvency certificate" confirming that the balance-sheet and solvency tests have been properly executed; an incorrect certificate shall lead to a personal liability of the respective director. De Kluiver,²⁴⁰ however, points out that the regime must not be overly restrictive.

b) Capital reduction

Capital reductions are particularly sensitive in terms of creditor protection. Most European countries deal with the matter by means of strict procedural requirements for reducing a company's capital. The same should apply to the EPC Statute which, against the background of creditor protection, cannot leave capital reductions to contractual freedom. An appropriate statutory procedure for capital reductions would include the requirement for a qualified majority resolution by the shareholders, the requirement to settle or secure third-party claims through collateralization, and the obligation to register the reduction with the respective registrar. There are essentially two alternative ways of regulating the details of capital reductions in the EPC Statute:

i) Reference to Article 32 of the Second CLD

The EPC Statute could deal with the details regarding capital reductions by referring to Article 32 of the Second Company Law Directive which provides for obligatory registration with the registrar and publication in the official gazette. Subsequent to these publications, according to the Directive, the creditors are granted a certain period of time to file for the collateralization of claims that were existent before the capital reduction took place.

²³⁹ Dine, Presentation at the European Commission's 2008 Conference

²⁴⁰ de Kluiver, Presentation at the European Commission's 2008 Conference

ii) Reference to financial requirements for distribution

However, Baums, considers that the reference to Article 32 of the Second Company Law Directive would not be ideal because creditors, employees and tort victims do not actually read the official gazettes regularly and therefore risk to be deprived of their right to collateralization of claims. Baums therefore suggests regulating the procedures for capital reduction in a completely different way. He proposes structuring the requirements analogous to those for distribution limits including a balance-sheet test and an insolvency test (see above for details). I agree that this would be the most modern and appropriate way of regulating capital reductions.

5. Subordination of shareholder loans to the company

Another sensitive issue in terms of creditor protection regards shareholder loans to the company. Shareholders can finance their company by formal contributions (see above) or by other types of non-equity inputs, e.g. shareholder loans to the company (factual capital contribution). In some Member States of the European Union shareholder loans up to a certain amount are considered a substitution for company equity and are therefore subordinated claims in case of insolvency. This principle should be considered for the EPC as well, particularly if the EPC's minimum legal capital is set at a very low or symbolic amount. On the other hand, the subordination of shareholder loans to the company would probably not be necessary if the EPC Statute offered an effective regime of other creditor protection measures including a wrongful trading clause.

G. Key Issue Group: Duration, termination and dissolution of the company

The duration, termination and dissolution of the company are issues that concern its internal structure and working, rather than its external relations. These issues should therefore be dealt with exclusively in the model articles of association.²⁴¹ Regarding dissolution in particular, Holmquist suggests that the model articles of association annexed to the Statute should require for a three-

²⁴¹ Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech

quarter majority resolution to dissolve the company.²⁴² Furthermore, it is advisable that the EPC Statute provides for an alternative dispute resolution (ADR) scheme in the model articles of association.²⁴³



²⁴² Ibid.

²⁴³ See also: Holmquist, Presentation at the European Commission's 2008 Conference, Closing Speech

VI. Relation of the reform process in South African to the European project

The question this chapter seeks to answer is: What can European legislators learn from the ongoing company law reform in South Africa? The equally justified question regarding potential lessons from the European project for South African lawmakers surpasses the scope of this mini-thesis and must be left to another investigation. A close look at the South African company law reform and a comparison with the pan-European company project reveals a significant topical gap in the European discussion.

Both, the South African reform and the European project put a strong emphasis on the legislative objective of enhancing the growth of both, small and medium-sized businesses. The South African reform does so by differentiating and applying a different set of legislation to widely held companies as it does to closely held companies. The European project does so by modelling the EPC around the definition and the needs of small and medium-sized businesses. As explained before, the term “small and medium-sized businesses” encompasses a whole range of business types, very small ones as well as relatively large ones. The fact that small and medium-sized businesses account for 99,8%²⁴⁴ of all European companies illustrates how broad the concept really is. It also illustrates the importance of the EPC project. According to the European Commission’s definition²⁴⁵ (see above for more details) a medium-sized enterprise has less than 250 employees and their annual turnover does not exceed € 50 million. Small enterprises have less than 50 employees and they have an annual turnover not exceeding € 10 million.

A small enterprise is therefore a completely different business compared to a medium-sized business. However, this difference is currently simply ignored by European lawmakers, academics and practitioners who are busy drafting the EPC-Statute. Although flexibility is meant to be one of the key features of the EPC Statute, the lawmakers are presumably going to put forward a draft which does

²⁴⁴ Ibid.

²⁴⁵ European Commission, Recommendation 96/280/EC of 1 January 2005 concerning the definition of micro, small and medium-sized enterprises

not provide for any differentiation in terms of size of business. In this regard there is a lot to learn from the South African Companies Bill 2007. As said before, the Companies Bill 2007 offers a variety of provisions, forming a detailed and bespoke system of facilitations for closely held companies in order to specifically enhance the growth of smaller businesses. The European EPC should adapt the idea of differentiation between widely held and closely held companies. It should provide a definition of closely held companies and widely held companies reflecting the fact that closely held companies are typically the preferred legal form for smaller companies as opposed to medium-size and large companies. This obviously would result in a reduced uniformity of the EPC as a legal form – an adverse effect which, in my view, would be made up for by a higher degree of necessary flexibility on the side of small businesses. On this basis the Statute should stipulate a series of necessary facilitations for closely held companies in order to be as flexible as possible. The following could be considered for regulation in the EPC Statute without being exhaustive:

- A closely held company under the EPC Statute could be defined as a company whose shareholders are exclusively natural persons, and not legal persons. Alternatively it could be designed along the lines of the Companies Bill 2007 stipulating certain facilitations for companies all shares of which “are owned by one person, or by two or more related or inter-related persons” (see section 7 (3)).
- The EPC Statute could overall leave even additional contractual freedoms to founders of closely held companies regarding certain Key Issues and provide increased flexibility for small businesses as opposed to medium-sized businesses.
- The EPC Statute could require the widely held EPC to have a higher minimum legal capital than the closely held EPC. It could also under certain circumstances allow shareholder contributions in a closely held EPC to be delivered not only in cash or in kind, but also in the form of services.

- The EPC Statute could provide for a special regime and facilitations for closely held companies regarding shares, share classes and transfer restrictions.
- The EPC Statute could notably facilitate a number of formalities with regards to the formation and registration of closely held companies as opposed to widely held companies. It could for example pattern on section 94(1)(a) of the Companies Bill 2007 and regulate that, unlike widely held EPCs, closely held EPCs are not obliged to keep a register of directors, auditors and secretaries. Moreover, similar to s15(1) of the Companies Bill 2007, the closely held company under the EPC Statute should not be required to file its articles of association for registration. Even the maximum costs for registration could be lower for closely held EPCs than for widely held EPCs.
- The EPC Statute and/or the model articles could also facilitate a great number of procedural issues with regards to the internal workings of the EPC like for example section 80(1) of the Companies Bill 2007 does by means of a shortened period of notice in advance of shareholder meetings for closely held companies.
- Like section 89(8)(a) of the Companies Bills the EPC Statute could provide for a simplified management structure and even make certain exceptions from the rules on the disqualification of directors.
- On the other hand, an exemption for closely held companies under the EPC Statute from certain obligations regarding financial accountability like in section 7(3) of the Companies Bill 2007 regarding the application of sections 97 to 103 and 116 to 118 of the bill, will neither be possible, nor necessary because national laws in that field provide for sufficient differentiation and legal facilitations in terms of business size.
- Finally it must be pointed out that a two-type system in the EPC Statute differentiating closely held and widely held companies would result in the

need to a different approach regarding the model articles of association. In line with the results of this investigation there would have to be three different types of model articles: two unambiguous models with a quasi-regulatory residual function, one of them for the closely held and one of them for the widely held EPC and a third set of provisions with a purely model function catering for a range of alternative options and possibilities.



VII. Conclusion

The legislative process regarding the Statute for a pan-European Private Company has left the phase of data-mining behind. Lawmakers of the European Commission, together with a small circle of legal practitioners and academics from across Europe, are currently paving the way for a first draft of the EPC Statute. They are doing this by collecting and discussing thoughts on the potential scope, structure and content of a future EPC Statute. From this discussion various pivotal Key Issues have emerged which can be systematized in several Key Issue Groups. All Key Issues and Key Issue Groups are more or less legally inter-related and form a complex patchwork of possible regulations and references.

All that remains now is for this patchwork to be consolidated into one comprehensive and coherent solution, the most important cornerstones of which are suggested in this mini-thesis. The EPC Statute will notably have to be diligently drafted against the background of its main objective to enhance the growth of small and medium-sized businesses in Europe. In order for the EPC to become a true option for these businesses, the future Statute needs to put particular care and emphasis on two things. Firstly, it needs to be uniform throughout the European Union with regards to the statutory laws governing its structure. This means notably that the Statute must be exempt from references to national laws as far as possible. And secondly, the Statute needs to be as flexible as possible in terms of regulatory options and contractual freedom for founders and shareholders. In order to enhance flexibility in terms of company size, the EPC Statute should amongst other things follow the example of the South African Companies Bill 2007 and differentiate closely held EPCs and widely held EPCs. On this basis, the Statute should provide for a number of legal facilitations regarding closely held companies.

Overall one can recommend that the EPC and its structure should be governed predominantly by the EPC Statute itself. References to national laws must only be made if legally indispensable (e.g. tax and accountancy matters) or politically not otherwise conceivable (e.g. employee participation). To a varying degree the

EPC Statute should, with regards to most of the Key Issues, only provide for the very basic structure and necessary minimum of regulation; further details should be left to contractual freedom and the model articles of association. Other Key Issues need to be regulated exhaustively in the Statute. There should be different versions of the model articles of association catering for different functions: firstly, an unambiguous default function filling potential regulatory gaps in the actual articles of association. Secondly, a pure model function in terms of a diversified toolbox of inspiration for founders and draftsmen. A functional linkage between the Statute's basic structure for the EPC and the additional model articles of association will be crucial for a comprehensive and uniform regime with a maximum of flexibility for entrepreneurs.



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