

## Think Small First – the European Private Company

Around 99% of businesses in the European Union are small and medium sized enterprises (SMEs) and they account for 70% of employment in Europe. A European Investment Bank consultation has found that the well-being and growth of SMEs will be the key to Europe's future competitiveness. However, most small businesses remain within national borders. In June this year, the European Commission launched its **Small Business Act** (SBA) entitled "Think Small First".

The SBA sets out ten principles to make life easier for SMEs. These include creating an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded; facilitating access to finance; helping SMEs benefit more from the Single Market and enabling SMEs to deal with environmental challenges. As part of the SBA, the Commission have proposed certain legislative changes including a Regulation providing for a European Private Company to be called "*Societas Privata Europaea*" ("SPE").

The SPE is a company form designed for SMEs. Small businesses will have the option of setting up an SPE which follows the same rules throughout the EU instead of a private limited company or GmbH or SARL depending on where they are based. The advantage of an SPE will be that it is a flexible transparent company form, with the same type of management structure throughout the European Union and a European label that will be easily recognisable in all Member States. It is intended that the SPE will exist in parallel to national company forms.

Many of the proposals for the SPE are similar to the private limited company that exists in the common law jurisdictions of Ireland and the UK but some proposals will not be so recognisable.

The main provisions for the SPE are as follows:-

- it will have limited liability for its shareholders;
- the shares may not be traded publicly on any market;

- it may be set up by an individual or other entity from scratch or by transformation, merger or division;
- it may have its registered office in one Member State but conduct its business from another Member State; it may also transfer its registered office to another Member State;
- registration will be by electronic means;
- it may have a capital of only €1;
- shareholders will have the freedom to decide the manner in which they take decisions e.g. in person, by video-conferencing etc.;
- shareholders will have the freedom to decide the rights attaching to shares such as voting rights; and
- the Regulation provides rules for the protection of creditors and pre-existing rights of employees.

The Commission hope that the Regulation will enter into force on 1st July 2010. An EU Regulation is directly applicable in all Member States without the requirement for implementing legislation in individual Member States.

The proposal does not make the creation of an SPE subject to a cross-border requirement (e.g. shareholders from different Member States or evidence of cross-border activity). The Commission felt that to require cross-border participation from the start would significantly reduce the potential of the SPE as a company form particularly amongst small businesses. It found that just 8% of small businesses engage in cross-border trade.

## **Formation**

A SPE may be formed from scratch or from an existing company, whether by transformation, merger or division.

Perhaps the most innovative aspect of the SPE from an Irish point of view will be its ability to transfer its registered office in one Member State (the home Member State) to another Member State (the host Member State). This ability to change registration

from one Member State to another has its origin in the *Centros* decision of the European Court of Justice. It will be possible therefore for an SPE to have its registered office in one Member State (e.g. Ireland) but have its principal place of business or central administration in another Member State (e.g. France).

The name of an SPE must be followed by the abbreviation “SPE” to identify its type e.g. O’Rourke Reid SPE.

## **Capital**

The minimum capital requirement of just €1 is a departure from the traditional approach in many civil law jurisdictions that have strict minimum capital requirements well above the proposed €1 minimum. However, studies have shown that creditors look at other aspects than capital, such as cash flow, personal guarantees and retention of title clauses to protect their interests.

Consideration for the shares may be in cash or in kind. The shareholders are free to decide what property, rights or services are acceptable as payment in kind and when the consideration is to be paid or provided. If payment in kind is to be provided the articles of association must state whether an expert valuation of non-cash consideration is required or not.

Distributions such as payment of dividends, the purchase by a company of its own shares or incurring a debt may only be made if the SPE satisfies a “balance sheet” test i.e. the assets of the SPE fully cover its liabilities. There is a provision in the proposed Regulation for an optional “solvency certificate” to be given by the management body. If such a certificate is required by the shareholders the grounds for such certificate and the criteria to be met must be defined in the articles of association.

## **Shares**

Shareholders will have the power to decide on the internal management structure and governance of the SPE through its articles of association. As in private limited



companies in Ireland, these articles will form the constitution of the SPE and may only be varied by a qualified majority vote. The proposed Regulation suggests that a majority of at least 2/3 but the shareholders through the articles of association may provide for a larger majority. At present, Irish company law requires a 75% majority to change the memorandum and/or articles of association of a private limited company.

The shareholders in a SPE will have a large degree of freedom to determine the rights and obligations attaching to shares. These can include pecuniary (e.g. right to receive a dividend) and non-pecuniary rights (such as voting rights or the right to appoint a director). If the rights or obligations attaching to shares or to a particular class of shares are to be varied, such resolution will require a qualified majority and the consent of any shareholders affected by the variation.

Article 17 of the proposed Regulation allows for the expulsion of a shareholder under certain conditions. If a SPE wishes to expel a shareholder, the shareholder must have caused serious harm to the SPE's interests or his continuation as a shareholder must be detrimental to the SPE. A resolution of shareholders must be passed after which the SPE may apply to the designated competent court for an expulsion order. In the interim, the court may decide whether to suspend any voting and other non-pecuniary rights of the shareholder until the final decision is taken. Where a court orders the expulsion of a shareholder, it shall decide whether his shares are to be acquired by the other shareholders and/or the SPE itself and on payment of the price of the shares. It is likely that the designated competent court in Ireland would be the High Court.

Article 18 proposes that a shareholder may withdraw from an SPE if the activities of the SPE are being or have been conducted in a manner which causes serious harm to the interests of the shareholder as a result of one or more of the following:-

- (a) the SPE has been deprived of a significant part of its assets;
- (b) the registered office of the SPE has been transferred to another Member State;
- (c) the activities of the SPE have changed substantially;

- (d) no dividend has been distributed for three years even though the SPE's financial position would have permitted such distribution.

In order to withdraw, the shareholder must submit his notice of withdrawal in writing to the SPE stating his reasons. The management body is required to request a resolution of the shareholders on the purchase of the withdrawing shareholder's shares by the other shareholders or the SPE itself. If the other shareholders fail to adopt the resolution or dispute the reasons for the withdrawal, the designated competent court may, if satisfied that the interests of the withdrawing shareholder have suffered serious harm, order the acquisition of the shares by the other shareholders or the SPE itself. If the dispute is limited to the price for the shares, the court can appoint an independent expert to value the shares. There are various time limits set out in the Regulation.

### **Organisation of the SPE**

There are two main categories in the internal organisation of the SPE. First, there are shareholders rights and obligations and second, there are directors' duties and the organisation of the management body (board).

The shareholders determine the organisation of the SPE through the articles of association. Article 27 of the Regulation lists those matters which must be determined by shareholders, whether by simple majority or qualified majority.

Any variation in the rights of shareholders, their expulsion or withdrawal, reduction in the share capital, transfer of the registered office from one Member State to another, transformation, merger, winding up and amending the articles of association all require a qualified majority of at least 2/3 of the shareholders. The articles of association may provide for a greater percentage qualified majority.

Approval of the accounts, distributions to shareholders, acquisition by the SPE of its own shares, redemption of shares, increases in the share capital, the appointment or removal of directors or auditor, or changes in the term of the appointment require a

simple majority of shareholders.

There is no requirement to hold general meetings, as resolutions may be adopted in writing subject to the provision of sufficient information to the shareholders to allow them to take informed decisions. This means that shareholders have broad information rights regarding the affairs of the SPE. The board may only refuse to give access to information if doing so could cause serious harm to the business interests of the SPE.

Minority shareholders have the right to challenge collective resolutions subject to the provisions of national law. For example, in Ireland, the legislation will be the Companies Acts and ultimately, the Company Law Consolidation Bill. The Regulation contains two specific minority rights:-

- (i) shareholders holding 5% of the voting rights have the right to request the board to submit a proposal for a resolution to the shareholders.
- (ii) in the case of suspicion where a serious breach of law or of the articles of association of the SPE has occurred, shareholders holding 5% of the voting rights have the right to request the designated competent court to appoint an independent expert to investigate and report on the finding of the investigation to shareholders.

All decisions not listed above or subject to the articles of association are the directors to make.

Each SPE must have a management body which is responsible for the management of the SPE. There is no requirement in the Regulation to have a dual board (e.g. as is the case in Germany) or a unitary board (e.g. as is the case in Ireland). It is a matter for the shareholders to decide whether and how the Board of Directors is to be composed. It would appear that it is possible for an SPE to have just one managing director i.e. to be a sole director company. The composition and organisation of the Board should be set out in the articles of association. The articles should include eligibility criteria (if any) for directors and the procedure for appointing and removing the directors.



As in all companies in Ireland, directors are required to act in the best interests of the SPE. A director must act with care and skill in the conduct of the business. These duties may be enforced by the SPE and not by individual shareholders or creditors. Directors liability for loss or damage suffered by an SPE due to the breach of their duties may be derived from the Regulation, the articles of association or resolutions of the shareholders. However, the liability of directors shall be governed by the applicable national law. In Ireland, this would mean for instance, that they may be personally liable for the debts of an insolvent SPE.

Directors are required to avoid actual or potential conflicts of interest between their own personal interests and those of the SPE. However, such conflict situations may be authorised by the articles of association of the SPE.

### **Transfer of Registered Office**

An SPE can transfer its registered office from one Member State to another Member State (host Member State) subject to the procedure set out in the Regulation and the consent of the shareholders. Where the SPE is subject to national rules on employee participation (e.g. Germany, Denmark etc) it is required to enter into negotiations with the employee representatives prior to the transfer, particularly in circumstances where the host Member State does not have any or any equivalent rules on employee participation.

### **Conclusion**

Other legislative proposals in the SBA include a new General Block Exemption on State Aids which aims to make it easier for SMEs to benefit from aid for training, research and development and environmental protection. There is a new proposal on VAT which will offer Member States the option to apply reduced VAT rates for locally supplied services including labour intensive services and an amendment to the directive on late payments to help ensure that SMEs are paid within the 30 day limit.

The legislative proposals contained in the Small Business Act and the SPE Regulation

are currently under negotiation between the Commission, the Council of Ministers and the European Parliament. Of particular concern in these negotiations are the employee participation rights contained in the proposed Regulation. It is expected that the proposed Regulation will be finalised in 2009 for commencement on 1<sup>st</sup> July 2010.