

The Second Company Law Directive

(Directive 77/91/EC)

Explanatory Screening Meeting
21/06/2006

Overview

- Full title: Directive 77/91/EEC on the formation of public companies and the maintenance and alteration of their capital
- applies only to public limited companies (however, many MS have extended the scope of the implementing measures to private companies)
- Applies to incorporation of a plc but also to conversion of another type of company into a plc
- provisions protect the interest of creditors but also minority shareholders (e.g. principle that all shareholders who are in the same position should be treated in the same way, Art. 42).

Formation of public companies

- minimum content of the instrument of constitution (statutes): *inter alia*
 - the company's type and name (name has to contain an element clearly distinguishing this type of company from others);
 - the amounts of the company's subscribed and authorised capital;
- Liabilities incurred before authorisation to commence business (where authorisation needed): responsibility to be determined by the MS

Minimum Share Capital

- minimum share capital which must be subscribed before a company may be incorporated: EUR 25,000 (although the Directive provides for a regular update of this amount, it has not been changed since 1977).
- However, most Member States now define the minimum share capital amount at a level which is considerably higher than the amount stated in the Directive (e.g. DE: EUR 50,000).
- The capital can be issued for cash or non-cash consideration. In any case, the capital may be formed only of assets capable of economic assessment and may not include an undertaking to perform work or supply services.

Subscribed capital

- The subscribed capital is the aggregate of the nominal values or accountable pars of all the shares issued by the company:
 - nominal value shares: the subscribed capital corresponds to the sum of the nominal values of all subscribed shares.
 - accountable par shares (representing a percentage of the statutory capital): the aggregate of the accountable pars per share issued corresponds to the subscribed capital.
- Shares may be issued above (but never below) their nominal value or accountable par, i.e. at a premium; the premium in itself does not constitute a part of the subscribed statutory capital.

Shares issued for consideration

- Shares issued for cash must be paid up at the time the company is incorporated to at least 25% of their nominal value or, if none, their accountable par.
- Where shares are issued for a consideration other than in cash, the consideration must be transferred in full within five years of the incorporation.
- If capital is issued for non-cash consideration, an independent expert has to assess the value of the consideration.

Distributions to shareholders

- The Directive describes the circumstances in which distributions to shareholders may be made and those in which a company may acquire its own shares:
 - Except for cases of reductions of subscribed capital, no distribution may be made when on the closing date of the last financial year, the net assets as set out in the company's annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes;
 - Any distribution made contrary to these rules must be returned by the recipient, if the company proves that he knew or should have known about the unlawfulness of the payment;
 - Acquisition by a company of its own shares are in principle not allowed. However, MS may permit companies to acquire their own shares subject to a number of conditions (in particular, authorisation by the general meeting and respect of a ceiling of 10% of the subscribed capital)

Increase and reduction in capital

- The Directive enshrines the basic principle that a decision to increase a company's share capital must ultimately rest with the shareholders (authorisation by general meeting).
- Shares issued for cash must be offered on a pre-emptive basis to existing shareholders in proportion to the capital represented by their shares (protection of minority shareholders).
- Concept of the "authorised capital" (general authorisation by the statutes or the GM to the competent body - normally the board of directors – to increase the subscribed capital up to a maximum amount). Authorisation cannot be given for a period of more than five years, renewable.
- The general meeting must also approve any reduction in capital (except under a court order). However, the subscribed capital may never be reduced to an amount less than the minimum capital.

Simplification of the 2nd Directive

- Proposal presented by the Commission on October 29, 2004 (COM(2004)730 final)
- Proposes simplification along the lines set out in the 1999 recommendations of the SLIM - the Simplification of the Legislation on the Internal Market - Working Party and those of the “High Level Group of Company Law Experts” in its 2002 report.
- Amendment should help to facilitate capital related measures of public limited liability companies, thereby enabling them to react, with regard to capital size and capital structure, to developments in the markets more promptly and at less cost.

Simplification of the 2nd Directive

- Informal agreement on the text between Parliament, Council and Commission in March 2006
- Formal adoption by the Council expected for July or September 2006
- Amendment will bring about the following changes:
 - public limited liability companies will be enabled to attract **non cash contributions** to their capital without having to resort to a special expert valuation where there is a clear point of reference for the valuation of such contribution (e.g. stock exchange price);
 - public limited liability companies will generally be able **to acquire their own shares** up to the limit of the company's distributable reserves, over an increased period of authorization by the general meeting;
 - public limited liability companies will also generally be able to grant, up to the afore mentioned limit, **financial assistance** with a view to the acquisition of their shares by a third party, but subject to safeguards imposed by the Directive's objective of protection of both shareholders and third parties (e.g. the transaction takes place at fair market conditions; the credit standing of the third party is duly investigated).
 - creditors will, under certain conditions, generally be able to resort to **judicial proceedings** where their claims are at stake as a consequence of a reduction in the capital of a public limited liability company.

Questions?