

**CONCEPT OF SINGLE MEMBER COMPANIES IN  
THE LIGHT OF EU HARMONIZATION  
- Comparative Analysis of Serbia, Germany, United Kingdom -**

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## ABSTRACT

The thesis focuses on concept of single-member companies in three jurisdictions, Serbia, Germany and the United Kingdom. The aim of the research is to compare how these countries have harmonized their national company law with the Twelfth Company Law Directive in order to find out what reform proposals are necessary (if any) for Serbia to be closer to the other two analyzed EU member states with respect to one-man corporations.

The comparison follows the Directive's articles step by step evaluating the above mentioned countries' laws with respect to personality of single member/shareholder, general meeting, publicity requirements, stock corporations and specific form of entrepreneurs in context of one-man companies.

The paper demonstrates that none of the examined countries has accepted the Directive's provisions literally and even though the all three jurisdictions had the same starting point concerning the paper's topic (moreover the UK did not have a long legal tradition on that) Germany and the United Kingdom have developed more complex legislation than Serbia. It shows up that it is necessary for Serbia to change its acts very soon especially concerning in consequence and incompleteness of the relevant rulings.

## INTRODUCTION

The purpose of the paper is to analyze the application of the Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited-liability companies<sup>1</sup> in three legal systems; especially the states' discretionary power concerning particular provisions. Two member states are taken as example, Germany and the United Kingdom, to identify the differences and similarities in the single-member company regulations in comparison with a non-EU member, Serbia. Following the Directive's structure the order of its articles serves as the basis for the order of the paper's chapters.

In order to try to find the best solution to the currently unresolved problems related to the member states' non-harmonized practice in regulation of the single member limited liability companies in 1988 the Commission of the European Community made a proposal for enactment of a new directive. As the Commission defined the reason for introducing such common measures was "to improve access of the greatest number of small enterprises to incorporation thus improving the protection of third parties, to facilitate succession, improve management and promote self-employment in a harmonized legal framework".<sup>2</sup> The Twelfth Company Law Directive is to give guidelines solving several discrepancies the different legislators are necessarily faced with because of unusual nature of single-member company.

But, by the mere fact that many people think so it is not an atypical form of individual corporations but subtype of private or/and public limited liability companies having special characteristics beside the basic features of the main corporation types. It can be founded either by one shareholder from the very beginning of its existence or the ongoing company can

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<sup>1</sup> Twelfth Council Company Law Directive on single-member private limited-liability companies 89/667/EEC, 1989, O.J.(L 395)

<sup>2</sup> *Comission Proposal for a Twelfth Council Directive on Company law concerning single-member private limited companies*, at 17, COM (1988), 101 final (May 18, 1988).

become single-member due to different occasions with the results that all shares are aggregated to one person.

In order to understand why the Directive has emerged the evolution of this concept should be illustrated; the starting point is the period during the legal history when formation of a company only by one person was strongly prohibited. Under conditions when formation required conclusion of an agreement which necessarily assumed presence a minimum of two people, it was unimaginable to replace them by only one person. However, when we are talking about single-member enterprises we are talking about companies and not partnerships. This division should be considered to justify that even without a contract in ordinary sense one person can be the only shareholder.

As in other fields of law development of this part of company law was affected by requirements of the market. In closed economies justification of this modern approach was in allowing the existence of nationalized societies where the state wanted to be (and was) the only founder. On the other side, in the capitalist regimes certainty of creditors demanded that a company not automatically dissolve when during doing business shares had to be concentrated in one shareholder's hands.<sup>3</sup>

All problems of recognition of single member companies concerned seizure of liability of the sole member for the duties of the company. There were two possibilities either to accept the sole shareholder's unlimited liability because of protection of the company's creditors or to limit his liability. The second opportunity raises the question of defenses against abuses and frauds of the company's assets by the single member remaining to the company only the obligations.

Today strong division of legal personality of the entity and its components is not contested anymore. Because businessmen prefer to limit self-risk in doing business alone and at the

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<sup>3</sup> See MIRKO VASILJEVIĆ, *KOMPANIJSKO PRAVO: PRAVO PRIVREDNIH DRUŠTAVA SRBIJE I EU* (COMPANY LAW: LAW on CORPORATIONS in SERBIA and EU) 59-60 (3rd ed. 2007)

same time to enjoy preferences of a corporation (especially separation of legal personality of the company and its shareholders) over the last years single-member companies have become more and more popular.

The first concept refers to quasi - sole traders who 'throw over' the duties on the company. It is liable with all of its assets without involving the shareholders, even though they can take different legal acts – suretyship, guaranty or assumption of debt – to take over the obligations. Yes, on the other side it means that the individual has to pay alone the registration costs including the founding capital (what as we know varies between very high and very low amounts) and to take care on the formalistic incorporation procedure. If the company becomes single-member during its existence, other hardships may occur, as double taxation or financial incapacity of the sole shareholder.

Another practical applicability of this corporation subtype is found in the field of the 'group of companies'. Larger associations prefer to create more subsidiaries with the parent company in the centre. "But recognizing a subsidiary as an 'independent' corporation is not the equivalent of regarding the subsidiary as uncontrolled."<sup>4</sup> Having voting rights in the election process of the board of directors, approving certain acts or preparing bylaws the parent company being the only shareholder can easily obtain control over the, otherwise, independent subsidiary (subsidiaries).

However, both cases have their particularities. The common feature (and main reason of the traditional hostility toward the single-member companies) is the high degree of opportunity to abuse the legal personality of the company for different machinations under the so called 'alter ego' doctrine. This means that the sole shareholder acts as an entrepreneur disregarding the corporate entity using the company as a 'veil' to hide his identity and real motives. Usually personal assets are mixed with the assets of the company or in this way he tries to

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<sup>4</sup> Thompson & Thompson, *The Parent / Subsidiary Relationship*, <http://www.t-tlaw.com/cor-01.htm>

avoid personal limitations or incompatibility of his activity. This is also applicable on the parent/subsidiary relationship where the two corporations being indistinguishable for the outsiders act as one entity.

Although having 'third state' status the Serbian legislation is worth being dealt with very carefully because of its potential EU accession in the (near) future.

This concept is not a new one in Serbia and the national regulation of this topic has been harmonized with the Directive, too (as one of the requirements to develop the national company law in accordance with the EU standards); but unfortunately it doesn't mean that it perfectly covers every question. Although many businessmen still do not know what it is about, the basic problem is deeper than pure non-understanding the differences between a sole trader and a sole shareholder concerning their liability. To attract foreign investors (whose number is required to increase after Serbia's EU accession) the legal conditions of establishment and managing of the companies in Serbia should be encouraging factors and not obstacles.

In order to figure out the defects with what the investors need to be faced every time they expand the business on the Serbian market and the way of recovery of these defects the thesis is to answer whether small- and medium sized enterprises have really profited from the Directive, whether Germany, UK and Serbia use their discretionary powers defined in the Directive in the same way and in same fields and last but not least whether the Serbian law needs reform in light of the investigated regimes and if so, how.



# CHAPTER 1 – THE TWELFTH COMPANY LAW DIRECTIVE

## ***1.1 The way from the Proposal to the enactment***

Member states had very different national rules concerning our topic before the adaptation of the Directive. Some of the EC countries threw away the concept of companies with sole member in full; still the others allowed formation by natural but not by legal persons. But, not being against establishment of one-man companies they were even divided in question whether transformation of company into single-member one during its existence should have winding up as a necessary consequence or not. But we can conclude that general intolerance dominated toward one-man companies in the Community. It was a big task to avoid this attitude and at the same to create such EC wide legislation that “will encourage the application [of a new category] in countries with little tradition of single-member companies”.<sup>5</sup>

The recital of the Directive summarizes the problems trying to make a uniform solution acceptable to everyone. It allows the concept of single-member companies in case of formation, during its existence, concerning the groups of companies, spreads the discretion of the member states in case of sanctioning, limiting or/and securing the use of it. In light of this list we can assume that the Directive is a long one but it is not the case.

Saving that it has only nine articles there were debates about the basic standards need to be respected by the member states. According to Wooldridge "the draft . . . based upon a somewhat bold interpretation"<sup>6</sup> of the article 54(3)(g) of the EC Treaty<sup>7</sup> that, being the Directive's legal basis, did not (and could not) serve the creditors' best interest. The

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<sup>5</sup> Scope of Community legislation on single- member private limited companies, EUR. PARL. QUEST. No: 2102/91 of 15 Feb. 1992, at 55, O.J. (C 38) (1992)

<sup>6</sup> Frank Wooldridge, *The Draft Twelfth Directive on Single-Member Companies* (1989) European Business Law 86., explanatory memorandum 4 [hereinafter Wooldridge] quoted by Vanessa Edwards, *The EU Twelfth Company Law Directive*, 19(7) Company Lawyer 211, 212 (1998) available at 2010 WL [hereinafter Edwards]

<sup>7</sup> Treaty establishing the European Economic Community, March 25, 1957, 298 U.N.T.S. 26.

recommended safeguards are to protect the company-members' position that can easily conflict with the creditors' stake. Although the aim of the harmonization was to encourage individual entrepreneurs to limit their liability under legal personality of a company at the same time - unfortunately- it extended the opportunities to abuse this legal form and to play the investors false in every possible way.

The Proposal required the creation of a stronger legal instrument being more able to limit such acts by imposing a lot of bureaucratic steps. These provisions were avoided by the explanation that single-member companies should be a compromised form between sole traders and traditional companies simplifying and not complicating its functioning.

## **1.2 Reasons for reform**

Few years after the Directive came into force a written question was asked from the Commission how it evaluated the overall success of the Community's objectives in this area.<sup>8</sup>

Although there was no possibility to give adequate answer because only three years have passed in the Directive's existence we can conclude that even after twenty years of its application there are certain areas serving as the basis for debates.

Ten years ago Vanessa Edwards summarized its more and less beneficial provisions related to existing national company law regulations in light of harmonization objectives but unfortunately even today her words stand unchallenged.

Whether the overriding aim of harmonization can be said to have been achieved in any real sense by the directive is also doubtful: since the directive permits private or public single-member companies or sole traders with limited liability, and permits member states to restrict the number of single-member companies which an individual may form and to prohibit a company from forming a single-member company, the divergences between the laws of the member states are unlikely to be much eroded by the directive. However, it will at least

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<sup>8</sup> *Supra* note 5, at 55

ensure that all member states provide for some form of limited-liability trading for an individual.<sup>9</sup>

When the Directive was enacted the aim was to promote small- and medium-sized enterprises (SME) together with their competitiveness throughout the Community, especially in those countries that did not know the concept of single-member companies.

It was part of a larger project started with the Community Action Programme for SMEs, approved by the Council on 3 November 1986. "Promoting the access of individual entrepreneurs to the status of company, which represents the best framework for business development in the internal market"<sup>10</sup> provides good explanation for the connection of the Directive to the SMEs. They are very preferable forms of business associations because of their flexibility responding to changes quickly (fewer people have to decide than in large firms) and their efficiency achievable by "careful management to avoid waste, downtime and unnecessary expense, the use of sophisticated manufacturing systems, good labour relations and assembling a well-trained, experienced and motivated labour force."<sup>11</sup> Handicaps as difficulties in selling, marketing, research or less credibility can be avoided by creation of adequate legal background without necessity to link the small corporation to larger one.

Due to harmonization some of the basic problems do not exist today but there are proposals for reformation in order to react on the current developments of the market.

It is said that where no cross-border issue is included national laws of member states are enough to regulate the question. Formal requirements should be reduced on minimal level eliminating the obligations of record in writing of the contracts and general meeting-resolutions, and duty of entry in the share register when an ongoing company becomes single-member. It is another question whether without all these provisions the Directive has *raison d'être* because in light of these it is seemed not to be necessary anymore. If the reformers

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<sup>9</sup> Edwards, *supra* note 6, at 212

<sup>10</sup> Commission Proposal, *supra* note 2, at 3

<sup>11</sup> CLIFF PRATTEN, THE COMPETITIVENESS OF SMALL FIRMS 68 (1991)

excluded every important part under the aegis of simplification a just nine-article long rule would lose approximately half of its content. The 'EC legislator' has to review its scope very deeply in order to simplify the internal procedures to maximum extent and at the same time preserve its original objectives because otherwise the only option remains to repeal it.<sup>12</sup>

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<sup>12</sup> European Commission, *Consultation on the Simplification of EU Company Law and Accounting and Audit Regulation*, <http://www.berr.gov.uk/files/file41189.doc>

## CHAPTER 2 - GENERAL OVERVIEW OF RELEVANT LAWS

Comparison between rules on single member companies of an Anglo-Saxon and a continental legal system already justifies a deeper analysis of this question; but adding another continental regime with studiously different legal-political background makes the problem more interesting from comparative legal perspective.

Serbia as a non-EU country has implemented the Twelfth Company Law Directive but without any significant innovative regulations. As in the other post-communist states single-member companies had long tradition in the totally state-owned Serbian economy.

Germany was one of the rare member states (together with Belgium, Netherlands, France and Denmark) that had one-man company friendly legislation before the Directive's adoption.

Last but not least the United Kingdom that did not permit such companies and it was required to change the law in accordance with the Directive what in its case seemed to be big step.

This chapter presents the above mentioned regimes' basic company-rules being at the same time basis for one-man companies' determination. In order to get an elementary picture about single-member companies' treatment in general in the relevant laws these definitions are analyzed step by step according to their main elements.

### **2.1 Serbia**

The Serbian legislation has accepted the conception of both one-man private and public limited liability companies under the same legal regime as in the Twelfth Company Law Directive. It does not mention any limitations or sanctions what are allowed under the directive to be imposed. The main legal source for corporations is the Act on Business Companies<sup>13</sup>, and as such it has special impact on the application of other laws concerning corporate legislature of the country.

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<sup>13</sup> Zakon o privrednim društvima [Act on Business Companies] (Serbian Official Gazette, No 125/2004 )

The five major elements of corporations are reflected in the article on definition and legal forms of corporations. Being general it covers single-member public and private limited liability companies, too.

*"Corporation is legal person what is established by legal and/or natural persons by articles of association for the purpose of conducting activities with the aim of gaining profit."*<sup>14</sup>

#### **a) legal personality**

From outside single-member company is very similar to an individual entrepreneur. Although the latter has some common characteristics with corporations (e.g. firm, place of business, activity) because he is also one of the economic subjects on the market, at the same time he is liable for the duties concerning the business he is engaged in with all of his assets (including personal assets). So, many times individual entrepreneurs who have enough capital to finance the establishment of a company rather choose this possibility; the only shareholder can easily abuse the legal personality of his company limiting his liability in artificial way ('using the corporate veil').

#### **b) establishment by founding act (article 7(1))**

Articles of association beside establishment of the company have legal importance of general legal act that serves as basis for the company's functioning (it is very important especially in case of public companies where the company-statute is not an obligatory act any more).

Articles of association have two statutory forms: agreement and decision. The first one refers to the companies with more shareholders, the second one to the one-man companies. The decision has character of individual legal act what is not a contract on establishment (there is no more wills at the same time) but unilateral legal act of the individual as the founder.

Considering the trifling character of the Law regarding the topic it is strange that the form of the establishing act is separately regulated.

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<sup>14</sup> *Id.* Article 2(1)

### c) founders

Although the general definition of the corporations talks about the founders in plural, at the particular provisions on the private and public limited liability companies we can consider possibility of establishment by only one person. Founders can be either legal or natural persons, or they can establish even together a company (so legal and natural persons are the founders). In every case the formulation ‘or/and’ emphasize their equality in the legal standing. It means there is no restriction; a company can be the sole founder of another company under the same conditions as a natural person. The only specificity is the one-man **closed** public company what can be founded only simultaneously without public offering the shares; for the successive establishment of public companies minimum two founding shareholders are needed.<sup>15</sup>

### d) activity and aim of establishment to gain profit

Corporations under this Law are to be founded to gain profit, no matter what kind of activity they deal with if it refers to production, sale or/and provision of services on the market. So it means that in some way the activity should be commercial (in legal boundaries). There is no statutory division among them concerning the type of the activity but there are further requirements to be respected if they are engaged in special fields (especially in public interest).

It is worth mentioning the proposal of the Executive Council of the Autonomous Province of Voivodina about the status changes of the agricultural professional agencies. The pristine agricultural social companies - now professional agencies - on the territory of Voivodina with state capital of 100% will be founded as single member limited liability companies in the future what seems to be the most acceptable model of transformation for them. The state would be the only shareholder but Voivodina would have the founding and managing rights.

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<sup>15</sup> In case of **successive establishment** there is initial public offering of shares what are to be subscribed by the founders and third persons, too (so, even if there is only one founder, another ‘outsider’ is needed); **simultaneous incorporation** includes only founders.

It is an interesting example how Serbia solved the problem of reorganization of the social companies in the process of privatization using the modern forms of companies.

## **2.2 Germany**

### **2.2.1 Private Limited Liability Company – Gesellschaft mit beschränkter Haftung (GmbH)**

Even before enactment of the Twelfth Company Law Directive for the German legislation concept of one-man limited liability company (GmbH) was not unknown. Although the situation when an ongoing company became single member had long been permitted before, formation by artificial as well as by natural persons was allowed only from 1980.

Although the Act on Limited Liability Companies<sup>16</sup> does not contain an overall definition on GmbH the first section says "*...companies with limited liability may be formed for any lawful purpose by one or more persons*".

#### **a) purpose of establishment**

In Germany there is no 'ultra vires' doctrine; the GmbH can be formed without limitations on its object. It means that it can deal with either profit- or non-profit-making activities in accordance with this provision what is quite different from the Serbian Act. So, if somebody engages in e.g. charitable activities without primary intent to make profit, a one-man GmbH has significant advantages: "[a] GmbH enjoys a separate legal personality and is deemed to be a commercial undertaking having limited liability, even if it does not pursue a commercial purpose."<sup>17</sup>

However, GmbH (being 'commercial company' under section 13.) is considered to be 'merchant' and subject to relevant provisions of the Commercial Code (it shows its primarily business purpose). In case of non-profit making activity other form than GmbH might be appropriate for the founder.

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<sup>16</sup> Gesetz betreffend die Gesellschaften mit beschränkter Haftung [Act on Limited Liability Companies] of 6. September 1965 (BGBl. I S. 1089), last amended by statute of 31. July 2009 (BGBl. I S. 2509) § 1

<sup>17</sup> MADS ANDENAS & FRANK WOOLDRIDGE, EUROPEAN COMPARATIVE COMPANY LAW 116 (Cambridge University Press 2009)



## **b) founders**

The general term ‘persons’ includes both natural and legal persons with opportunity to limit the number of eventual shareholders even to one. In this case "[t]he total share capital may be subscribed to by only one shareholder (in that case, only one share in an amount corresponding to the total share capital is issued)"<sup>18</sup>.

## **c) articles of association (section 2,3)**

Although this element is included into another section it is worth mentioning in this part. When somebody writes a comparative analysis he/she is faced with the problem of translation; like me now. The exact German term *Gesellschaftsvertrag* means literally *company agreement* which term cannot be applicable in case of single-member GmbH; there are no two or more shareholders who can express their will to agree in a contract form. In this question the Serbian legislators reacted well by entering into the Law two forms of articles of incorporation: to avoid possible terminological misunderstandings in the future the only shareholder should sign a decision (and not an agreement). However, in case of translation on English ‘articles of association’ can cover both situations successfully.

As the recital of the Twelfth Company Law Directive says: ... *Member States are free to lay down rules to cover the risks that single-member companies may present as a consequence of having single members, particularly to ensure that the subscribed capital is paid ....*

Germany has improved the occasion and in both cases of one-man GmbH and AG made special rules to secure payment of cash contributions.

The sole founder had to pay one-quarter of the cash contribution (or at least fifty percent of the minimum capital) and place the full kind contribution at the disposal of the company; and he/she was required to provide security for the outstanding amount.<sup>19</sup> The other case covered the situation when within three years upon registration of the company all shares were

<sup>18</sup> KLAUS J. MÜLLER, THE GMBH – A GUIDE TO THE GERMAN LIMITED LIABILITY COMPANY 16 (2d ed. 2009)

<sup>19</sup> Act on Limited Liability Company, *supra* note 16, §7 (2), sentence 3. [It is abolished by ‘Momig’]

concentrated in hands of one member (or the shares were shared between one shareholder and the company itself). Then the only remaining shareholder had to pay the outstanding cash contributions in full within three months from the unification of the shareholding (or either give guarantee for the payment or transfer the shares to third person).<sup>20</sup> Non-compliance with the above mentioned provision in the given time resulted dissolution of the company.

Today "[i]n the event that the company is formed by a single shareholder, it is not longer required that such shareholder furnish security for the outstanding amount of the share capital (if he does not elect to pay in the capital in full anyway)."<sup>21</sup>

### **Conversion from a GmbH to a GmbH & Co. KG**

GmbH & Co. KG is a limited partnership where GmbH is the only general partner (liable without limitation) and each limited partner (being liable up to the amount of his contribution to the partnership) "usually holds a share in the GmbH in portion to his holding in the KG."<sup>22</sup> This structure can be problematic if the GmbH is owned only by one person and the company is to be converted into a GmbH & Co. KG. Because "a conversion is only permissible if all of the shareholders of the converting entity prior to the conversion are shareholders of the entity after conversion and *vice versa*"<sup>23</sup>, it can result that in case of one-man GmbH the same person would be both the limited and the general partner. Possible solution is to transfer a portion of the share to another group prior to such status change.

### **2.2.2 Stock Corporation – Aktiengesellschaft (AG)**

The German legislation on companies is divided into two separate acts. The Stock Corporations Act expressly defines the commercial nature<sup>24</sup> of this type of company what can

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<sup>20</sup> *Id.* §19 (4)

<sup>21</sup> MÜLLER, *supra* note 18, at 11

<sup>22</sup> Christian Tyler Campbell, *Chapter 23: The Limited Liability Company*, in BUSINESS TRANSACTIONS in GERMANY 23-15 (Bernd Rüster ed. 1983)

<sup>23</sup> MÜLLER, *supra* note 18, at 159

<sup>24</sup> Aktiengesetz [Stock Corporation Act] of 6. September 1965, BGBl. I S. 1089, last amended by Statute of July 31, 2009, BGBl. I S. 2509 § 3

be founded by one or more persons. They are also responsible to establish the articles of association.

*"One or more persons who subscribe to shares against contributions shall establish the company's articles of associations (the "articles")."*<sup>25</sup>

As in case of GmbH in Germany one-man AG what was established from an ongoing company subsequent to its formation has long been recognized; and after 1994 it can be formed as single-member from the very beginning of its existence.

The security requirements are the same as they were at GmbH before the amendments. The single shareholder is required to guarantee for the payment of unpaid cash contribution (it is not expected for contributions in kind).<sup>26</sup>

Although the German implementation of the Directive has covered stock corporations, too, there are still endeavors to create appropriate form for small- and medium sized companies with basic features of an AG. This, so called 'small' AG would serve as an intermediate form between GmbH and AG combining their positive characteristics. E.g. control function of AG supervisory board should be retained (even though it can cause inflexibility scaring businessmen to use this new type of organization) but the minimum capital would be increased to ensure respect of public interest during the company's functioning or the power of GmbH managing directors should be limited.

It reflects very well the current legislation tendencies in the Community promoting small enterprises and outstripping the Directive's strict mandatory rules.<sup>27</sup>

### **2.3 United Kingdom**

In the beginning of this chapter I mentioned United Kingdom as one of the jurisdictions to that single-member companies were strange before the Directive's era but it is not completely

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<sup>25</sup> *Id.* § 2

<sup>26</sup> *Id.* § 36(2)

<sup>27</sup> Frank Wooldridge, *A simplified legal regime for small and medium-sized German public companies*, 22(1) COMPANY LAWYER, 27-30 (2001) available at 2010 WL

true. In practice many small businesses were managed by one person, even though there was another ‘non-effective’ shareholder who only lent his name as a member without any activities in the companies every day life. It served as solution to play out the regime without single-member company regulation.

There was no need on side of UK to enter a new Directive concerning one-man companies because of being familiar with the **concept of nominee shareholders**. This concept works even today; especially when the shareholder would like to save his/her privacy/anonymity. Disclosure of his/her personal data due to public record obligation can be avoided by appointment of a nominee shareholder. The latter would hold the shares on trust for the beneficial owner and only he, the trustee is identified in the register of shareholders. Although the company practically seems to have only one shareholder it fulfurs functions with two members.

Although the change was unnecessary at first sight creation of the internal market within EC constituted strong incentive to pass the Directive. UK has chosen for the implementation procedure a relatively simple approach: by adoption of The Companies (Single Member Private Limited Companies) Regulations<sup>28</sup> it changed the Companies Act 1985 only in parts concerning private companies limited by shares or by guarantee<sup>29</sup> "to read ‘one’ where ‘two’ was previously required"<sup>30</sup>. As we see before enactment the new Companies Act in 2006 only private limited companies were suitable forms to be organized as single-member (it can be explained by the fact that small business are usually established as private). In UK beside division on private and public companies, there is a further classification on limited and unlimited ones. Unlimited company is always private where the shareholders must pay the

<sup>28</sup> The Companies (Single Member Private Limited Companies) Regulations, 1992 No. 1699

<sup>29</sup> **‘Limited by shares’** means the same as in the continental law when the shareholders are liable to the extent of unpaid contributions; but **‘limited by guarantee’** is specific used primarily for non-profit organizations even without share capital or shareholders. The guarantors have to pay ‘post-investments’ from their personal assets if the company in the end of its existence stays without assets to pay the debts.

<sup>30</sup> JANET M. DINE, EUROPEAN PRACTICE LIBRARY – EC COMPANY LAW 7-5 (1992)

outstanding debts of the company in case of liquidation because there is no limit on their liability to contribute to the assets (if there are no enough corporate assets). The Regulation covered neither this type nor public limited liability companies. Those individuals who were liable for the payment of the debts of a private limited company became free from their duty after the Regulation came into force (in accordance with the transitional provisions).

Because the Companies Act 2006 does not provide an overall definition on all types of companies here more sections are taken to cover those elements that were examined previously.

#### **a) founders**

Companies Act 2006 has extended the application of single-member provisions on public companies, too. In the general part on *company formation* (what is common for both private and public companies being - otherwise - regulated separately within the Act) it is allowed to be formed either by **one or more persons**.<sup>31</sup> The same formulation is used as in the German legislation. Now there is no need anymore to use a nominee shareholder to gain advantage from an ostensible one-man company.

#### **b) purpose of establishment**

The paragraph on *method of forming company*<sup>32</sup> includes also the purpose of establishment what cannot be unlawful. It is an interesting solution that the activity is determined in negative way (what cannot be instead of what can be). Probably the explanation of such section-formulation is the traditional doctrine of ultra vires. Today it is not mandatory anymore 'unless a company's articles specifically restrict the objects' (in accordance with Section 31).

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<sup>31</sup> Companies Act, 2006, c.46, § 7

<sup>32</sup> *Id.* § 8

### c) articles of association

We could see the terminology-problems concerning the different expressions of the founding acts where the English law served as basis for translation.

If there was no agreement about the articles written down, the Companies Act 2006 provided Model Articles of Association (section 20) but only for private companies limited by shares. Two years later other models have been added to this one for both private companies limited by guarantee and public companies; and the Model for private limited companies has been extended in its scope.<sup>33</sup>

Their default application is necessary because a UK company must have such articles. In contrary to the continental system where the possibility of internal regulations is limited by statutes in UK there is large flexibility in prescribing the company rules by its members.

It is an interesting question how it applies in case of one-man companies. It is not answered in the Act whether the Model articles can be interpreted in accordance with the section 38. This supplementary provision spreads the application of rules of law and other enactments – otherwise regulating corporations with two or more persons - to one-man companies (of course with possible modifications of relevant sections). The Model is neither rule of law nor enactment but necessary to govern internal management of the company in case of lack of regular written ‘constitution’. In both Models for private companies limited by shares and guarantee when the company has only one director ‘the director may take decisions without regard to any of the provisions of the articles relating to directors’ decision-making’<sup>34</sup>. It can cover situation when there is a single shareholder because in those cases usually the only member also acts as managing director (even though it is not necessary). On the other side the Model articles for public companies evince that the drafter did not take attention on special nature of one-man companies. *"If (a) the company has fewer than two directors [...] then two*

<sup>33</sup> The Companies (Model Articles) Regulations 2008 No.3229

<sup>34</sup> *Id.* § 7(1) schedule 1, § 7(1), schedule 2

*or more members may call a general meeting [...]"*<sup>35</sup> which condition cannot be fulfilled if there is only one member.

However, all these questions are not problematic if the section 38 is applicable for these cases.

## **2.4 Conclusion**

To sum up, there are no big differences concerning the attribute of major elements of the relevant definitions from the perspective of single-member companies. They are allowed in the examined states even though the formulations are not the same. Sometimes general rules of interpretation are to be called to help in discovery of deliberate meanings, e.g. what the term ‘person’ exactly covers. In light of our analysis the character of activity or denomination of founding act are not so significant questions but it is important to understand the specificities because of their engagement on the concept of single-member companies. The UK’s solution in section 38 is very useful in order to prevent eventual misunderstandings on particular application of one-man companies in the Companies Act’s wider context or general company law. Neither Serbia, nor Germany has similar article; but without that they should regulate single-member enterprises very carefully. That especially concerns Serbia which statute even in the main definition on corporations does not pay any attention on single-member companies. Although it does so later in special parts on types of corporations the outsider at first sight would assume that in Serbia there is no any legislation on enterprises with one member.

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<sup>35</sup> *Supra* note 33, § 28 schedule 3

## CHAPTER 3 – MEMBERSHIP

### 3.1 General overview

In this chapter the personality of the sole shareholder/member is examined that necessarily includes the parent/subsidiary relationship (of course in the context of membership in single-member corporations). These issues would be analyzed in three jurisdictions together with the national approaches on pyramid structures as one of the most questionable problem areas of this topic.

According to the Twelfth Company Law Directive a private limited liability company can be founded by a sole member or it can function with only one person as single-member company after decreasing the membership during its existence.<sup>36</sup> The latter case served ground for company's nullity in the First Directive; but it should be interpreted in accordance with national laws.<sup>37</sup> Because the member states are bound to accept single-member private companies under the Twelfth Directive today this ground is applicable only on stock corporations (if particular countries have decided not to expand provisions about one-man companies on them).

The Proposal required the shares to be nominative "to facilitate verification of the fact that a company has only one member and to safeguard transparency when shares are transferred"<sup>38</sup>; but because of publicity formalities contained in other parts of the Directive (and also in the First Directive) this provision of the Proposal was denied being 'too much'.

The more interesting problem area refers to the second paragraph of the article 2 that would be probably changed if the Ninth Directive on the Conduct of Groups containing a Public Limited Company as a Subsidiary was enacted. It is about member states' discretion on the

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<sup>36</sup> Twelfth Company Law Directive, *supra* note 1, art. 2(1)

<sup>37</sup> First Council Directive (Publicity Directive) 68/151/EEC, art. 11(2), 1968 O. J.(L 065)

<sup>38</sup> Commission Proposal, *supra* note 2, at 5



membership related matters. Today they are allowed to regulate within their national laws the questions when a natural person is the sole member of more companies and a legal person is single-member of another company.<sup>39</sup> The original draft conditioned the second situation to two alternative requirements. If the company was established by one founder it would have unlimited liability until increasing the membership or if an ongoing company became single-member unlimited liability could be avoided only by finding more members within one year. These articles had to preclude sharing the companies' assets in fraudulent way; but this problem exists still today because the above mentioned restrictions did not get place in the final version. Another alternative for the member states was fixing a minimum capital for single-member companies together with the requirement that both the one-man company and its sole member (being legal person) are to respect limits of article 27 of the Fourth Directive on Annual Accounts<sup>40</sup> otherwise the sole member becomes unlimited liable for obligations. Especially under influence of Germany these restrictions were ruled out because they affected too 'aggressively' other fields of law regulating groups of companies. The current form of the Directive allows the countries to adopt sanctions or special provisions in this question particularly touching parent/subsidiary relationship under control of one shareholder/member.

### 3.1.2 Parent/subsidiary relationship in general

According to different possibilities parent company can be engaged more or less in its subsidiary's business. "Even when a subsidiary owned by another corporation and is completely integrated, classical corporation law still insists on the formal autonomy of the affiliate corporation."<sup>41</sup>

To control the management, finances and the overall performance preserving at the same time the subsidiary's independence the parent company should be the sole shareholder (as the

<sup>39</sup> Twelfth Company Law Directive, *supra* note 1, art. 2(2)

<sup>40</sup> Fourth Council Directive on Annual Accounts 78/660/EEC, art. 27, 1978 O.J. (L 222)

<sup>41</sup> Aurélie Catel Duet, The Governance of Corporate Groups,  
[http://halshs.archivesouvertes.fr/docs/00/16/78/40/PDF/paper\\_catel-duet\\_Milan.pdf](http://halshs.archivesouvertes.fr/docs/00/16/78/40/PDF/paper_catel-duet_Milan.pdf)

owner and the manager of the subsidiary). The aim is to retain the coordination of the separated parts with the centre notwithstanding the legal and geographical boundaries between them. Because usually they are not located at the same place, the subsidiary has high level of factual autonomy in decision-making on daily basis that having the same interests between the subsidiary and the parent company does not threat the functioning of the whole corporation.

In most cases the dominant entity is legal person that plays its shareholder role such as voting and information rights, but also can elect directors from the subsidiaries extending its self-involvement into their working. Restrictions on creation of single-member companies like this would discourage development of the entire economic sphere. Multinational corporations use this business form very often and also create sometimes more separate companies engaged in different economic areas (but to some extent connected to each other) to decrease necessary connection with other firms particularly in manufacturing. This is the only way to cover the whole production (or even service provision) process from the beginning to the end-user. However, it can be in conflict with some competition rules; from company law perspective such entities are treated to be useful even though financially exhaustive. It is not the same as 'chain of companies'.

**'Chain of companies'** includes "single member companies whose single member is an artificial person being the sole member of another company."<sup>42</sup> Although the Directive's first Proposal recommended its prohibition in the end it was 'thrown away'. This is known in both practice and theory as pyramid structures. "This device is based on the idea that the separation of ownership and control can be obtained by chaining several companies."<sup>43</sup> According to a recent study managed by the EU Commission on the "proportionality between ownership and

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<sup>42</sup> Commission Proposal, *supra* note 2, at.5

<sup>43</sup> External Study Commissioned by the European Commission, *Report on the Proportionality Principle in the European Union* (May 2007) 7, [http://ec.europa.eu/internal\\_market/company/docs/shareholders/study/final\\_report\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf)

control" it is the most commonly used control enhancing mechanism in large companies of EU together with multiple voting rights shares and shareholders agreements. This fact constitutes the real reason why the member states objected its forbidding under the Twelfth Directive. Probably the drafters thought on the 'abusive pyramids' where the single-member companies' main (or only) assets are their shareholding in another company. Because of hard traceable corporate structure the outsiders cannot really see the seclusion of rights and duties. Maybe this question as the others concerning corporate groups will be solved by the Ninth Directive, but today it is left for national laws to regulate this topic.

### **3.2 Serbia**

In the Serbian Act on Business Companies there are no restrictions that a natural person in how many companies can be single member. It depends only on his/her available assets for such purposes. When 95% of shares of an ongoing company are bought the shareholder is entitled to get the remaining 5% from the discordant members, and this way achieves full ownership.<sup>44</sup> But it works *vice versa*, too. When the remaining 5% was not publicly offered but shareholders of that part would like to sell their stock under the same conditions the owner of 95% is to accept it.<sup>45</sup> It is important to mention because sometimes becoming single member of a company does not depend on somebody's will or on a 'prefabricated' plan. It would be unjust to punish him by avoiding this possibility only for being a sole shareholder in more corporations; as we can see the way of acquisition of shares can be very different.

Relevant part of the Act on Business Companies regulates affiliated corporations narrowly which types, concern and holding are distinguishable from each other. The first one deals with a business as its dominant activity besides managing the controlled entity, still the second one is engaged only in financing, managing the subsidiary (that means under the Serbian law

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<sup>44</sup> Act on Business Companies, *supra* note 13, art. 447.

<sup>45</sup> *Id.* art. 448.

holding is primarily ‘pure holding’). When the affiliated companies are organized as group of companies the parent corporation must have the tasks of both holding and concern. There are no special limitations on number of founding company’s members but unlike in comparative law the controlling entity (either holding or concern) should be legal person (in one of the forms of corporations accepted by the Act on Business Companies). When the parent company and its subsidiary act as single economic unit; there is no real and traceable partition between the transactions of one and another and especially when the controlling company is the sole shareholder of the subsidiary the former will be liable for the latter totally. Breaching the general provisions on good faith and fair dealing against the subsidiary both the parent company and its director(s) are responsible.<sup>46</sup> However, it should be interpreted together with articles of Law of Obligations on principles on due diligence and honesty.<sup>47</sup>

Question of pyramids is not separately dealt with; a single-member company can be the sole shareholder of another and so on. The only problem will arise in case of one member’s liquidation in the chain, especially if it is ‘abusive pyramid’ because probably the whole chain will be destroyed. It is the same when a single-member parent company is liquidated. Its value should be determined that necessarily includes the value of the subsidiary as its functional part. Who buys the parent company as legal person in the bankruptcy proceeding that buys at the same time the subsidiary. But by ‘shopping’ a functional part the vendee gets ownership only on that part and the whole legal person remains still under liquidation procedure.<sup>48</sup>

### **3.3 Germany**

In Germany there is no restriction how many times a natural person being single member/shareholder can have the same status in other companies. The question that is trickier refers to legal persons as single founders of more one-man companies. Because Germany was

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<sup>46</sup> *Id.* art. 32-34, 36, 37

<sup>47</sup> Zakon o obligacionim odnosima [Law of Obligations] (SFRJ Official Gazette No 29/78, last amended No SRJ Official Gazette 31/93) art. 12, 13, 16

<sup>48</sup> Zakon o stečaju [Bankruptcy Act] (Serbian Official Gazette No 104/09) art. 135, 136

one of the opinion leaders against the initial limitations of the Twelfth Directive on this corporate form we can assume that this area is allowed and at the same time regulated in details in this member state.

According to a recent expert-study managed by the European Commission in Germany the pyramid structure is the most often used control enhancing mechanism besides the other forms.<sup>49</sup> It evinces the admittances of chain of companies that was also one of the debated part of the Twelfth Directive.

### 3.3.1 GmbH

On one side there are certain steps reflected in court decisions toward approximation of different interests in order too make balance between the creditors' protection and limited liability of such one-man companies; but on the other hand even today there are gaps in statutory regulation.

A GmbH is more likely to be dependent company in de facto groups than in contractual ones. In private limited liability companies the managing director is bound by the shareholder's instructions and decisions (e.g. decisions about appointment or removal); so, "there is, in principle, no need to enter into a domination agreement since its effects (instruction to the dominated entity) correspond to the corporate structure of the GmbH anyway."<sup>50</sup> To sum up, lack of particular regulation can be explained by the different management structure of GmbH in comparison with AG. The managing directors are liable for the financial losses (duty of due care) and their adequate compensation even if they have acted in accordance with the single shareholder's resolution<sup>51</sup> because the general articles protecting minority shareholders and creditors should apply in absence of other statutory solutions.

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<sup>49</sup> See *supra* note 43, at 48

<sup>50</sup> MÜLLER, *supra* note 18, at 172

<sup>51</sup> Act on Limited Liability, *supra* note 16, § 43

If a GmbH holds 100% of equity capital in another entity, they are presumed to be ‘affiliated enterprises’ defined under AG Act and form group of companies<sup>52</sup> based on existence of control (a careful analysis can determine which AG Act provisions are applicable by analogy on this situation).

"Focusing regularly on the *company* ("das Unternehmen") and the *corporate group* ("den Konzern") and the dependency relationship between these entities, corporate liability law tended to base the management's liability more on the corporate architecture than on the management's concrete doing, as seen from economic and business perspectives. Courts, thus, aimed at identifying dependency relationships among corporate entities within the group."<sup>53</sup>

The Federal Court of Justice in Civil Cases (BGH) had three important cases concerning liability of single shareholder-parent company for losses suffered by its subsidiary. The first, *Video* case presumed the sole shareholder liability if it was ‘permanently and extensively’ engaged in the subsidiary’s management (under standards created in the previous *Autokran* case).<sup>54</sup> BGH in the *TBB* case reduced this liability for those situations only when the parent company abused its powers (it was enough that it did not show sufficient consideration for the subsidiary).<sup>55</sup> The last case, *Bremer Vulkan* constitutes the major deviation from the basic principles. The BGH ruled that analogous application of relevant AG Act articles is excluded and "the protection of the dependent company against actions taken by its sole shareholder is limited to maintenance of its base capital and safeguarding of its existence".<sup>56</sup>

Exact separation between act of subsidiary and parent company is important to determine eventual liability of the dominant corporation’s directors/shareholders toward the controlled

<sup>52</sup> Stock Corporation Act, *supra* note 24, § 18(1)

<sup>53</sup> Peer Zumbansen, *Liability Within Corporate Groups*, 3 GERMAN LAW JOURNAL 1 (2002), available at <http://www.germanlawjournal.com/index.php?pageID=11&artID=124>

<sup>54</sup> In case of detrimental and lasting mismanagement the parent company is liable for the creditors of the subsidiary who have direct claim against it.

<sup>55</sup> Stock Corporation Act, *supra* note 24, § 302, § 303

<sup>56</sup> PETRI MÄNTYSAARI, *COMPARATIVE CORPORATE GOVERNANCE* 387 (2005)

one. In case of lack statutory solution of this problem courts are required to fulfill the gaps, especially when provision on stock corporations cannot be called to help.<sup>57</sup>

### 3.3.2 AG

Stock Corporation Act has significant influence on drafting the Ninth Directive and as we could see in 3.3.1 sometimes supplements the corporate groups' legislation in private limited liability companies. This is the reason why the introductory provisions on group of companies (paragraphs 15-19) do not define the form of corporations (they do not have to be necessarily public limited liability companies).

If an enterprise holds the majority of shares of another enterprise the former is the parent company of the latter, subsidiary.<sup>58</sup> This definition remains even if there is no majority of shareholding but relation between a wholly-owned subsidiary and its parent company. They seem to be 'affiliated enterprises' even though there is no exact explanation of this term. It necessary contains the affiliate (subsidiary) and the enterprise (parent). Under paragraph 17(2) it is presumed that majority of ownership means at the same time stronger controlling rights: the sole shareholder (or managing directors of it) takes actions affecting its subsidiary even though "[t]he owning enterprise can rebut this presumption only if it can prove that it is unable to significantly influence the management of the majority owned enterprise."<sup>59</sup>

An ongoing company can become wholly-owned subsidiary if it is integrated with 100% of its equity capital into the parent company (requirement that both the companies are stock corporations).<sup>60</sup> As in the Serbian legislation there is also possibility of compulsory (forced) sale on behalf of the majority shareholder who holds minimum 95% of the share capital (but it should be decided on the subsidiary's general meeting).

<sup>57</sup> See Dragana Radenkovic Jocić, *A single member company convenient or not for the founders*, 2(3) FACTA UNIVERSITATIS (Series: Economics and Organization) 209 – 219 (2005), available at <http://facta.junis.ni.ac.rs/eao/eao2005/eao2005-03.pdf>

<sup>58</sup> Stock Corporation Act, *supra* note 24, § 16 (1)

<sup>59</sup> Walter Oppenhoff & Thomas O. Verhoeven, *Chapter 24: The Stock Corporation*, in BUSINESS TRANSACTIONS in GERMANY 24-154 (Bernd Rüster ed. 1983)

<sup>60</sup> Stock Corporation Act, *supra* note 24, § 319

### 3.4 United Kingdom

Besides definitions of parent company and subsidiary the Companies Act 2006 determines what wholly-owned subsidiary means that is high of priority for our topic. "*A company is a "wholly-owned subsidiary" of another company if it has no members except that other and that other's wholly-owned subsidiaries or persons acting on behalf of that other or its wholly-owned subsidiaries.*"<sup>61</sup> It is important to know that talking about company this expression covers every form.

After deciding the *Salomon v. Salomon* case the principle of separate legal personality between the company and its members has become decisive in the UK company law, especially by spreading its strict application on corporate groups. Although for long time it had been accepted that every member in the group had its independence (concerning liability for own actions) today parent/subsidiary relationship must be treated as single economic unit. "[A]n economic entity could be established where the holding company exerted a substantial degree of control over the affairs of the subsidiary company, to the extent that the holding company controlled and dictated the corporate policy of its subsidiary."<sup>62</sup> Irrespective of the fact that the single shareholder (parent company) can manage its subsidiary's affairs totally alone courts do not 'pierce the corporate veil' against the defendant controlling company just "because the corporate structure has been used so as to ensure that the legal liability (if any) in respect of particular future activities of the group (and correspondingly the risk of enforcement of that liability) will fall on another member of the group rather than the defendant company."<sup>63</sup> It was first decided in *Adams v Cape Industries plc* case that facts as being single shareholder and through this status influencing the subsidiary do not enough to justify 'piercing the corporate veil'. Exceptionally it can be overstepped if courts interpret statutes otherwise; or if the above mentioned structure is

<sup>61</sup> Companies Act, *supra* note 31, § 1159 (2)

<sup>62</sup> Corentin Kerhuel, *Coursework* at 6, <http://www.box.net/shared/x994obb4f4>

<sup>63</sup> *Id.* at 5



abused ('*mere façade*'); or if the subsidiary acts as authorized agent of the parent company (or its members).<sup>64</sup> The last case is interesting with respect to requirements of agency law; the parent company is bound by the acts of its agent/subsidiary only if there is express agreement between them.

To sum up, it cannot be said that the parent company or its managing directors have never been liable for their acts on detriment of the controlled company but it always depends on facts of actual situation. "The English courts have seen no reason why companies (or individuals through the use of companies) cannot order their affairs with the use of subsidiaries to provide for limited liability and indeed priority of claims if insolvency were to occur. Time and again the English courts say that the principle in *Salomon* cannot be avoided simply because it may prejudice some creditors."<sup>65</sup>

The UK is one of the EU member states that even though allows pyramid structure<sup>66</sup> it conditions that to certain limitations. A UK-incorporated holding company besides having substantial shareholding in a subsidiary throughout twelve-months ("period beginning with the start of the UK-incorporated holding company's requisite continuous twelve-month ownership period and ending with the time of disposal, and immediately after the time of disposal") it must be trading company (or member of it).<sup>67</sup>

### 3.5 Conclusion

We can conclude that the different levels of economic development of the examined states cause discrepancies in their regulations because usually the above mentioned company-structures are used by 'stable' corporations engaged in international business; more competitive with this respect a country is less expectable its rules related to group of

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<sup>64</sup> See *supra* note 62

<sup>65</sup> Simon Bowmer, *To pierce or not to pierce the corporate veil - why substantive consolidation is not an issue under English law* 15(8) J.I.B.L. 193, 197 (2000) available at 2010 WL

<sup>66</sup> Companies Act, *supra* note 31, §1159 (1)(c)

<sup>67</sup> See <http://www.coddan.co.uk/s-94-incorporate-a-holding-company-in-the-uk.html>

companies are elaborated. Common policy is likely to be introduced by the recommended Ninth Company Law Directive protecting the creditors' interest on more coordinated level within the EU than the existing legislations can provide.

## CHAPTER 4 – PUBLICITY

### 4.1 General overview

The Twelfth Directive's publicity requirement should be interpreted together with the First Council Directive that prescribes compulsory disclosure for both public and private limited liability companies: "the basic documents of the company should be disclosed in order that third parties may be able to ascertain their contents and other information concerning the company, especially particulars of the persons who are authorized to bind the company."<sup>68</sup>

The Twelfth Directive mentions only the situation when "a company becomes a single-member company because all its shares come to be held by a single person."<sup>69</sup> It means that the situation of incorporation by single member should be registered from the very beginning of the company's existence under the same conditions as in case of corporations with more shareholders (it is not covered explicitly by the Directive). On the other hand, in order to avoid potential abuses if the one-man company continues to act toward the outside world as having more members both the shareholder's identity and the fact of such membership-change are to be entered into the companies' register (because the article is applicable together the article 3 (1), (2) of the First Council Directive the term 'companies' register' includes also commercial and central registers or any other forms where each of the companies are registered therein).

The problematic part is the possibility to record these data instead of central registers supervised by courts or other commercial agencies in a 'book' that is kept by the company itself. To improve cross-border transactions optional provisions of this kind should be reduced because such voluntary choice can cause certain discrepancies: the central registers will not contain relevant information being accessible to third party only in the company's own

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<sup>68</sup> *Supra* note 37, at recital

<sup>69</sup> Twelfth Company Law Directive, *supra* note 1, art. 3

register. This alternative method undermines the basic intention to achieve a high level of coordination between the member states in maintenance of public records. However, this occasion was not negotiated in the programme for simplification of EC company law at all. The proposal was to delete this requirement in full because of being a complicating factor in case of single-member companies.

In the Commission's Draft the publicity requirement was expanded on the letters and order forms but the final act did not accept this idea with explanation that too bureaucratic nature of single-member companies would not be favorable to small businesses. Instead of emphasizing this obligation interests of the internal market can be better served by strengthened control of Member States' behavior in respect of accounting duties.

## **4.2 Serbia**

The company becomes separate legal subject at the moment of entering the relevant data about it into the Business Register. Before that moment the founders and other persons are responsible jointly and severally with all of their personal assets. In accordance with the Act their liability continues but the incorporated company can join, too, if after registration assumes the debts.

The main act on corporations does not contain article on publicity requirement. Registration and publication of data concerning corporations are regulated by the Law on Registration of Business Entities.<sup>70</sup> This Law covers duty of record of certain changes affecting the corporations' organizational structure, status and position in the legal transactions (beside the mandatory registrations of establishment and winding up). The situation of concentration of all shares in hand of one person can be seemed to be a change falling into this scope (even though it is not mentioned literally). In case of incorporation there are information needed to

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<sup>70</sup> Zakon o registraciji privrednih subjekata [Law on Registration of Business Entities] (Serbian Official Gazette No 55/2004, last amended No 55/2004 )

be notified to the Serbian Business Registers Agency<sup>71</sup>; if they were modified during the company's existence the changes would be entered into the above mentioned register.

Change in membership includes both access of new member and termination of membership.

The competent persons' application for registration (the founder, person authorized by the founder for registration of establishment or/and changes or person authorized for this task by law)<sup>72</sup> must be compulsorily accompanied by amendments of the articles of association.<sup>73</sup>

They can be faced with discrepancies between the Business Registers Law and the official web site of Business Registers Agency. The former requires the notification of change to be done within 15 days from its occurrence, but the second one (on both languages, Serbian and English) mentions only five days. Although the Law was amended in 2005 the modifications did not concern the date-question. Currently, there is neither explanation for this difference, nor answer which of them should be respected by businessmen. Non-compliance with the time frame constitutes economic contravention sanctioned by fine. It applies both to the company itself and the liable officer/person in the company (but the amounts are different).<sup>74</sup>

Implementation of the Directive into the national law does not have to be in the same Act; but it might ease to control the country's fulfillment of the duties. The Serbian solution is good in one side because of being exhaustive in covering the questions of time (what is ambiguous in the other considered systems) and competent persons for application, but on the other hand it does not include exactly that action what is required in the Directive (similar as the situation in GmbH).

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<sup>71</sup> Business Registers Agency Home Page (English version), <http://www.apr.gov.rs/Default.aspx?alias=www.apr.gov.rs/eng>

<sup>72</sup> Law on Registration of Business Entities, *supra* note 70, art. 18.

<sup>73</sup> *Id.* art. 65.

<sup>74</sup> *Id.* art. 79.

Another interesting particularity of the Serbian regime is requisite of labeling the business letters and other documents of the company if it is single-member.<sup>75</sup> Notwithstanding that this part of the Directive's draft was thrown away the Serbian legislator treated it to be important.

### **4.3 Germany**

#### **4.3.1 GmbH**

The German limited liability company is a good example to illustrate that none of the Member States has adopted the Directive literally. The most rigid control of the data registration is present in this country. Commercial Registers are kept at courts (what constitutes the judicial side of the control) but the basic inspection is done at notary.

In case of any change of shareholding the managing director shall submit the new (revised) list of shareholders to the Commercial Register.<sup>76</sup> Because managing directors can be elected out of the company's membership it can happen that there is sole shareholder with one or more managing directors (but it is rare in practice). The director who has status of employee applies for registration after the contributions have been paid. He should notify the remaining shareholders' name, date of birth and place of residence (commercial register where the shareholder-legal person is registered) together with the shareholding; the requirement to enter the fact that the shares are concentrated at one shareholder subsequent to the company's formation is not specified in the Act.

The register must be informed 'immediately after every change' (including but not with limitation to changes in membership). As other abstract words in law the term 'immediately' can be interpreted in accordance with the general provisions of civil law on time or legal customs on the pre-determined territory; anyway it is task of court to decide in case of

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<sup>75</sup> Act on Business Companies, *supra* note 13, art. 22.

<sup>76</sup> Act on Limited Liability Companies, *supra* note 16, § 40.

litigation. This question can arise if the managing director causes damage to creditors by non-compliance with the above mentioned requirement.<sup>77</sup>

### 4.3.2 AG

Unlike in case of GmbH the Stock Corporation Act provides separate paragraph on *one person companies*. "If all the shares belong to one shareholder solely or jointly with the company then this fact together with the sole shareholder's surname, given name, occupation and place of residence shall be notified to the court without delay."<sup>78</sup>

The notification shall be given 'without delay'. It is an interesting occasion why the legal systems use so fuzzy determination of time of registration duty. 'Immediately', 'without delay' can be even synonyms; the question is which Law should be served as basis for their interpretation.

There is no sanction foreseen for non-compliance with this paragraph; and we also do not know who is obliged to take the action. In case of GmbH the managing director (who can be either the sole shareholder or a separate person) is personally liable for the caused damage to the creditors.<sup>79</sup> The Directive does not require infliction penalty on the guilty person but without adequate sanctioning by the Member States the article 3 remains inoperable.

It seems that neither GmbH- nor AG Act takes advantage of the option to register these data exclusively in the company's own registrar. The procedure is completed before the commercial court in the district where the company is located; they are also responsible for the entries made into the individual registers.

### 4.3.3 Pre-incorporation

Legal standing of German pre-incorporated single-member company can serve good basis for further debates especially in the academic surrounding.

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<sup>77</sup> Act on Limited Liability Companies, *supra* note 16, § 40.

<sup>78</sup> Stock Corporations Act, *supra* note 24, § 42.

<sup>79</sup> The managing director is also liable to affected shareholders or in our case to single shareholder under condition that the managing director is not at the same time the company's only member.

"Some writers take the view that it is an economic entity having partial legal capacity, whilst others adopt the view that it is a special property of the founder subject to the reservation that the pre-incorporation company is suitable organized."<sup>80</sup>

In stage of pre-incorporation GmbH 'as such does not exist', so, it cannot have legal personality; but because it has own assets (from the paid contribution) it is capable to sue or to be sued because of certain debts (so to be subject to duties together with the shareholder) as a sui generis company.<sup>81</sup> After registration there is no need to make transfer of liability of the shareholder because the company is liable for claims towards the pre-incorporated predecessor. It cannot be said about the sole shareholder. We should differ the position of the sole member and managing director if he is appointed from outside. In GmbH the director even though has authority to take certain acts in pre-incorporation phase, he is liable only exceptionally (being just an employee). In case of stock corporation the debts created out of the scope of his authority bind the director after registration under general agency law (like an agent without proper authority); but if there is agreement on assumption of debts by the company, he is no longer personally liable.<sup>82</sup> Especially this provision causes misunderstandings whether it can be applicable on the only shareholder doing the tasks of a managing director.

#### **4.4 United Kingdom**

The registration procedure begins by delivery of memorandum - and application of association; it has similar role as the incorporation document but does not have synonym in the continental regime. In the UK law memorandum and articles of association – at first sight being very akin – constitute the company's statute together. The first one establishes its legal personality and defines the powers; the latter regulates the internal management questions.

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<sup>80</sup> *Supra* note 17, at 77

<sup>81</sup> Act on Limited Liability Companies, *supra* note 16, § 11.

<sup>82</sup> Stock Corporations Act, *supra* note 24, § 41.



Today role of memorandum is changed; it is enough to include the shareholder's statement in what agrees to become member.

The Companies Act has a special section on single member companies<sup>83</sup> regulating the publicity requirement separately in three cases: formation of a company by single member, becoming single-member during existence and increase of membership from one to two or more. This, really complex way of implementation of the article 3 is very interesting in comparison with the Regulation's solution (amending the Companies Act 1985 in 1992). It stated: "A company shall not be prevented from registering under this Act as a private company limited by shares or by guarantee solely because it has only one member"<sup>84</sup>. Although the Directive imposes positive obligation (by the wording 'must') the Regulation followed that only partially. Registration application cannot be thrown away solely on basis of having one member but it does not say anything about the duty to enter this fact. It can be interpreted as freedom of the sole shareholder to register this change in the company's life only if wants because he/she will not be bared to do so. But the aim of the Directive is to harmonize this question and not to leave on the shareholder's discretion to decide whether to register the changes or not.

The Companies Act goes into details and specifies that beside the name and the address of the sole member, the statement that the company has only one member should be recorded in the Companies' Register. If the number of the members falls to one or it ceases to be single-member, the date of decrease/increase in the membership has to be entered, too. The due date of registration is not specified, so the shareholder does not know exactly in what time limit should notify the event without being in delay. The formulation 'upon the occurrence of that event' is very abstract; it can include either the day of occurrence or the day immediately after

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<sup>83</sup> Companies Act, *supra* note 31, § 123.

<sup>84</sup> The Regulation inserted a new sub-subsection in section 680 of the Companies Act 1985.

that. It is a further curiosity if the remaining shareholder does not realize at moment's notice that he/she has become the sole member.

Non-compliance with these provisions implies liability of the company itself and every officer who were in default. It is understandable because of company being separate legal person. The sanction is pecuniary not exceeding level 3 on the standard scale but in case of continued action the fine is determined as one-tenth of level 3 for every day of contravention.<sup>85</sup> After issuance of certificate of incorporation no longer the existence of the company can be called into question.<sup>86</sup> Before registration there is no company at all; contracts made on its behalf by the only founder results personal liability of the founder. The only possibility is to renew the contract with the company on the same terms as the previous one after registration. Then the company can assume the debts.<sup>87</sup>

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<sup>85</sup> The standard scale applies only to summary offences. Referring to the BLACK'S LAW DICTIONARY 1188 (9<sup>th</sup> ed. 2009) summary offences can be prosecuted without indictment. The level of a fine for a particular offence is fixed by relevant law, in our case by the Companies Act but the scale is contained in the Criminal Justice Act 1982. Level 3 is 1000 pounds in accordance with the current standard scale.

<sup>86</sup> Companies Act, *supra* note 31, § 15.

<sup>87</sup> SALEEM SHEIKH, A GUIDE TO THE COMPANIES ACT 2006 260 (2008)

## CHAPTER 5 – GENERAL MEETING

### 5.1. General overview

According to the next examined article of the Directive the sole shareholder is required to exercise the powers of the general meeting.<sup>88</sup> This wording including ‘shall’ assumes that there should be no possibility for the only member to convey this power out of the company’s membership. Although it is against the drafters’ first intention to allow other people’s intervention into the main decision making process, the final version of the Directive does not contain this prohibition. So, there is opportunity of delegation of powers.

The scope of general meeting’s competence has not been yet harmonized on the EC level. It is for Member States to regulate in national laws which decisions are to be brought in these sessions; as well as the penalties for non-compliance with the requirements are left to state law. The shareholder has to record the decisions taken on the general meeting in minutes; or it is enough to ‘draw up in writing’. The Directive does not specify what ‘writing’ covers. So, can it be everything suitable to be read, even done by electronic means or written informally on a piece of paper? Publicity of minutes protects third persons’ interests on certain level, but how this aim is achievable if there is no duty to record the single member’s decisions in such formal way.

During the negotiation procedure the proposal to specify the means of administration was thrown away. Every attempt to introduce some formalities into the single-member company regulation was refused even though sometimes they were necessary.

Today the simplification endeavors tend to reduce even the minimum requirements that constitute anyway the only possibility to protect the creditors.

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<sup>88</sup> Twelfth Company Law Directive, *supra* note 1, art. 4.

## **5.2 Serbia**

Every shareholder, all together constitute the general meeting of a company. To realize its sphere of activity different modalities can be determined by the founding act or/and company statute: session (attendance 'physically' or by use of modern audio-visual technologies) or decision making in writing without session.

One-man company has the same corporate structure and functions in same way as corporations with more members.

In single member limited liability company the only member shall exercise the powers of the general meeting and/or bring the decisions in competence of the meeting (in this part the Act has implemented the Directive's words literally). There is possibility that he/she gives authorization to somebody else delegating the voting rights; if the founding act or statute of members do not regulate otherwise (for one meeting only one authorization can be given only to one person in accordance with the Act).

Notwithstanding the founder and the managing director can be same persons the decisions always are to be signed by the single shareholder as founder (and not as managing director). In the former role he/she is the primary decision maker but as director he/she can act only as the agent of the company. Although in this latter case he/she can get opportunity by the founding act to make decisions independently (otherwise this action is in competence of the founder) in case of single-member companies it is usually not the case.

The single member or the authorized person should enter the resolutions into the book of decisions (without undue delay) and after piecing together sign the minutes. Whilst the Directive uses an optional terminology: either minutes or other writing, in Serbia beside compilation of minutes a separate document also has to contain the meeting's resolutions (even though these are general requirements applicable notwithstanding the number of members in a company). Interesting provision of the Serbian Act is that non-compliance with

the minutes' formal requirement does not affect the resolutions' validity if their authenticity can be determined in other trustworthy way.<sup>89</sup>

The implementation of the relevant article 4 of the Directive was full but still there is an important question, question of 'quorum' that should be dealt with in case of one-man companies. It is not addressed by the Directive but the United Kingdom has thought to be substantial issue (that is important for our comparative analysis). In the Serbian Act majority of votes of total number of shareholders/members constitutes the quorum and nothing else is given to this definition that in this form is deficient to be applicable on one-man companies. When number of shareholders is significant general provisions on companies (including quorum, too) cannot remain in their original formulation to be at the same time suitable for one-man companies' decision making.

Although in Serbia stock corporation and limited liability company are regulated separately, still they are located in the same act that makes possible (and easier) inter-reference between the different parts. The above mentioned solutions are applicable on stock corporations with sole shareholder, too, without any modification.<sup>90</sup>

## **5.3 Germany**

### **5.3.1 GmbH**

In the GmbH Act it is not said literally that the only shareholder (or by him/her authorized person) has the powers of general meeting; but because every shareholder can participate in the meetings in person or through his/her representative (attorney in fact) holding notarially certified power of attorney we can assume that this provision is applicable on cases only with one shareholder, too.

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<sup>89</sup> Act on Business Companies, *supra* note 13, art. 150 (5)

<sup>90</sup> *Id.* art. 275(3)

In one-man GmbH shareholder's resolution must be recorded in writing and signed by the shareholder without undue delay.<sup>91</sup> Again the problem is the abstract formulation of the time frame, even if there is no serious sanction for non-respect of this paragraph. "In the event the shareholder fails to prepare such written protocol of the resolution, the respective resolution is not necessarily deemed to be null and void, but the sole shareholder faces the problem of providing evidence of what was resolved upon, a problem that might be difficult to overcome."<sup>92</sup>

Like in Serbia in case of GmbH there is no separate paragraph on quorum in one-man companies. The only difference between them is that still the Serbian legislation regulates this question in general requiring statutory minimum number of shareholders to be present (or represented) for passing a resolution, in Germany there are different thresholds to be achieved for various categories of decisions (but not under concept of quorum).<sup>93</sup>

### 5.3.2 AG

The Stock Corporation Act has very similar approach to the Directive's investigated article 4 as the GmbH Act. There are only general paragraphs on shareholders' meeting, even though some particularities of AG can be very much for small companies' benefit (what in some sort includes single-member companies). If all the shareholders have appeared or represented (evidence that he/she can delegate the voting rights) than a resolution can pass without need to follow formalities (with condition that none of the shareholders objects which situation can be easily avoided in case of one-man company).<sup>94</sup> It means that requirements concerning the way of calling, place and time, notification etc. of the shareholders' meeting does not have to be respected; but the shareholder cannot diverge from the article 130 on *minutes*. Being in form

<sup>91</sup> Act on Limited Liability Companies, *supra* note 16, § 48 (3)

<sup>92</sup> MÜLLER, *supra* note 18, at 53-54

<sup>93</sup> Campbell, *supra* note 22, at 23-117/118 ["To ensure that individual shareholders cannot block the decision-making process of the company, the articles also usually provide that if the necessary quorum is not present at a meeting, a second meeting shall be called at which the quorum requirement shall not apply."]

<sup>94</sup> Stock Corporations Act, *supra* note 24, § 121

of notarial deed minutes should contain each ruling of the meeting (under condition that the company is quoted on a stock exchange).<sup>95</sup>

As it was mentioned previously the similarity between GmbH and AG is very high (especially concerning this field of their functioning) it can be said about the quorum regulation, too. AG Act does not contain anything with respect to this question but it allows the articles of associations to define this question otherwise.

#### **5.4 United Kingdom**

In accordance with the section *on records of resolution and meetings etc*<sup>96</sup> every company, both public and private limited liability ones must maintain records of minutes of proceedings and copies of the resolutions what are to be kept at least ten years. Offence<sup>97</sup> can be committed by every officer of the company who fails to act in this way under possibility to be punished (maximum fine is level 3 on the standard scale).

But as we get used to the Companies Act 2006 provides separate regulation for one-man companies.<sup>98</sup> The two sections on records should be interpreted together: "every company must keep records comprising details provided to the company in accordance with section 357 (decisions of sole member)".

Without saying literally that the sole member exercises the meeting's powers "it is possible for [him] either to constitute a meeting or to decide on an issue which requires a resolution in which case a written record of the decision must be kept."<sup>99</sup> It means that the only shareholder shall inform the company about details of the decision 'unless that decision is taken by way of

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<sup>95</sup> Stock Corporation Act, *supra* note 24, § 130 (1) sentence 2 provides exception: if the shares are not admitted to trade on an exchange, there is no requirement to record resolutions in notarial protocol. It is enough that its copy is signed by the chairman of supervisory board (unless this Stock Corporation Act requires ¾ majorities for passing the resolution).

<sup>96</sup> Companies Act, *supra* note 31, § 355

<sup>97</sup> BLACK'S LAW DICTIONARY 1186 (9th ed. 2009): Offence is defined as "violation of the law, a crime often a minor one; it may comprehend every crime and misdemeanour, or may be used in a specific sense as synonymous with 'felony' or with 'misdemeanour', as the case may be, or as signifying a crime of lesser grade, or an act not indictable, but punishable summarily or by the forfeiture of a penalty."

<sup>98</sup> Companies Act, *supra* note 31, § 357

<sup>99</sup> CHARLESWORTH & MORSE, COMPANY LAW 284 (15<sup>th</sup> ed, 1996)

a written resolution'. Then the company must be provided by a written record of the decision having effect of resolution (because only information about its details is not enough).<sup>100</sup>

Non-compliance with the information duty toward the company constitutes an offence punishable by fine of the standard scale (maximum level 2: 500 pounds). But the guilty person's commitment does not invalidate the decision because even being criminal sanction it does not have civil consequences on the decision's effectiveness (so, it has same results as the previous two legal regimes).

The United Kingdom is the only legislation (from the researched ones) which has paid attention to quorum in one-man companies. An individual member, corporate representative or proxy present at the meeting may all be "qualifying persons" with respect to the quorum and in case of single-member company only one *qualifying person* is enough to pass a resolution.<sup>101</sup> It evinces, too, that even though there is no separate section on the single shareholder's possibility to delegate the voting rights on general meetings he/she can appoint a proxy in relation to a particular meeting (what was the case in the other regimes, too).<sup>102</sup> If there are more members/shareholders, they can also authorize others to vote instead of them, but only such representatives are not enough to constitute quorum (this default rule is not applicable in one-man companies).

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<sup>100</sup> Written resolution in this context refers to the situation when all members assent to a transaction by what the company is bound but it is no necessary to hold a general meeting only to express the consent again. In case of single-member company it is questionable beside the only member who can object to the decision.

<sup>101</sup> Companies Act, *supra* note 31, § 318 (1)

<sup>102</sup> *Id.* § 324 (1)



## CHAPTER – 6 CONTRACTS BETWEEN SOLE MEMBER AND COMPANY

### 6.1 General overview

Whatever transaction between the company and its shareholders includes risk of conflict of interest; even though this risk is higher when there is only one member. It is easy to defraud creditors who are not aware of the separate legal personalities (and at the same time separate assets and liabilities) of the company and its member. This is the reason why the Twelfth Directive requires recording of these contracts (or drawing up in writing).<sup>103</sup> It means that even the national legislation on contract law would regulate the formalities otherwise (namely allows oral contracts for corporation matters) for agreements between the sole shareholder and the company represented by him written form is mandatory. It does not affect every contact; member states are free to decide whether they apply the above mentioned approach 'to current operations concluded under normal conditions' or limit to exceptional cases. There is no explanation what it means "but it is hoped that a commonsense approach will prevail".<sup>104</sup> The first proposal of the Directive was stronger than the final text: it "required the possibility of any agreement between the sole member and the company represented by him to be provided for in the company's statutes or instrument of incorporation, on the basis that such documents were accessible to any interested party at the companies register in accordance with the First Directive".<sup>105</sup> Because the sole shareholder can take over the functions of a managing director usually it is hard to distinguish whether he/she concludes a contract in self interest or acts on behalf of the company. In order to protect third persons' position in such transactions the drafters wanted to include an enumeration of every possible contact in the companies' main documents but this idea did not survive.

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<sup>103</sup> Twelfth Company Law Directive, *supra* note 1, art.5.

<sup>104</sup> Hugh Fraser, *Directors' interests in contracts: fair and foul dealing*, 15(2) COMP. LAW. 46, 49 (1994) available at 2010 WL

<sup>105</sup> Edwards, *supra* note 6, at 214

This article serves similar aims as the previous article 4 on general meetings: to react successfully on abuses by evidences recorded in writing.

## 6.2 Serbia

The Serbian Act on Corporations regulates this question in the same article as the requirements of general meetings in single-member companies.<sup>106</sup> Agreements between the only member (or his/her proxy/representative) and the company itself must be in written form. The terminology is not the best one because instead of being in written form there is another option to enter these contracts into the book of decisions. It is not understandable what the legislator's intention was. Either in writing or in book of decisions can mean that book of decisions does not have written form. Maybe it was result of deficient translation of the Directive on Serbian language.<sup>107</sup> So, if we try to interpret it properly (approximately in accordance with the drafters' original will) the answer is the option of the shareholder to record the transaction in the book of decisions; but it is only voluntary because any other way of documentation is appropriate under condition to be in writing.

Serbia also accepted the second part of the Directive that current operations need not follow the formalities.

Anyway, these transactions are taken either by the sole shareholder or the managing director (even though they can be same persons).<sup>108</sup> Because this is a common article for both limited liability companies and stock corporations, their different corporate structures (especially concerning the management) should be considered only in few words. In case of limited liability companies either managing director or a board can be appointed in the articles of associations (what refers to the close stock corporations, too), still the open public limited liability company always must have managing board. If we 'translate' this on case of one-man

<sup>106</sup> Act on Business Companies, *supra* note 13, art. 136 (2),(4)

<sup>107</sup> The UK Companies Act uses the terminology 'unless the contract is in writing' it can be entered in different documents.

<sup>108</sup> Although the general provisions concerning duties applies to control-shareholders in case of one-man companies the single shareholder answers the statutory definition of control-shareholder (article 367.)

companies the possibility of fraud and abuse is smaller when there is a managing board. Although the single shareholder can participate in its work, for the outsiders it will be obvious that he/she does not act as entrepreneur but as a member of another entity. Generally, all these are true on the other legal systems with similar corporate structures.

The shareholder (who can be at the same time the managing director if decides) is required to be loyal toward the company's assets, confidential information or its business opportunities.<sup>109</sup> In case of breach of this duty he/she is liable to the company for damages and if he profits from these businesses the transactions together with all the benefits must be assigned to the company<sup>110</sup> (personal liability is consequence of alter ego doctrine regulated in the Serbian legislation, too<sup>111</sup>).

However, these articles are applicable on all types of corporations under the Serbian Act, there are problematic parts being unsuitable for single-member companies. If the majority of shareholders give bona fide consent on these transactions the shareholder is excluded from liability. Does it mean that the sole member can excuse himself/herself? Because of lacking separate sanctions provisions for non-compliance with general duties are applicable in this case what results such gaps in the regulation as the previous one (this is only one of the evidences what serves the purpose of reform as soon as possible).

## 6.3 Germany

### 6.3.1 GmbH

Maybe the article 5 of the Directive is the only one that has been the most differently implemented into the national laws. The German GmbH Act has interesting solution interpreting the relevant paragraph on *representation by the managing directors*<sup>112</sup> in

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<sup>109</sup> Act on Business Companies, *supra* note 13, art. 33.

<sup>110</sup> *Id.* art. 37.

<sup>111</sup> *Id.* art. 15.

<sup>112</sup> Act on Limited Liability Companies, *supra* note 16, § 35 (4)

accordance with the Civil Code's article (BGB) on self-contracting and multiple representation.<sup>113</sup>

There are two possibilities either the sole shareholder is the sole managing director at the same time or there is board instead of individual manager. Anyway, both cases require that transactions between the company and its sole shareholder (so no matter whether he/she is director at the same time or not) must be entered in writing. It is not specified what kind of document should contain the written evidence; it is important only to record the contract immediately after being concluded; otherwise claim for damages arises in accordance with the paragraph on *managing directors' liability*.<sup>114</sup>

Although the Directive provides only optionally to member states to introduce this formality for every business contact Germany does apply this requirement on current operations under normal conditions, too, extending the scope of the paragraph maximally (it is not case in both Serbia and United Kingdom). This is good idea because such self-contracting is very dangerous and better to preclude potential misuse by the sole shareholder in advance than to tolerate the harmful consequences on the market later.

If all the shares are under control of the sole shareholder who is also the sole managing director the Civil Code is applicable. The transactions between the attorney-in-fact (who is the managing director in this context) and the company represented by him are no void only conditionally ineffective. "In the state of [such] pending ineffectiveness"<sup>115</sup> the agreements can be cured by subsequent approval what is in case of single-member companies done by amendment of article of association (even though there are thoughts that such assent to release the actors from the restriction can be included into the initial language of incorporation

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<sup>113</sup>Bürgerliches Gesetzbuch [Civil Code] of 18 August 1896 in the version promulgated on 2 January 2002 (BGBl. I p. 42, 2909; 2003 I p. 738), last amended by statute of 4 December 2008 (BGBl. I 2586) §181. ["An attorney-in-fact cannot, unless otherwise authorized, enter into transactions on behalf of his principal with himself in his name or in his capacity as attorney-in-fact for a third party, unless the transaction exclusively involves the fulfilment of an obligation."]

<sup>114</sup> Act on Limited Liability Companies, *supra* note 16, § 43

<sup>115</sup> MÜLLER, *supra* note 18, at 35

documents from the very beginning of company's existence). Besides self-contracting these limitations stand for multiple representation too what is the case when the managing director (as sole shareholder) represents his/her company in business with third parties also represented by him/her. The result is the same as in the previous situation.

This solution in the GmbH Act focuses very well on the problems I have mentioned in the part on Serbia. Still in the Serbian Act we do not know what cases are regulated or whether they are regulate at all, Germany avoids the non-understandings by covering both the sole shareholder being the managing director and the sole shareholder acting as private person.

### 6.3.2 AG

Unlike GmbH - the German Stock Corporation Act does not contain precise provisions on the contracts of the sole member with its public company. It can be explained by different relationship between the shareholders and managing directors in stock corporations from their dealings in private limited liability companies. In the former a separate body, so called supervisory board is liable to control the managing directors and to represent the company toward them for any purpose relating to business transactions; still in the latter the shareholders' influence is higher. The sole member who represents the company as member of management board governed by self-interests can cause financial disadvantage for the corporation but because of duty to report "transactions that may have a material impact upon the profitability or liquidity of the company"<sup>116</sup> to supervisory board there is high level of screening such intentions. Even if besides checking such acts result benefits for him, they are assumed to be 'hidden distributions'. As defined by the Federal Tax Court (BFH) they include "decrease in wealth or prevention of an increase in wealth of the company which is caused through the corporation's relationship to its shareholders."<sup>117</sup>

<sup>116</sup> Stock Corporations Act, *supra* note 24, § 90 (1),(4)

<sup>117</sup> MARCO ARDIZZONI, GERMAN TAX AND BUSINESS LAW 3-032 (2005) available at <http://books.google.com/books?id=TAHtXWpA9soC&printsec=frontcover&dq=german+business+law&cd=2#v=onepage&q=&f=false>

However, the sole shareholder and stock corporation as parties to a business are to be treated on equal footing as independent contractors (under the ‘arm’s length principle’) and any agreement between them "should be based on a clear-cut prior written contract"<sup>118</sup>.

#### **6.4 United Kingdom**

The Companies Act 2006 provides separate chapter on *contracts with sole members (who are directors)*<sup>119</sup> and because of that escapes those problems what the readers (practical users) of the Serbian Act are to be faced with. The section applies where the only member of the company enters into a contract who is director at the same time (it is allowed to be more managing directors beside him/her) and the transaction is not in ordinary course of business. These three conditions must be cumulatively fulfilled. Because it regulates only those cases when the single shareholder deals with the company as director (so theoretically on behalf of the company) the situation when he/she acts as private person being in business with the company are excluded from this scope. When the sole shareholder contacts his/her company with exclusively personal interest he/she will be always subject to liability notwithstanding of membership in the ‘aggrieved’ entity; but acting as managing director there are more spaces for abuse of the company’s separate personality. So, the purpose of this solution is to discourage them from wrongful trading out of ordinary business of the corporation. To ensure later control of these transactions they are to be recorded either in a written memorandum or in minutes of the first meeting after conclusion of the contract ‘unless the contract is in writing’ (so there is written evidence about their existence).

This section exhaustively covers every possible question what may arise in accordance with these contracts (and avoids misunderstandings what are present especially in the Serbian law). The company is not anymore liable for non-compliance with the formalities only the officer in default. The penalty is very high (what is reasonable with respect to the nature of the

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<sup>118</sup> *Id.*

<sup>119</sup> Companies Act, *supra* note 31, § 231

transactions and causable harms); level 5 on the standard scale is the maximum sanction what can be imposed (it is now no more than 5000 pounds). Anyway, the Companies Act follows the same way as in the previous sections and criminal character of the sanction does not affect the validity of the contract (even though it does not concern enactments or rules of law applying to this business question on other basis).

The last thing worth mentioning is the equalization of the managing director with the shadow directors in their treatment (only for the purposes of this section). "A shadow director is a person in accordance with whose directions or instructions the directors of a company are accustomed to act."<sup>120</sup> In our case the shadow director probably wanted to stay in background behind the single shareholder either as advisor or financier without giving his/her name to the company directly. But if the damage was caused because of his/her harmful instructions he is liable on the same grounds as the actor.

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<sup>120</sup> <http://www.manches.com/practices/corporate/service.php?id=250>

## CHAPTER 7 – PUBLIC LIMITED LIABILITY COMPANIES

### 7.1 General overview

The Directive only recommends inclusion of stock corporations and the member states are free to decide whether to accept that or not.<sup>121</sup> Although this article is located in the second half of the text its importance would justify location in the very beginning of this EU act. As we know from the legal history of UK (even though it is not the only system) for the countries without any tradition on single-member companies it was a big step even to introduce the new regulation only for part of the existing corporations; public limited companies are more complicated than to be harmonized with the Directive simultaneously.

Nowadays question of small- and medium sized enterprises that tend to be more often organized as single-member company than larger corporations is a hot topic in the EC legislation. Among others the EC Council made a proposal including reformation of the single-member companies' position in the legal regimes. Introduction of a simplified public limited liability company would be the final step that has been achieved (or worked on) in several national laws yet; but obligatory application of the Directive's requirements on public limited liability companies can serve as a zero point.<sup>122</sup>

Anyway, eventual harmonization of their legal status in all Member States is understandable. For the purposes of business transfer public limited liability companies are the most suitable association forms. But "[because of setting] high requirements concerning the minimum number of initial subscribers and/or shareholders . . . many entrepreneurs in small businesses refrain from choosing this legal structure, because it is too complex."<sup>123</sup> Private limited liability companies are good for small enterprises being less complicated in their nature and

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<sup>121</sup> Twelfth Company Law Directive, *supra* note 1, art. 6.

<sup>122</sup> Communication from the Commission on the transfer of small and medium-sized enterprises of March 28, 1998 O.J. (98/C 93/02)

<sup>123</sup> *Id.* at C 93/4



formalities but in case of medium-seized companies this form can result less credit standing before the banks and by non-issuance of bearer shares makes transfer of the company through generations more difficult.

The examined national laws has adopted article 6 of the Directive even though not all at once. The United Kingdom's stance illustrates the best the general objection against this concept but today most of the countries have expanded their single-member regulations on the public limited companies, too, especially being motivated by the above mentioned aims and approaches. The structure of the paper shows that even though the same rules are to apply to both types of companies, usually the terminologies vary from each other.

In Serbia every article concerning single-member companies are located at one place, under regulation on limited liability companies (that also refers to the stock corporations). In this case there is no discrepancy at all.

Germany has separate acts, so it excludes possibility of inter-reference between the parts. Although the consequences are always same (and they have to be) the way how we reach them is different. Usually the AG Act more concretely addresses the problems being easier to understand what it is about, still the GmbH Act is more abstract and mixes the paragraphs on single-member companies with the other general sections on polynomial corporations.

The UK legislation is special story in itself (having (sub)types of companies that are strange to other states). Inclusion of one-man stock corporations into the Companies Act the UK is the youngest one among Serbia and Germany in implementation of the article 6 of the Directive. The relevant sections are divided being general for both major types (public and private) and it fastens the application. Another good point of this Act is high level of specification of sections leading the reader to the demanded solution quickly. Without incorporation of the single-member company articles into the other ones those who are only new users of this entity form can get big help in its understanding.

## CHAPTER 8 – ENTREPRENEUR WITH LIMITED LIABILITY

### 8.1 General overview

The Directive provides an alternative regime for the Member States – especially for those who are opposed to the idea of one-man corporations.<sup>124</sup> It is possible that instead of formation of single-member company the particular state introduces such "legislation which would enable an individual businessman to set up an undertaking whose liability was limited to "a sum devoted to a stated activity"". <sup>125</sup> It would mean a sole trader with limited liability who should respect and apply the basic safeguards: contained not only in the Twelfth Directive but in the EC company law in general on accounting, disclosure or audit. This legal construction is specific and in time of its acceptance "[n]o-one yet [knew] what this [meant]".<sup>126</sup>

One of the rare examples is found in the Portuguese legislation where the individual entrepreneur can limit his/her liability by allocation of one portion of his personal assets on a bank account to represent the company's initial capital (however, it is not the best term 'company' to picture the actual nature of this entity). The "assets [on the account] are to be used solely for obligations arising from the business activity and those assets are the only assets to be used for such obligation".<sup>127</sup>

### 8.2 Serbia

In Serbia the division between individual entrepreneurs and companies concerning their liability is very strict. Sole trader is not separate legal entity; he is liable personally, directly

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<sup>124</sup> Twelfth Company Law Directive, *supra* note 1, art. 7.

<sup>125</sup> DINE, *supra* note 30, at 7-4

<sup>126</sup> Janet M. Dine, *The Community company law harmonisation programme*, 14(5) European Law Review 322, 328 (1989) available at 2010 WL

<sup>127</sup> Edwards, *supra* note 6, at 213

and without limitation with all of his assets for the debts arising out of the activity. Under the Serbian Law there is no possibility to limit his liability.

Anyway in every case it is the most prevalent form of individual organization that principally answers the need of small associations. Sanctions for the same contraventions are lower; bookkeeping is more severe and cheaper than for companies. Because single-member companies are acceptable and used in high percentage by the population there is low possibility to change/extend the current law in the near future by introducing any new business forms for traders.

### 8.3. Germany

Although Germany has been allowing one-man companies with long tradition by the *Law for the Modernization of the Private Limited Companies Act and to Combat its Abuse*<sup>128</sup> (*MoMiG*) a new subtype of GmbH is set up being especially designed for individual entrepreneurs. ‘**Unternehmergesellschaft**’ (UG) in English means *entrepreneurial company* what tends to promote small businesses in and out Germany. "UG as a kind of “interim solution” for entrepreneurs on their way to a “genuine” GmbH"<sup>129</sup> is regulated, upon the whole, by the Act on Limited Liability Companies reducing or adding some formalities being in accordance with the specific nature of UG. It means indirectly the application of the Twelfth Directive what is implemented into the German law.

There is neither requirement for minimum capital nor possibility to contribute in cash.

Although the entire initial capital has to be paid from the very beginning the founder can

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<sup>128</sup> Gesetzentwurf der Bundesregierung. Entwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) [Act to Modernize the Law Governing Private Limited Companies and to Combat Abuses] of 23. Oct. 2008 (BGBl. I S. 2026)

<sup>129</sup> Jessica Schmidt, *GMBH – SPECIAL ISSUE The New (Entrepreneurial Company) and the Limited – A Comparison 3*, [http://www.germanlawjournal.com/pdfs/Vol09No09/PDF\\_Vol\\_09\\_No\\_09\\_1093-1108\\_Articles\\_Schmidt.pdf](http://www.germanlawjournal.com/pdfs/Vol09No09/PDF_Vol_09_No_09_1093-1108_Articles_Schmidt.pdf)

determine its amount. Because there is no requirement of minimum number of shareholders, it can be even single-member (either natural- or legal person or both).<sup>130</sup>

Necessarily, UG has drawbacks, too. Because the company's name including the mandatory 'UG' can reflect possible financial weakness it discourages business partners' potential investments. Minimum capital is not determined neither the creditors can rely on the entrepreneur's (founder's) personal assets.

It is hard to say that this 'mini GmbH' is appropriate to fall under the scope of article 7 of the Directive (because both legal persons and more founders at the same time can profit from it, not only individual traders) but anyway, its attractiveness primarily for the entrepreneurs is to be expected. "Limitation of liability "for free," simplified incorporation procedure, no need for translations, the comparatively less strict German rules on distributions (albeit with the "UG-twist" of the mandatory reserve) – what more could an entrepreneur want?"<sup>131</sup>

#### **8.4 United Kingdom**

Entity falling into the scope of article 7 is said to be similar to a company limited by guarantee<sup>132</sup>; but again, it is not exactly that form what has been aimed to create by the Directive.

Company limited by guarantee is legal person usually for non-profit making activities established by one or more founders (legal or natural persons) who are not obliged to contribute during the company's existence only in the event of winding up (their promise/guarantee to contribute a predetermined amount is mature only then). It means that even nominal sum is enough to be paid; no matter that it cannot cover the debts because the members are not personally liable. It is also allowed to offer a promise to do a work for the company as contribution.

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<sup>130</sup> There is an exception referring to simplified incorporation procedure. If the UG uses the sample statutes it can have maximum three shareholders; otherwise it is not determined.

<sup>131</sup> Schmidt, *supra* note 129, at 14

<sup>132</sup> See DINE, *supra* note 30

This type of English company serves best the functions of article 7 in the investigated legal systems, but we can conclude that none of them has implemented the article literally.

### **8.5 Conclusion**

Simplification-tendencies concerning especially small enterprises throughout the EC tend to move toward structures that are promoted by the article 7. Providing a huge range of possibilities for businessmen to build up corporations being maximally in accordance with their ideas and financial opportunities such 'limited liability entrepreneurship' can serve very much the needs of current economic world. Although none of the investigated legal systems use this category in its original conception they try to create similar circumstances in their legislations (except Serbia). The basic objective of the article 7 was to help individual traders in limitation of their liability for duties of their enterprise; but if there are provisions being beneficial for small companies there is no need to introduce more facilitation into the regulation on entrepreneurs. This is evinced by the German and the UK solutions on this question.

## CONCLUSION

The aim of the paper is to evaluate the Serbian rulings on single-member companies in comparison with relevant provisions of the German and the UK acts. These countries even being EU members could use their discretionary powers partially in adaptation of the Twelfth Company Law Directive and it has resulted different approaches toward the same articles. The task is not to estimate the law of these countries but to find some positive points in them that can be successfully implemented into the Serbian legislation.

Nowadays concept of single-member companies is used in discussions on small- and medium sized enterprises. These debates did not sidestep Serbia, too; especially in period of transition and privatization process SMEs played key role in economic restructuring of the state because of higher efficacy in comparison with large former public companies. On one hand in the EU various measures are introduced to promote this kind of enterprises; whilst on other side in Serbia there is a tendency of decrease in their number. The solution to necessary consequences of such decline lies in reformation (or reformulation) of the basic Serbian rules on corporations that evinces the deepness of the problem in this non-EU country.

The official translation of the major Serbian company law act is 'Law on Business Companies'; but it is not the best one because it assumes to regulate only companies and not other corporation forms (similarly as it is done in the UK where there are separate laws on partnerships and companies). It is another question why the Serbian legislator did not use this UK Companies Act's terminology in translation of its act. It would be better to rename the English version of the statute to be Act on Business Corporations instead of the actual title. Also comparing the English variant articles themselves with the original Serbian ones, there are so huge discrepancies that the real meaning is not presented at all in the translation. It is a bigger problem that the latter can be said about the whole Act notwithstanding its language.

Analysis of regulatory obstacles on development of small- and medium sized enterprises in Serbia<sup>133</sup> determined labor relationship, social insurance, tax law, custom procedure and accessibility of public funds and permissions as fields being most important to be legally advanced. It emphasized that the problem is not the quality of the statutes themselves but in the way of their practical application.

However, there is strong reason to disagree with this approach. In light of the examined legal systems we can conclude that the problems do exist in the quality of Serbian law. Although it has harmonized approximately its whole company law with the EU standards it is shown to be more a literal acceptance of relevant provisions than real adaptation in accordance with the existing national opportunities. Strategy plans, action plans etc. (in this case the different titles cover the same) are only empty words without expert groups and cadre experienced in EU law. Fast steps taken by the legislator in order to keep the deadlines in EU-accession-procedure do not serve very much the country's long term interests. It is proven on high level if we compare the same articles in Germany and the United Kingdom with the Serbian ones.

Unfortunately, such negligent work is typical and instead of creation of Action plan on better rules the country should give the tasks to educated lawyers.

On the pages of the paper gaps in the Serbian Act on Business Companies were analyzed in general terms. Until not getting inside views of other more perfectly formed laws these defects are not apparent at first reading.

The Twelfth Directive leaves to the states' discretion to regulate penalties for non-compliance with particular provisions. Both Germany and the United Kingdom have done it almost in every possible article where the context required such sanctioning. Although the Serbian act

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<sup>133</sup> See MILAN LALOVIĆ & ZORAN SKOPLJAK FOR CENTAR ZA RAZVOJ PREDUZETNIČKOG DRUŠTVA [Entrepreneurial Society Development Centre], ANALIZA REGULATORNJIH PREPREKA ZA RAZVOJ MALIH I SREDNJIH PREDUZEĆA U SRBIJI [ANALYSIS of REGULATORY OBSTACLES on DEVELOPMENT of SMALL- and MEDIUM SEIZED ENTERPRISES in SERBIA] (2008), [http://www.prsp.sr.gov.yu/attachment/attachment/Analiza%20regulatornih%20prepreka%20za%20razvoj%20MSP%20u%20Srbiji\\_final.doc?id=565](http://www.prsp.sr.gov.yu/attachment/attachment/Analiza%20regulatornih%20prepreka%20za%20razvoj%20MSP%20u%20Srbiji_final.doc?id=565)

also contains solutions on this question those parts are applicable on the whole document generally (and on every type of corporations); but atypical nature of single-member companies would justify separate rules on this problem. It can be also said about the basic definition on business associations where the founders are only mentioned in plural. Adding 'one or more' before the 'natural and/or legal persons' can avoid this more academic question (as it was done in Germany and the UK). Alternative, UK-type resolution may be an extension of application of any article on one-man companies which articles are otherwise applicable on entities with more members. It can be very beneficial in such countries as Serbia where the rules on this concept are formed by simple translation of the Directive's relevant provisions without any thinking on possible consequences.

It is connected to the next issue, the issue of quorum. It is statutory regulated and necessarily covers situations with bigger membership; but such quorum is not adequate when there is only one member. Although it is only formality (and can be subject to different rules of articles of association) and in practice usually the management related requirements in single-member companies are not revered a constitutional state should request this level of perfectionism in its acts.

The other area is related to the pyramid structures that are allowed in Serbia; it is really dangerous in such country where basic values of business moral are not respected. Instead of overall elimination of chain of companies possible limitations should be introduced especially against abusive forms when pure shareholding in another company constitutes the company's all assets. An instable economy as the Serbian one cannot allow itself so big risk which is necessarily presumed in such structures without adequate regulation.

There are only few paragraphs (analyzed in the paper) that directly concern single-member companies and still they are 'low-class'; the other parts of the Act (having 457 articles all together) should be critically examined in same way to discover the statute's real effects.



Because of lack of control before its enactment necessary changes cannot be carried out time- and cost efficiently. This is the reason why so often in Serbia (as the case was with the Business Registers Act) the acts are amended immediately next year of coming into effect. The only question is if the legislator is so fast to react on improper rulings in other cases, why the Act on Business Companies is not treated in the same way. Transparent statutory provisions would avoid inconsistent interpretations especially in practice that directly affect legal security.

To sum up, the Serbian legislative body should 'borrow' experience from other in legal sense developed countries to make its own law more perfect and clear. The problem is that the gaps are not intentionally preserved to help people in evasion of law but it is result of the law-maker's negligent work that is more serious causing a country-wide effective trouble.

## APPENDIX

### 1. ENGLISH TRANSLATION of RELEVANT PROVISIONS of ACT on BUSINESS COMPANIES<sup>134</sup>

**Articles from 1 to 47** concern business corporations in general and because of that use of the term ‘company’ is not adequate.

#### **Article 12 - Liability for Obligations of Pre-incorporated Corporation**

(1) Founders and other persons are liable jointly with all of their assets for the obligations undertaken in relation to the establishment of the corporation, unless contracts with third parties who have claims on that basis provide otherwise.

(2) For the obligations referred to paragraph 1 of this article the corporation is liable jointly with the founders or other persons specified in paragraph 1 of this article if after registration assume these obligations in accordance with this law.

#### **Article 15 - Abuse of Legal Person**

(1) Limited partners of limited partnership as well as members of limited liability companies and shareholders of stock corporations may be held personally liable to third parties for obligations of the corporation if they abuse the corporation for illegal or fraudulent purposes or treat the corporation’s assets as their own as the corporation being legal person does not exist.

(2) Persons referred to in paragraph 1 of this article are responsible for the obligations of the corporation jointly.

(3) Liability referred to paragraphs 1, 2 of this article shall be determined by the competent court taking into account all the circumstances of abuse, but especially that the general principle of limited liability does not apply to cases from paragraph 1 of this article.

#### **Article 22 - Use of Business Name and Other Information in Documents**

(1) Business letters and other documents of corporation, including those in electronic form, which are addressed to third parties contain the following information: business name and legal form of corporation, registered office, registry where it is registered and the registration number of the corporation; business name and address of bank in which it has account, bank account number and tax identification number.

(2) Business letters and other documents of company with limited liability, closed- and open joint stock company, in addition to data from paragraph 1 of this article, contain information

<sup>134</sup> The official translation is available at

<http://www.apr.gov.rs/LinkClick.aspx?fileticket=EfO7DH6pvsE%3d&tabid=181&mid=733>; but some of the most important articles are attached in the author’s translation because of non-acceptance of the official version.

about the founding capital of the company indicating how much of it is paid in and subscribed.

(3) Business letters and other documents of single member limited liability - and joint stock company contain indication that it is single member company.

### **Article 33 - Duty of Loyalty**

(1) Persons referred to paragraph 1 of article 31 of this law, are obliged to act conscientiously and loyally toward the corporation.

(2) Persons referred to paragraph 1 of this article who have personal interest, are obliged in particular not to use the property of corporation in their personal interests, not to use beneficial information of the corporation for personal enrichment, not to abuse positions in the corporation for personal enrichment, do not use business opportunities of the corporations for personal needs, etc.. (Hereinafter: the duty of loyalty).

### **Article 37 - Consequences of Breaching the Rules on Conflicts of Interest and Competition Prohibition**

(1) Violation of conflict of interest and competition prohibition gives the company, in addition to right to damages right to:

1) recognize transactions made for self account by the breaching party as to be executed on behalf of the corporation,

2) any amount of money generated from activities conducted on behalf of the breaching person to be assigned to corporation,

3) all claims arising from activity performed on behalf of such person to be assigned to corporation.

(2) Rights that corporation has on basis of violations of conflict of interest and competition rules may be performed by corporation and general partner, member or shareholder who has or represents at least 5% of company capital, within 60 days of discovery of the committed violation, or three years from the date of violation.

### **Article 136 - Definition and competence [of general meeting] General provisions**

(1) Members of limited liability company compose the general meeting.

(2) In limited liability company with one member that member or authorized person exercises the powers of general meeting.

(3) After adoption of decisions within the competence of general meeting of limited liability company member of limited liability company in paragraph 2 of this Article prepares and signs minutes and the taken decisions records in the book of decisions.

(4) Agreements between member referred to paragraph 2 hereof and the company must be in written form or entered in the book of decisions, unless in case of current operations concluded under normal conditions

### **Article 143 - Proxy**

(1) Member of company may appoint any other person to vote for him in general meeting by

signing a written power of attorney, unless provided otherwise in the Articles of Association or company agreement.

(2) Member of limited liability company may neither be represented in the general meeting by proxy who would have only part of his voting rights, nor give attorney in law to more persons.

(3) Legal representatives of natural persons and representatives of legal entities in their own companies represent without authorization with respect to paragraph 1 of this article.

(4) Power of attorney is given for one session of general meeting, including the repeated meeting.

(5) Director or members of the Board of limited liability company may not be proxies of members who are employed in the company and related persons to them within the meaning of this law.

### **Article 151 - Book of Decisions**

(1) Decisions adopted in general meeting of members of limited liability company shall be entered into a separate book of decisions without delay.

(2) Decisions referred to paragraph 1 of this article are valid from the date of issuance, unless provided otherwise in the Articles of Association or company agreement.

### **Article 366 - Definition and Types [affiliated corporations]**

(1) "Affiliated corporations" in this Law mean two or more corporations which are linked either:

- 1) by ownership of shares or partnership interests (corporations linked by share in capital);
- 2) by contract (corporations linked by contract); or
- 3) by both capital and contract (mixed affiliated corporations).

(2) Affiliated corporations as defined in paragraph (1) of this Article include one controlling (dominant) corporation and one or more dependent corporations.

(3) Affiliated corporations (by capital, contract or mixed) are organized as concerns, holdings, business groups or other organizational forms in accordance with provisions of this Law.

(4) Affiliated corporations are organized as concerns when the controlling corporation has any business activity being its dominant activity besides the management of its dependent corporations.

(5) Affiliated corporations are organized as holdings when the dominant corporation's exclusive business activity is management and financing of the dependent corporations.

(6) Affiliated corporations organized as business groups when the controlling corporation's business activity includes activities referred to in both paragraphs (4) and (5) of this Article.

(7) Linking of corporations in violation of laws governing protection of competition is prohibited.

### **Article 367 - Control by shares in capital**

(1) Controlling member of limited liability company or controlling shareholder of stock corporation in terms of this law is the person who alone or together with other persons (collective action):

- 1) has more than 50% of voting rights in the company, which means ownership and voting rights of more than 50% of ordinary shares in stock corporation (majority share)

2) otherwise exercises controlling influence over management and conduct of company affairs by virtue of his status being member or shareholder (or on contractual basis in accordance with this law).

(2) The person who alone or with one or more other persons has more than 20% of the votes in the general meeting has significant participation in terms of this law.

## 2. ENGLISH TRANSLATION of RELEVANT PROVISIONS of **BANKRUPTCY ACT<sup>135</sup>**

### **Article 135. - Sale of bankruptcy debtor as legal entity**

Subject of sale may be the bankruptcy debtor as legal entity, with the consent of the creditors' committee and with prior notification of secured creditors in accordance with paragraph 2 of article 133 of this Act. In case that the liquidator does not adopt the proposal of secured creditors on a more favorable way of property's encashment referred to paragraph 5 of Article 133<sup>136</sup> of this law, the bankruptcy judge will decide about the proposal by resolution within 5 days, especially taking into account the suitability of bankruptcy debtor's sale as legal person referred to paragraph 2 of article 132<sup>137</sup> of this law, and whether the valuation of the bankruptcy debtor as legal person or property being subject to security is performed in accordance with national standards for the management of bankruptcy estate and whether such sale achieves obviously unfavorable settlement of secured creditor in comparison with separate sale of property. In case of adoption of secured creditor's proposal bankruptcy judge may order the liquidator to take one or more of the following measures:

- 1) adjournment of sale;
- 2) new estimation of suitability referred to paragraph 2 of Article 132 of this law or the valuation either of the bankruptcy debtor as legal person or of property which is subject to security;
- 3) separation of secured property from the assets of bankruptcy debtor being sold as legal entity, and separate sale;
- 4) other measures in order to provide adequate protection of secured creditor's interests.

Before sale of the bankruptcy debtor as legal person, liquidator is required to estimate its value.

Sale of the bankruptcy debtor as legal entity can not be done contrary to the provisions of the law governing the protection of competition, and the authority responsible for the protection of competition acts with particular urgency in shortened procedure.

### **Article 136. - Consequences of Sale of Bankruptcy Debtor as Legal Person**

After sale of bankruptcy debtor as legal entity, bankruptcy proceeding is suspended in relation to the bankruptcy debtor.

Contract on sale of the bankruptcy debtor as legal entity must contain provision that the property of the bankruptcy debtor that was not subject to estimation referred to paragraph 2 of article 135 of this law enters in the bankruptcy estate.

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<sup>135</sup> There is no official English translation of the Serbian Bankruptcy Act.

<sup>136</sup> Article 133, Procedure of sale

<sup>137</sup> Article 132, Way of encashment

Money obtained from sale of bankruptcy debtor as well as assets of the bankruptcy debtor referred to paragraph 2 of this article enters in the bankruptcy estate and bankruptcy proceedings in relation to the resulted bankruptcy estate continues.

Bankruptcy estate is registered in the registry on bankruptcy estate kept by authority responsible for keeping the registry of business entities and it is represented by the liquidator.

The authority referred to paragraph 4 of this article maintains the registry on bankruptcy estate via Registrar of bankruptcy estate.

Provisions of law regulating the registration of business entities are also applicable on the conditions and procedure of Registrar's appointment, as well as its powers and obligations, unless provided otherwise in this Act.

In case when the bankruptcy debtor is sold as legal entity, secured creditors who had security on any part of the bankrupt's property have priority right in the division of assets achieved by sale, according to the priority they have acquired in accordance with the law, and in proportion to the estimated participation in the property's value which property is subject to security in relation to the estimated value of the legal entity.

For claims against bankruptcy-debtor arising before suspension of bankruptcy proceeding neither bankruptcy-debtor nor its vendee are liable to the creditors, and legal entities providing services of general interest for the bankruptcy debtor can not suspend the performance of these services because of unpaid bills incurred before opening of insolvency proceedings.

Changes (of legal form, founders, members and shareholders and other data) on the basis of contract on sale of the bankruptcy debtor as legal entity are registered in the registry of economic entities and other relevant registries, in accordance with the law regulating registration of business entities.

Government shall prescribe the content and method of recording and keeping the registry of bankruptcy estate, as well as the type and amount of fees for registration and other services provided by the authority responsible for maintaining the registry.

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