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Adaptation of Lithuanian Close Company Law to EU Law: Problems and Lessons Learned

On 1st of May 2004 Lithuania became an EU Member State, together with nine other countries. EU membership had a huge influence on many areas of legal regulation in Lithuania. Lithuanian company law was not an exception. This impact was enhanced by the fact that statutory regulation of companies in Lithuania did not have old traditions. The respective legal forms of companies have been introduced and regulated just in the year 1990, following Restoration of Independence of the Republic of Lithuania. This statutory regulation has been reformed several times, considering both: developments within the domestic business environment, as well as trends of the European company law.

The presentation involves the assessment of the impact of the EU membership on regulation of Lithuanian close companies. In other words, it tries to identify whether it encouraged the improvement of Lithuanian company law or maybe it was only an irritant for national legislator, as well as to present the Lithuanian experience and lessons learned. Due to a limited scope, the presentation involves only close (private) company regulation, because the

EU Member States had more flexibility in this area.

Without a doubt, the greatest impact on close (private) company regulation was made by the need to harmonize the Lithuanian legislation with EU legal acts. Although the EU Company Law directives were mainly addressed to public companies, but some provisions had impact on private company regulation, for instance, refusal of the prohibition to purchase company's own shares, the mandatory annual audit in large private companies or company's financial aid for acquisition of its shares. Other initiatives were related with implementation of the Shareholder Rights Directive (2007/36/EC), which mainly aims to ensure the proper realization of shareholder rights to participate and vote in the meeting of shareholders using electronic means of communication. Another effect was that after Lithuania's accession to the EU the list of active Lithuanian commercial legal entities was supplemented by the European supranational corporate forms: European Economic Interest Group, European Company and the European Cooperative Society.

The presentation also involves the issue of establishment of the entities by elec-

tronic means, which was likely to have been caused by Directive 2009/101/EC and European Commission's initiatives on reduction of the costs and administrative burdens for the foundation of companies and promoting cross-border establishment. Unfortunately, existing on-line registration in Lithuania does not mean real cross-border registration yet, because some technical issues should be solved, together with other Member States.

Because of EU membership the Lithuanian legislator had to take into consideration the European trends and actualities: practice of the European Court of Justice regarding free movement (corporate mobility), horizontal regulatory competition between EU Member States and the European Commission's initiatives in the field of private companies regulation, such as the European Commission's proposal (2008) on the Statute for a European Private Company (*Societas Privata Europaea, SPE*) and the proposal (2013) for a Directive on Single-Member Private Limited Liability Companies (*Societas Unius Personae, SUP*). One of main issues, which have to be addressed in this field – the issues of minimum capital requirement for private limited liability companies. Attempts to reduce the limit failed, but in Lithuania this issue was partially solved by presentation (since 1 September 2012) of a new private entity form – a small partnership – with limited liability and no minimum capital requirements. However, this theoretical model of a vehicle for small and medium-size business in Lithuania proved not to be effective in practice, mainly because of the tax aspects.

In summary, EU membership resulted in improvement of Lithuanian close companies' regulation – Lithuanian legislator is monitoring trends in the European company law, with the inclusion of innovative legal provisions as well.

Chronology

July 1990 – the first Law on Companies (Lith. – *Akcinių bendrovių įstatymas*, abbreviation: *ABI*).

July 1994 – 1994 ABI reform.

December 1995 – official application for EU membership. Under the Commission's opinion as of July 1997, Lithuania was not been assessed as ready to join.

April 1998 – amendments of ABI.

The preparation of the new law started already in 1998, when implementing the measures of the programme for Lithuania accession to EU (national programme for the adoption of the *acquis*), in order to improve and modernize the Lithuanian law on companies and achieve full harmonization thereof with the business law of European Communities, at the same time, seeking to solve problems in the application of this law.

December 1999 – invitation to start negotiations.

July 2000 – 2000 ABI reform – the new ABI was adopted on 13/07/2000 and came into force on 01/07/2001 (*2000ABI*).

December 2002 – official end of negotiations.

July 2003 – 2003 ABI reform – came into force on 01/01/2004 (*2003ABI*). Those changes mitigated many requirements related to *UAB*.

1st of May 2004 – Lithuania became an EU Member State.

Lithuanian close company BEFORE Private limited liability company (Lith. – *uždarojiakcinė bendrovė*, abbreviation: *UAB*; hereinafter referred to as *UAB*).

It was (and is) the most popular legal form of business organization in Lithuania.

Such popularity of *UAB* is mainly determined by its:

- assumed flexibility,
- comprehensive statutory regulation,
- limited civil liability of shareholders,
- lower amount of required minimum share capital,
- simplified procedure for transferring shares,
- clear structure of company's management and possibility to choose from a wide range of management structures, etc.

On 08/05/1990 the Law on Enterprises of the Republic of Lithuania was adopted (it remained valid until the 01/05/2004) which listed companies, i.e. [other] private legal entities, that can be established in Lithuania:

- individual (personal) company (Lith. – *individuali (personalinė) įmonė*, abbreviation – *IĮ*),
- general partnership (Lith. – *tikroji ūkinė bendrija*, abbreviation – *TŪB*),
- limited (trust) partnerships (Lith. – *komandinė ūkinė bendrija*, abbreviation – *KŪB*),
- public limited liability company (Lith. – *akcinė bendrovė*, abbreviation – *AB*),
- Under the amendments of 01/06/1993 – cooperative society (cooperative) (Lith. – *kooperatinė bendrovė* (*kooperatyvas*)).

– Under the amendments of 05/07/1995, another new form of incorporation – an investment company (Lith. – *investicinė bendrovė*), was added to the list of enterprises. This form lost its validity after the adoption of the Law on Collective Investment Undertakings of the Republic of Lithuania as of 25/07/2003. Investment companies were not recognized as a separate form of legal entity – they were acting as public limited liability companies.

Main features of *UAB*'s regulation BEFORE membership (negotiation process):

1) Statutory prohibition of public stock trading (Article 2(4) of 1990 *ABI*).

2) It seems that the developers of 1990 *ABI* applied both models of ensuring of closed (private) nature (*intuitu personae*) of regulation of private company:

a) Statutory limitation on the number of shareholders – not less than 2 and no more than 50 (now – up to 249); however, while calculating the maximal number of shareholders, the law allowed an exclusion of permanent employees of the company (Articles 2(4), 4(1) of 1990 *ABI*);

b) Consent clause – if it is determined in the articles of association (now – pre-emption rights) – it may determine the necessity of **consent of the Board** to transfer the registered shares (Article 34(2) of 1990 *ABI*), i.e., the incorporators were able to choose one of the most commonly used systems of restrictions on share transfer in private companies – so called **consent clause**. Thus, control of the right of per-

sonal choice (Latin *delectus personae*) can be assigned to the shareholders remaining in the company, and by using this right they can protect themselves from unwelcome outsiders.

3) Minimum authorized capital (since 1994 to 2015—approx. EUR 2,896; since 2015 – EUR 2,500). In 1990 ABI the minimum size of the required authorized capital was not established.

4) ‘Mixed’ system of corporate structure:

– The bodies of the company management were named as follows: **the general meeting of shareholders, the supervisory board, the management board**

– The general meeting of shareholders of *UAB* can decide not to set up the management board at the same time transferring its functions to the head of the company’s administration and general meeting of shareholders (such possibility was not allowed in the case of public limited liability companies (*AB*)), we can assume that **the head of the company’s administration has been considered as the management body**, although this has not been explicitly stated in the law.

– The supervisory board may be not formed.

5) Requirement to have an elected auditor

6) Prohibition for company to purchase its own shares

Harmonization

Mainly the EU Company Law directives were addressed to public companies, but some provisions had impact on *UAB* regulation.

Some influenced changes before official invitation to start negotiations:

– **Twelfth Company Law Directive 89/667/EEC** on single-member private limited-liability companies

– **Cancelled requirement for the minimum number of shareholders (1994 ABI).**

Cancelled requirement of detailed definition of the company's business activities:

– **Second Company Law Directive 77/91/EEC**(Article 2(b))

– The requirement to specify all possible economic activities in the articles of association was revoked – only the nature of economic activity is sufficient (*2000ABI*). Thus, the shareholders themselves could decide on the detailed definition of the company's business activities in the articles of association thereof.

Mandatory annual audit

– **Fourth Company Law Directive 78/660/EEC** (together with Eighth Directive –*the Accounting Directive*)

– The requirement for each company to have an elected auditor was revoked; however, companies were left the possibility to provide such control body in its articles of association (Article 37(1) of *2000ABI*).

– Equally important change was the determination of the mandatory annual audit in large *UAB*(Article 60(2) of *2000ABI*) – in 2003 limits (amount of the assets and income limit of sales)were increased twice – audit is required only in those *UAB*, which meet at least two of the following criteria:

a) the net income of sales exceeds 10 million Lithuanian Litas during the fiscal year (since 01/07/2015 – 3.5 mill. EUR);

b) the value of assets indicated in the balance sheet exceeds 5 million Lithuanian Litas (since 01/07/2015 – 1.8 mill. EUR);

c) the average number of employees during the financial year exceeds 50.

Purchase of company's own shares

– **Second Company Law Directive 77/91/EEC** (Article 19)

– The prohibition to purchase company's own shares applied to *UAB* was refused (Article 55 of 2003 *ABI*).

Establishment by electronic means

– **Directive 2009/101/EC** (before 21/10/2009: **First Council Directive 68/151/EEC**)

– In order to reduce the administrative burden related to establishment and registration of *UAB*, the idea to establish *UAB* electronically was implemented (2009). It was the first necessary step in providing the opportunity to reject mandatory notarial confirmation of documents of *UAB* establishment and other documents submitted to the Register of Legal Entities, if these documents conform to confirmed model documents of *UAB* establishment. However the actual opportunity to provide documents of *UAB* establishment electronically was accessible when the Registry keeper installed the information system on 03/11/2010. Firstly, one could establish *UAB* with only one founder electronically, but later, when the Ministry of Economy confirmed the model form of *UAB* establishment agreement on the 16/12/2010, such opportunity was provided to several founders.

Improvement of shareholders rights – Shareholder Rights Directive (2007/36/EC)

– *ABI* amendments in 2009:

– The provision established under amendments of the 17/07/2009 gave the right to shareholders to participate directly in the meeting of shareholders and to vote using electronic means of communication,

– right to submit questions for company in advance which are related to the agenda of shareholder's general meeting and the company is obliged to answer to them until general meeting (Article 16¹).

– The amendments of 15/12/2009 also regulated particular alterations of shareholders pre-emption right to acquire the shares of the *UAB* being sold. These amendments show the tendency to give more freedom for *UAB* shareholders to regulate interrelationships at their own discretion.

Financial aid

– **Directive 2012/30/EU** (Article 25)

– **New provision** (05/06/2014 *ABI* amendments): financial aid is permitted:

- **for financial organizations**
- **for companies when its shares are acquired by its employees**

Minimum capital requirement

Influence:

1. Free movement (corporate mobility) – right of freedom of establishment

– **ECJ practice:** *Centros* (1997), *Inspire Art* (2003), *Uberseering* (2005), etc. – the result of this activist jurisprudence from the ECJ is that there is now a considerable measure of **corporate mobility within the EU**.

A practice had developed of businesses from other Member States incorporating in the UK, driven by the absence of minimum capital requirements for private companies and the speed, ease and low cost of incorporation. This practice was not welcomed by the 'home' Member States. The Court has struck down various efforts by individual states to impose their rules of corporation law on firms operating locally but incorporated in other member states.

So once incorporated in Member State A:

1) that company must be recognised as such in all other Member States, even if it conducts no business in the state of incorporation (*Umberseering*);

2) that company can choose to operate in another Member State either through a subsidiary, branch or agency (*Centros*);

3) where the choice is to act through a branch, Member State cannot impose obligations on the branch equivalent to those imposed to businesses incorporated in the Member State (*Inspire Art*).

2. Horizontal regulatory competition

– More recently, among the EU states a certain degree of *regulatory competition* has been inspired by decisions of the ECJ. Some Member States have moved to liberalise their domestic requirements and speed up their formation processes **in order to compete**.

– First way: Reduction or elimination of the minimum capital requirement (MCR) for private companies- in 2011 the average MCR was EUR 7,000 with the median EUR 3,000. Since 2003, MCRs have been reduced in 10 Member States. However, in 5 countries only EUR 1 has to be paid as MCR (e. g. the UK, Ireland, Cyprus, France (2003) or Germany).

– Second way: In addition, some countries have introduced new legal forms for start-ups with no or EUR 1 MCR

– since 2009, German *Unternehmergesellschaft (UG or Mini GmbH)* with a EUR 1 MCR

– in France – *SAS* (2003)

– in Spain – *S. L. N. E.*

3. The European Commission's initiatives on private companies:

– In June 2008, the European Commission published its proposal on the Statute for a European Private Company (*Societas Privata Europaea, SPE*). However, due to a failure to reach the Member States' consensus on the *SPE* Statute the Commission has already abandoned its proposal on *SPE* (in October 2013).

– In its first draft (2008) – EUR 1 MCR for *SPEs*

– The last version (2011) of the *SPE* Statute (Article 19(3)) states that: the Member States have the right to set a higher MCR for *SPEs* registered in their territory, however, it should not exceed EUR 8,000.

– in April 2014, the Commission published its Proposal for a Directive on Single-Member Private Limited Liability Companies, which would provide an EU-wide set of harmonised rules for single-member private limited liability companies and would result in appearance of national legal form of company called *Societas Unius Personae (SUP)* with the minimum capital requirement of at least €1, or at least one unit of the national currency in Member State in which this is not the euro

– latest amendments in the SUP Proposal: Member States may require the SUP to build up legal reserves as a per-

cent age of the profits of the SUP and/or up to the amount of minimum share capital required for national private limited liability companies.

– first issue for Lithuanian legislator would be to decide whether to present a radically new legal form for single-member private limited liability company or to introduce a sub-type of existing *UAB* with special rules on the issues regulated by the SUP Directive and with the possibility to re-register as an *UAB*.

Lithuanian strategy:

– **Failed attempts to reduce the MCR (2009 and 2012). Up to LTL 1000 (app. EUR 290).** The Ministry of Economy argued this by the aim to **facilitate business conditions**, to **promote the establishment of companies** and to **make *UAB* more attractive legal form for small and medium-sized businesses**; the European Commission proposed to set the 1 euro MCR to the SPE and considered the requirements of minimum capital in respect of *UAB* as **additional difficulties for electronic registration of companies**; the **tendencies of the «decapitalization» idea** of certain business entities emerging in Europe, the **freedom of establishment** recognized by EU and the fact that today the authorized capital of the closed-type companies basically **no longer performs the function of creditor protection** and function of information about the company's solvency.

– **Presentation of new form – *Small partnership* (2012):**

– Its introduction to the legal system of Lithuania was significant when dealing with some issues of *UAB* regulation significant to small and medium business and

providing flexible form of business organization.

– This form of incorporation is not deemed to be a company, but a certain form of partnership.

– **No MCR**

– **Limited liability**

– **More flexible regulation**

– In fact, the adopted law had some restrictions in connection to the number and status of the members (**maximum 10 physical persons could be the members**).

– as well as *UAB* can be established **electronically**, using **confirmed model forms** of the documents of establishment.

– **More flexible and simpler management system.** In the provisions of the small partnership, one can choose one of two management systems according to particular needs (Article 12 of *MBJ*): either **to have only the meeting of members of the small partnership**. Unlike in *UAB*, where the employment agreement is subject to mandatory conclusion with its manager, the **civil (service) contract is concluded with manager** of the small partnership.

– **BUT:** This theoretical model of a vehicle for small and medium-size business in Lithuania proved not to be effective in practice, mainly because of the tax aspects (since 2015 – a duty to pay monthly state social insurance contributions).

Instead of conclusions

– EU membership resulted in improvement of Lithuanian close companies regulation- Lithuanian legislator is monitoring trends in the European company law, with the inclusion of innovative legal provisions as well.

– **Strengths: Lithuania is possibly among those jurisdictions where incorporation of a *UAB*, in particular a single-member *UAB*, is the easiest. Incorporation of a small partnership is even simpler.**

1) New possibility for SMEs – *small partnership (SP)*. To pursue business activities in the form with limited civil liability, to choose between ordinary *UAB* and simpler and more flexible *SP*.

2) Incorporation costs are not very high compared with other EU Member States. While **the amount of MRC** (EUR 2,500 for *UAB* and no MCR for *SP*) **is among the smallest in Europe**

3) **Establishment by electronic means** – Payment of notary's fees, however, can be avoided by forming a *UAB* or a small partnership electronically.

4) The incorporators can save costs of legal services by using the approved forms of **model incorporation documents**

– **Evidence:**

– Newly incorporated *UAB* numbers continuously increased with each year (during 2004 – 2918 *UAB*) and reached the top in 2012 – 10902 *UAB* was established. However over the year of 2013 (i.e. after emergence of the small partnership as a form of legal entities) latter number decreased by more than a quarter – only 7977 incorporated *UAB* per year and 7962 during 2014. The appeal and competitiveness

of the new form is represented by rapidly increasing number of registered small partnerships and notably decreasing number of new *UAB*. The number of incorporated **small partnerships** during the 4th quarter of the year 2012 was equal to 124, **during year 2013 – 2713** and during three quarters of 2014 – 2584.

– Impressive leap in *Starting a business* rank (189 countries evaluated): **from 107** (World Bank Group *Doing Business 2013*) **to 11** (*Doing Business 2014* and 2015) **and to 8** (2016)¹ (**from 189**) – mainly, because Lithuania made starting a business easier by **creating a new form of limited liability company with no MCR**; also by **introducing online registration** for limited liability companies and eliminating the notarization requirement for incorporation documents.

2014: Procedures (number) – 4. Time (days) – 6.5. Cost (% of income per capita) – 0.9. Min. capital (% of income per capita) – 0.0. **2015:** Procedures (number) – 3. Time (days) – 3.5. Cost (% of income per capita) – 0.7. Min. capital (% of income per capita) – 0.

2016: Procedures (number) – 2. Time (days) – 3.5. Cost (% of income per capita) – 0.6. Min. capital (% of income per capita) – 0.0.

¹ Lithuania made starting a business easier by introducing online VAT registration.