LAW ON BUSINESS COMPANIES

1.17

WHITE BOOK BALANCE SCORE CARD

Recommendations:	Introduced in the WB:	Significant progress	Certain progress	No progress
Limited liability partnerships (LLPs) should be prescribed by the Company Law	2013			√
The provisions in the Company Law that deal with limitations to the authority of a company's representatives should be harmonized with the provisions of the Law on Contracts and Torts.	2011			√
Common practical issues should be resolved, such as regulating members' additional payments, the reduction of the value of the share, etc.	2018		√	
Clearly defining reasons for lifting the corporate veil.	2018			√
Corrections of technical flaws in the Company Law should be made to eliminate inconsistencies and provide clear procedures and competencies.	2013			√
The increase in the share capital through debt-to-equity swap (conversion) should be clearly regulated.	2016			√

CURRENT SITUATION

The Law on Companies (RS Official Gazette Nos 36/2011, 99/2011, 83/2014, 5/2015, 44/2018 and 95/2018) (hereinafter: the Company Law) came into force on 4 June 2011 and is applicable as of 1 February 2012.

The Company Law is a step further in harmonizing Serbia's corporate legislation with that of the EU, primarily with its directives and with the latest solutions in the comparative law of countries with developed market economies. According to a Screening Report of the EU Enlargement Working Group at the beginning of 2015, the Republic of Serbia achieved a good level of alignment with the EU acquis in the area of the Company Law.

Now, after more than seven years of the implementation of the Company Law, we can conclude that its main characteristics are:

- application of standards harmonized with EU legislation;
- harmonization with the Law on the Capital Market;
- certain problems that were a characteristic of the previous Law have been resolved;
- precise determination of certain legal concepts;
- the distinction between joint-stock companies and other forms of business organization and
- single-tier and two-tier management systems.

However, despite the progress made in these fields, the necessity for further adjustments of the Company Law is indisputable, so that it can meet the needs of the market and market participants.

The latest amendments to the Company Law came into force on 10 December 2018. This time the Company Law in its latest provisions defines and explains in a more precise manner that all documents (e.g. all kinds of legal transactions, agreements/contracts that are carried out or concluded by a company) are valid and cannot not be made null and void or objected to in court proceedings if a company's stamp was not used or put on them. In addition, in order to foster good corporate governance, the Company Law introduces a new article which only applies in the case of an open joint-stock company. Thus, an open joint-stock company is obliged to make available on the company's website the following accurate and up-to-date information: the profession and previous positions of the members of a board of directors/supervisory board and the information regarding their current membership in other boards or positions they may have in other companies as well.

At the moment of publishing of this text, the public consultations on the amendments to the Company Law were completed and those amendments propose the introduction of a new financial instrument - the right to acquire a share issued by a limited liability company and a reserved own share, as a new legal institute, for the purposes of issuing this financial instrument.

This is a special form of stimulation and motivation, by giving employees, management and third parties (investors, consultants, etc.) the opportunity to gain participation in the capital of a company.

The new financial instrument is non-transferable, issued by the limited liability company, and gives the consenting holder the right to acquire a share on a particular day at a certain price.

It was also suggested that employees of limited liability company and joint stock companies participate in the distribution of profits, as well as to increase the percentage of own shares that the company can distribute to employees and members from 3% to 5%.

However, as these amendments have not yet entered into force, we will be able to comment on them in the next edition of the White Book.

POSITIVE DEVELOPMENTS

The Company Law introduced a number of developments in Serbia's legal system, among other, changes in the regulation of the corporate governance system. Both limited liability companies (LLCs) and joint stock companies (JSCs) may now choose to have either a single-tier (shareholders' assembly and directors) or two-tier (shareholders' assembly, supervisory board, and directors) corporate governance structure. Also, the provisions on the initial capital were amended, so that the initial capital may now be denominated only in RSD. The minimum initial capital requirement is now set at RSD 100 (instead of EUR 500 in RSD equivalent, as prescribed by the previous Company Law). A limited liability company (LLC) may now be registered with the Serbian Business Registers Agency (SBRA) even before the initial capital has been paid in. The possibility has been introduced for shareholders to make additional payments without raising their stakes in the company. Parties are free to stipulate the jurisdictions of other courts, as well as arbitration bodies. A new set of rules has been introduced for squeeze-out and buy-out procedures. The total value of a company's own shares, which a company can keep after the expiration of three years from the date of acquisition, may not exceed 20% of its share capital, with respect to closed joint stock companies, while that threshold is 10% of their share capital for an open joint stock company. These are just some of the changes which have significantly affected the functioning of Serbia's economy.

Banks and the SBRA have eased requirements, thus facilitating a smoother company registration process.

There have been some positive developments in the practice of the SBRA as well, which can now be described as stable, and in particular the positive practice of publishing guidelines in dealing with certain situations which are not sufficiently clearly regulated under the Company Law.

These recent amendments to the Company Law should solve some of the problems pointed out in the previous year, in particular issues related to the institute of enforced liquidation, the situation when a company is without a director, as well as the situation when the procurator's authority is limited by requesting a co-signature. Also, the latest amendments enabled the establishment and operation of the European Company (Societas Europaea) and the European Economic Interest Grouping (EEIG), in accordance with the Statutes of the European Economic and European Economic Interest Groupings, and also envisage cross-border acquisitions and mergers.

We would also like to point out improvements concerning decision-making procedures by a limited liability company's (LLC) general assembly, i.e. concerning the number of voting general assembly members, as well as the adoption of a decision at a repeated session of a two-member LLC when one member is absent, in which case the other member has the right to sign the decision.

REMAINING ISSUES

Although the Company Law was amended to fix a few technical errors, it still contains a certain number of technical flaws that are likely to cause confusion in their application. Certain general provisions contained in the first section of the law titled "Initial Provisions" are not fully aligned with the more specific provisions contained in the section of the law dealing with the particular form of a company. As a result, in some cases the corporate bodies' authorities and the procedures they must follow still remain somewhat unclear.

One of the concepts introduced by this Law is "lifting the corporate veil." When stating the reasons for the application of the related provisions, legislators made a clumsy formulation creating a dilemma on whether those reasons are the only applicable ones or are given exempli causa.

Other inconsistencies of the Law include the provision prohibiting a single-member LLC from acquiring own shares, which is contrary to the Company Law's provisions on status changes. Also, the FIC pointed out the need for changing the Company Law, Article 150 in particular, in order to avoid interpretations of the Law according to which the value of a share cannot be reduced, so an explicit prescription of this possibility would be a significant improvement.

Another issue to be underlined is the increase in a company's share capital through a debt-for-equity swap, provided by Article 146, paragraph 1, item 3 and Article 295. Specifically, the Company Law does not provide a precise explanation in terms of the procedures and conditions of such a swap, and this should certainly be regulated.

Article 295 prohibits debt-for-equity swaps in public joint-stock companies, which is contrary to Article 67, paragraph 4, item 3) of the Law on Tax Procedure and Tax Administration, for which reason it is necessary to harmonize these two laws. Furthermore, the SBRA's practice on this matter is not uniform.

An issue that still remains unresolved is the situation when a shareholder leaves a company and the additional payments he made are not paid back to him, when this issue is not regulated in the share transfer agreement.

Also, provisions governing the obligation to repay payments to members of a limited liability company, regulated by Articles 185 and 275 of the Company Law are inconsistent. In fact, Article 185(2) envisages that a bona fide company member may only claim the return of payments if this is necessary to settle the claims of the company's creditors, while Article 275(4) allows for this possibility only if a shareholder knew or ought to have known that such a payment was made in violation of the provisions of this Article, which clearly reveals the need for harmonizing these provisions.

The provisions of the Company Law restricting the powers of representatives to represent the company are still inconsistent with the relevant provisions of the Law on Contracts and Torts, which is sedes materiae for this area.

Another disadvantage of the Company Law is the absence of the concept of limited liability partners in a partnership. The existence of such a concept would be particularly relevant for partners in professional partnerships, since they should be allowed to enjoy limited liability protection, while third parties' risks could and should be covered by liability insurance. The FIC has noted this deficiency and emphasized the necessity of change as described.

The currently applicable Company Law can be considered as a big step forward because it introduces several new concepts and regulates certain matters differently, however, issues still exist, imposing the need for change. The effects of new Law Amending the Company Law are yet to be seen in the forthcoming period. Also, endeavours are still necessary to eliminate inconsistencies between the Company Law and the various other laws regulating business operations, finance, securities, real property, and other related areas.

FIC RECOMMENDATIONS

- Limited liability partnerships (LLPs) should be prescribed by the Company Law.
- The provisions in the Company Law that deal with limitations to the authority of a company's representatives should be harmonized with the provisions of the Law on Contracts and Torts.
- Common practical issues should be resolved, such as regulating members' additional payments, the reduction of share capital of a single-member limited liability company, etc.
- Clearly defining reasons for lifting the corporate veil.
- Corrections of technical flaws in the Company Law should be made to eliminate inconsistencies and provide clear procedures and competencies, harmonizing provisions within the Law itself.
- The increase in the share capital through debt-to-equity swap (conversion) should be clearly regulated.