# LAW ON 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 share capital of a single-member limited liability company, 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, harmonizing provisions within the Law itself. | 2013 | | √ | |
| The increase in the share capital through debt-to-equity swap (conversion) should be clearly regulated. | 2016 | | | √ |

## CURRENT SITUATION

The Companies Law ("Official Gazette of the Republic of Serbia", Nos 36/2011, 99/2011, 83/2014, 5/2015, 44/2018, 95/2018, 91/2019 and 109/2021) ("Law") came into force on 4 June 2011 and is applicable as of 1 February 2012.

By signing the Stabilization and Association Agreement with the European Union, the Republic of Serbia undertook the obligation to harmonize its domestic law with the EU acquis. Within the negotiations on the accession of the Republic of Serbia to the EU, Chapter 6 – Law has a special role, which includes issues of establishment and operation of companies in EU member states, in accordance with which the Republic of Serbia would be provided with better business conditions on the EU market, simplified procedures and the possibility of establishing new forms of economic entities. The Law is an indicator of progress in harmonizing the legislation of the Republic of Serbia with the EU acquis, which is important for the process of integration of the Republic of Serbia into the EU.

The main characteristics of the Law 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 regulation have been resolved;
- the distinction between (public) joint-stock companies and other forms of business organization and;
- single-tier and two-tier management systems.

The latest amendments to the Law were in November 2021 which is the seventh time the Law undergoes changes since it was enacted ten years ago. These latest amendments introduced various changes, such as:

- Each company must register for use of e-government services.
- The companies may have only legal entities as directors.
- Provisions on approving the transactions involving personal interests contain more details and duties.
- There are new (confusing) provisions in relation to the (i) agreement between the company and a new shareholder regarding the share transfer, and (ii) nullity of share transfer agreement (as explained below in more detail).
- More information must be registered in relation to the company's seat.
- For all individuals registered in the companies' registry (director, shareholder, member of the supervisory board, etc.) gender is mandatory as registration data.
- Each joint stock company must provide to a shareholder, who initiated litigation procedure against the company based on legal grounds provided by the Law, the information related to the court case (even if in ordinary course of dealings such information would not be available to such shareholder).
- The total remuneration of the director (of a joint stock company) includes salary or other remuneration provided in employment/management agreement and may

include the right to incentives through the allocation of shares of the company or another affiliate of the company. Also, the shareholders holding at least 5% of the share capital are now entitled to access the documents and data on the amount and structure of the total remuneration for each director and member of supervisory board.
- The public joint stock companies are now obliged to prepare the policy which will in detail regulate the fixed and variable parts of compensations to directors and supervisory board members. Such policy is to be adopted by the shareholders meeting, and any payments must be made in accordance with that policy. Additionally, the detailed report on the compensations to directors and supervisory board members must be part of the annual financial statements of the company, is subject to audit and must be publicly available for at least 10 years.

## POSITIVE DEVELOPMENTS

There are no improvements in terms of fulfilment of the recommendations published in last year's White Book, but there are some improvements as a result of the latest amendments to the Law. This mainly relates to the following:

- So far, companies were obliged to have at least one natural person performing the function of director. Now, this requirement is no longer applicable, and the companies may have only legal entities as directors.
- If the owner of the premises has not consented to the registration of the registered seat of the company at its premises, the owner is entitled to file a lawsuit requesting deletion of the registered seat address of such company. If the company does not register a new proper address within 30 days following the final court ruling accepting the owner's claim, the companies' registry shall be entitled to initiate a compulsory liquidation procedure over such company. This novelty has obvious aim to address the problems which occurred in practice involving false addresses and addresses at locations without the consent of the owner.
- It is worth mentioning that earlier amendments introduced the:
- institute of reserved own share of an LLC which, in a nutshell, allows companies to give to employees the right to acquire a share in the company. More specifically, the right to acquire share, which is a non-transferable financial instrument, gives the consented holder (does not have to be an employee) the right to acquire a share on a particular day (maturity day) at a certain price, if certain conditions are fulfilled.
- distribution of the profit to the employees.

These institutes provide an opportunity for the LLC to stimulate its employees to perform their jobs in the best way possible in a way not previously envisaged, by giving them the opportunity to become shareholders of that company, following the example of companies and economic systems of the EU and the USA. Until this moment, only limited number of companies used this option – the full effect of this possibility is yet to be achieved in practice.

In relation to the registration aspects, there is an improvement as well - now the shareholder may file for registration of the dismissal of the representative, if there is no already appointed new representative, which was not the case earlier.

Positive progress has also been made through the BRA's cooperation process with the National Bank of Serbia, the Tax Administration, the Anti-Money Laundering Administration and the market inspection in a manner which enables fast and efficient exchange of information on business entities.

Also, with the introduction of the possibility of founding a single-member and multi-member limited liability company electronically the establishment procedure has been significantly simplified.

## REMAINING ISSUES

One of the disadvantages of the 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 latest amendments introduced a rather confusing provision requiring that for a third party to become a shareholder in a LLC, an agreement between that party and the company itself must be made (person nominated by the shareholders meeting signs on behalf of the company). It seems that the purpose of this amendment is to provide a legal basis for the existing practice where in case of a share

capital increase by a third party, the Serbian Business Registries Agency ("BRA") required an agreement on accession to be signed between existing and new shareholders. On the other hand, according to the BRA, this provision will apply only in special (in practice very rare) cases where the company's memorandum of association provides that consent of the company itself is required for transfer of the share to a third party. There is a concern that the wording of the provision is such that this provision apparently applies even if a third party becomes a shareholder by acquiring shares from the existing shareholder. Requiring such an agreement does not only seem to lack purpose but is arguably detrimental to the status of minority shareholders in LLC's. It appears that this provision may give the right to majority shareholders to block the minority shareholders to rightfully transfer their shares to third parties (by blocking execution of such an agreement at the level of shareholders' meeting). It seems that this was not the intention of the legislator but is apparently an unfortunate inadvertent effect.

The latest amendments also contain a provision that, if a nullity of a share transfer agreement is established by a court ruling, the parties can request from the BRA to change the registration of the title to the affected share. It is not clear whether this newly introduced article will override the principle of reliance in the registered data, providing that the parties cannot bear negative consequences if they relied on the registered data (which is of paramount importance for the certainty of legal transactions), and whether subsequent acquirers of the share (in case of sale chain) acting in good faith would bear consequences to their title to the share if the title of one of the previous sellers in the sale chain would be declared null. We hope this controversy will be resolved in court practice in favour of the reliance principle, but until then the huge legal uncertainty remains.

On a related note, the Law allows various restrictions (regarding the share transfer) to be prescribed in the company's memorandum of association. However, there is no prescribed consequence if such restrictions are breached, which may limit practical aspects of limitations provided under the memorandum of association.

The latest amendments also enhanced "mechanism" in relation to the approval of transactions involving personal interests. While there is a general comment that these duties may be deemed as too burdensome, in any case it should be: (i) clarified that there is no need for publishing the details about the related party transaction, if there an exception to a duty to approve respective personal interest transaction, (ii) clarified if an exception related to the Republic of Serbia refers to the transactions only involving the Republic of Serbia or transactions with companies where the Republic of Serbia is shareholder (irrespective if Republic of Serbia is a party to the respective transaction); (iii) provided that subsequent approval for these transactions is allowed.

The "standard" comment about e-signing under Serbian legislation should be considered from the perspective of executing the decisions of corporate bodies as well – electronic signatures recognized in other countries should be acceptable in Serbia (and not only qualified electronic certificates in Serbia). This would significantly speed up the business operations.

In relation to the representatives' responsibilities, it is required to (i) harmonize non-compete duty with employment regulation, (ii) reflect provisions regarding director's liability in joint stock companies (Article 415) to the LLCs as well, (iii) clarify if fiduciary duties are applicable to the representatives of the branch and representative offices. Also, the Law should prescribe consequences if decisions of various management boards (e.g. board of directors) are not adopted in line with the law.

The provisions of the Law restricting the powers of representatives to represent the company are inconsistent with the relevant provisions of the Law on Contracts and Torts. It should be clear that the respective provisions of the Law, as lex specialis, have a prevailing effect.

Currently, any dividend paid between the regular shareholders meetings are deemed as interim dividend (which triggers additional duties for the companies). There is no reason that distribution of dividends (representing the profit based on annual financial statements) made after the regular shareholders meeting is considered as an interim dividend i.e. current approach is too formalistic.

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.

Other inconsistencies of the Law include the provision prohibiting a single-member LLC from acquiring own shares,

which is contrary to the Law's provisions on status changes.

One of the insufficiently clear institutes of the 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.

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 Law does not provide a precise explanation in terms of the procedures and conditions of such a swap, and this should certainly be regulated. It is also required to clarify if the evaluation made by external expert is always needed when the share capital is increased by the in-kind contribution.

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.

## FIC RECOMMENDATIONS

- Limited liability partnerships (LLPs) should be prescribed by the Law.
- The new confusing provisions in relation to the (i) agreement between the company and a new shareholder regarding the share transfer, and (ii) nullity of share transfer agreement should be amended to avoid legal uncertainty.
- The provisions in the Law on Contracts and Torts that deal with limitations to the authority of a company's representatives should be harmonized with the provisions of the Law.
- Consequences for breaching the share transfer restrictions provided under the Memorandum of Association should be prescribed by the Law.
- Consequences for adopting the decisions by various corporate bodies (such as board of directors) contrary to the law should be prescribed by the Law.
- Common practical issues should be resolved, such as regulating shareholders' additional payments, e-signing, representatives liabilities, share capital increase and approving the transactions involving the personal interest.
- Difference between regular and interim dividend should be prescribed in a less formalistic approach.
- Clearly defining reasons for lifting the corporate veil.
- Corrections of technical flaws in the Law should be made to eliminate inconsistencies and provide clear procedures and competencies, harmonizing provisions within the Law itself.