THE NEW APPROACH IN THE REGULATION OF NOMINAL CAPITAL IN COMPANY LAW: FUNDAMENTAL CHANGES OR DEADLOCK?

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Abstract

1. The Traditional Concept of Nominal Capital in Continental Laws (Basic typology of companies: companies with unlimited liability of partners and limited liability companies – their effect on the regulation of nominal capital) *2. Functions and Aims of Regulating Nominal Capital* (The traditional reasoning of capital and creditor protection and the analysis of its correctness) *3. Competition of Company Laws* (After 2004 a new chapter of competition has started among the newly accessed member states to draw more and more foreign investments and promote small and medium-sized enterprises – the increasing role of company law and the regulation of nominal capital) *4. New Dawn Breaks?* (New tendency is examined to abandon the traditional concept of nominal capital regulation) *5. Summing Up*

Key words

Company law, nominal capital, limited liability, registration of companies, competition

1. The Traditional Concept of Nominal Capital in Continental Laws

It is believed that the regulation of nominal capital plays a major role in company law, fulfilling various functions (detailed below) and thus serving the common good. First of all, let us sketch what we mean by the „traditional concept" of nominal capital.

Basically there are two types of business/commercial companies, regardless of the applicable law. The first group is characterized by the unlimited liability of the partners for the debts of the company. In other words, in this type of companies, there is at least one partner who personally, with his personal means, is held liable for debts exceeding the company's capital. The legislative approach towards these companies is simple: given that at least one partner bears unlimited liability, there is no practical need to introduce mandatory rules on the

company's nominal capital. The unlimited liability of the partners makes unnecessary to state nominal capital minimums. The above idea is reflected practically in every national laws all over Europe, e.g. in German law (see the *offene Handelsgesellschaft* and the *Kommanditgesellschaft*), in French law (see the *société en nom collectif* and the *société en commandité*), in British law (see the partnerships), in Czech law (see the *veøejná obchodní spoleènost* and *komanditní spoleènost*) and in Hungarian law (*közkereseti társaság, betéti társaság*), and so on.

The second group can be distinguished from the first with respect to the liability of the partners for in this group the partners (members, shareholders) are not liable – with narrow and strict exceptions – for the debts of the company. Their liability is limited to their initial contributions and assets in the company[1]. This is the point where we reach the core of the traditional concept of nominal capital regulation. Regulations usually consider important, as a quid pro quo for the limited liabilty of the partners, to state mandatory rules on nominal capital minimums. Nominal capital minimums are in most cases substantial amounts. This concept is present in many national codes of company law, eg. in Germany, Austria and Switzerland) (*Gesellschaft mit beschränkter Haftung*, *Aktiengesellschaft*), in Italy (*societá a responsabilitá limitata, societá per azioni*) Spain (*sociedad limitada, sociedad por acciones*) Poland (*spółka z ograniczoną odpowiedzialnoscią, spółka akcyjna*), Czech Republic (*společnost s ručením omezeným, akciová společnost*) or in some sense in Hungary (*korlátolt felelősségű társaság, részvénytársaság*) this idea is reflected in continental laws, however, is not that clearly followed in the Anglo-Saxon world. There is, indeed, a mandatory regulation on the minimum nominal capital for companies limited by shares, but this regulation follows from Great Britain's accession to the European Community and has not much to do with common law traditions. Private companies, not being subject to the unification and harmonization of European company law, still can be set up with any amount of nominal capital – eg. one pound.

The basic idea behind this regulation is that creditors are deprived of the possibility to seek satisfaction for their claims against the members of the company, the sole basis for satisfying their claims being the company assets[2]. Thus, if we regulate the minimum amount of nominal

[1] BODOR, MÁRIA: *Korlátolt felelősségű társaság* (Budapest, 2001, 34. p.); FÖLDES, GÁBOR (ed.): *Pénzügyi jog* (Budapest, 2001, 56. p.); Act C. of 2000., Art.35., chapter (3).
[2] KISFALUDI, ANDRÁS: *A társasági jog* (Budapest, 1996, 48. p.)

capital of companies operating under the limited liability of its shareholders and partners, creditors are given at least a slight ray of hope to settle their claims, at least in part. In other words: the regulation of nominal capital is stemming from the noble idea of creditor-protection in company law and thus serving the purposes of creditor-protection.

The above idea seems reasonable and correct. However, we have to ask: is it true?

2. Functions and Aims of Regulating Nominal Capital

To answer our question, we have to first have a look at what we have believed earlier concerning the functions and aims of the regulation of minimum nominal capital for companies with partners with limited liability.

It is believed by some that the regulation of nominal capital minimums plays a filter-role: filters promoters and only the capable, the economically potent is allowed to proceed and set up a company and at the same time enjoy limited liability. In this sense, nominal capital is the redemption-price of limited liability. This approach also states that nominal capital regulation can secure the required „seriousness" of establishing a company[3]. If promoters risk a substantial amount, they are by all means more serious in their business conduct and thus the regulation of nominal capital guarantees prudent business operations better.

The basic reasoning for the necessity of nominal capital-minimums is creditor-protection. According to this concept, the larger minimum on nominal capital is set forth in our codes, the larger level of protection creditors can enjoy. We must agree to some extent – creditor-protection is – and always has been[4] – indeed a top priority in company law and a goal company law should promote.

Considering all the above and acknowledging that this kind of reasoning can be considered partially right, we believe that the traditional concept of nominal capital regulation, as interpreted and sketched above is unnecessary, a viewpoint that has already had its day. Even our company law in force discredits its fundamental components: nominal capital is not

[3] E. g. KOMÁROMI, GÁBOR: A korlátolt felelősségű társaság (In JUHÁSZ JÓZSEF (ed.): *Korlátolt felelősségű társaságok kézikönyve*, Budapest, 1990, 38. p.)
[4] FEHÉRVÁRY, JENŐ: *Magyar kereskedelmi jog rendszere* (1941, Budapest; 254. p.)

qualified security deposit for the risks of business activity[5]. It goes without saying that nominal capital is a part of the company assets (the company capital – equity capital), nevertheless companies are free to use their nominal capital to their own ends.

Our point of view is that there is no convincing reasoning to maintain a company law with madatory rules on nominal capital minimums, especially on private companies (limited liability companies). (The legal approach towards companies limited by shares should be somewhat different and should set forth rules on share capital minimums.) We strongly believe that the regulation of nominal capital minimums can not serve the purposes of creditor-protection and thus is considered improper and inadequate means to reach its goals in this aspect.

3. Competition of Company Laws

Following the 2004 accession of ten new member-states[6] to the European Union, a new chapter of economic competition has started, which has been enhanced after the latest expansion-round[7]. Prior to the accession of the former socialist block, a considerable competition also existed to draw foreign investments and efforts were made in the then-candidate countries to make themselves more attractive for foreign capital than the others. In the 1990's candidates had many means to reach their goals, basically offering considerable tax allowances or even tax-exemptions to spur up economic growth and thus contribute to the economic transition and closing-up.

In the EU the above means are no longer disposable, there is only a limited arsenal to benefit from, for only techniques in full conformity with European law are allowed. This results in the new chapter of rivalism, the competition of member states. In this competition company law has started to play an incresing role. The age of tax-allowances seems to have passed. Company law has to promote investements and supply as much level of freedom for promoters and partners as possible. At the same time, a modal shift in EU policy on company

[5] Our company law in force states no requirements to treat nominal capital as safety deposit and after examining our Companies Act, we can adamantly state neither the concept of our code, nor the particular rules require such treatment.

[6] 1 May, 2004. The following countries accessed the Union: Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia.

[7] 1 January, 2007 with Bulgaria and Romania. With respect to the commitment of the EU in favour of the West-Balkan region, further expansions can be foreseen.

law has been realised: creditor-protection has lost considerable ground in favour of the preferential treatment of small- and medium sized enterprises.

This new situation rises the value of competition law regulation: the more competitive a company law is, the more competitive the country's economy can be. Company law is of course only one element of a complex web of means to strengthen economic growth, but it is clearly seen, that it is playing a larger role than it played before 2004 and the competition is more fiery in the former socialist states, however, it carries over to other member states too.

4. New Dawn Breaks?

It seems that some legislations started to realize the vital importance of the above and started to take measures to modernize their company laws, with respect to the regulation of nominal capital also. At the new millenium, the below nominal capital minimums were in force in some European company laws on private/limited liability companies:

- France: 7. 500 euros[8]
- Portugal 5. 000 euros[9],
- Czech Republic: 200. 000 Czech korún[10]
- Slovakia: 200. 000 Slovakian korún[11]
- Slovenia: 2.100.000 tolar[12] (approx. 8.000 euros)
- Lithuania: 10. 000 lita[13] (approx. 1.820 euros),
- Estonia: 40. 000 Estonian krona[14] (approx. 2.470 euros),
- Bulgaria: 5. 000 leva[15] (approx. 1.200 euros),
- Poland: 50. 000 zloty[16] (approx. 12.000 euros).
- Switzerland: 20. 000 francs[17],
- Germany: 25. 000 euros[18],

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[8] SÁRKÖZY, TAMÁS (ed.): Társasági *törvény, cégtörvény 2006.* (Budapest, 2006,, 31. p.)
[9] *Decreto – Lei no. 262/1986: Código das Sociedades Comerciais*, 276. §
[10] CZIRFUSZ, GYÖRGY – HULKÓ, GÁBOR: Korlátolt felelősségű társaság alapítása Csehországban (In: *Fiatal Oktatók Tanulmányai* Vol. 2., Győr, 2004, 190. p.)
[11] *Zakón c. 513/1991 Sb. Obchodní Zakoník*, 108. §
[12] 30/1993 *Zakon o Gospodarskih Družbah*, 410. § (1)
[13] Companies Act, (VIII – 1835/2000.) 2. § 4.
[14] Estonian Commercial Code, (*Riigi Teataja* 1995, 26-28, 355), 136. §
[15] *Търгоски закон*, 1991. 06. 18., 117. §
[16] *Ustawa z dnia 15 wrześniz 2000. r.: Kodeks spólek handlowych,* Art. 154. § 1.
[17] *Bundesgesetz betreffend die Ergänzung des Scweizerisches Zivilgesetzbuches (Fünfter Teil: Obligationenrecht),* Art. 773. B.

- Austria 35. 000 euros[19].
- Hungary: 3.000.000 forints (approx 12.000 euros).

The British and Irish private companies were allowed to operate without mandatory regulation on their nominal capital minimum.

In recent years the outlines of a new trend could be seen: moving further from what we defined as the traditional approach towards nominal capital. It is hard to decide whether this „trend" will become a constant tendency or not. What we can observe is that more and more legislations change their viewpoint on nominal capital and to a little extent handle the old approach on nominal capital minimum regulations as barriers to market entry and obstacles to run small or medium sized enterprises. This matter has not been dealt with independently and isolated from other important rules affectring SME's market position. Changes were usually carried out hand in hand with an overall simplification of both substantial and procedural rules, including the introduction of more favourable registration deadlines and registration fees[20].

In Spain, the new „simplified" private company was introduced, along with many new rules to encourage the will to enterprise, however, the nominal capital of 3.012 euros was left unamended[21]. From 2003 it is possible in France to set up a limited liability company *(société à responsabilité limitée*) with symbolic nominal capital of one euro – thus practically the strict regulation of nominal capital minimum was abolished completely.[22] It is worth to keep an eye open on the Japanese reforms in company law: reflecting global trends, promoters are free to establish a „one-yen-company", a private company with a nominal capital of at least one yen.[23] As we know, there are considerable efforts in Germany to reduce the nominal capital minimum of the GmbH to 10.000 euros – after realizing that approximatelly 15.000 companies of German interest are set up in Great Britain each year to capitalize on the

[18] *Gesetz betreffend die Gesellschaften mit beschränkter Haftung*, 1892. 04. 20.), 5. § (1)
[19] 58/1906 *Gesetz betreffend die Gesellschaften mit beschränkter Haftung*), 6. § (1)
[20] See Act LXI of 2007, considerably amending both the Companies Act and the act on registration procedure.
[21] FERNANDO JUAN MATEU: The Private Company in Spain – Some Recent Developments (*European Company and Financial Law Review*, 2004/1)
[22] SÁRKÖZY: op. cit. 2006, 31. p.
[23] SÁRKÖZY: op. cit. 2006, 53. p.

divergences between the German and British company laws. In the Netherlands, a proposal for reforms in this sphere is also in the works.[24]

Can we call it a new dawn? Or is it just the trend of the present and will be forgotten soon? We believe that it is rather the first than the second, however, we can not decide. Nevertheless, we should stress that finally the Hungarian legislation started to follow the path beaten by the above countries and decided to reduce nominal capital minimums. During the preliminary works of our new Companies Act[25], efforts were made to bear through the concept of the „thousand-forint limited company"[26]. These efforts finally turned out to be unsuccesful, Act IV. of 2006 left the former rules on nominal capital unamended. But then, out of the blue, with a 2007 alteration of the code, the nominal capital limits changed radically, however not that radically as aimed earlier.

With respect to our current law in force, the nominal capital minimum on limited liability companies was reduced to 500.000 forints (and 100.000 forint if it is a single member company). The minimum nominal capital of 20.000.000 forints on joint-stock companies was reduced to 5.000.000, applicable only to private companies, the limit of 20 million is still in force on public companies.

5. Summing Up

We believe that the basic goal of company law is to draw up an equilibrium between the rightful expectations of creditor-protection and the promotion of freedom concerning the establishment and operation of companies. However, we strongly feel that the basic goals of creditor-protection can be reached through traditional means of civil law, basically contract law and the arsenal company law employs is not necessary adequate to supply the same level of protection. In this sense, company law can not guarantee anything but a rather limited success in creditor protection.

On the other hand, rules of creditor-protection, if not serving their real purposes, can be considered considerable barriers to market entry for SME's and can be treated as

[24] SÁRKÖZY: op. cit. 2006, 31. p.
[25] Act IV of 2006.
[26] See SZEGEDI, ANDRÁS: Az „ezerforintos" kft. védelmében (Gazdaság és Jog, 2007/3)

anticompetitive measures. Anticompetitive in the sense of the competitiveness of companies and in the sense of anticompetitiveness of company law. That is why we support the idea of the reduction of nominal capital limits in company law. We are of course aware of the fact that this measure in itself is not able to supply competitive advantages, but can play a major role even in a symbolic way. However, we urge reforms be carried out completely and steadily and thus modernise company law.

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[3] FEHÉRVÁRY, JENŐ: *Magyar kereskedelmi jog rendszere.* Budapest: Grill Kiadó, 1941.

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