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LIMITED LIABILITY COMPANY'S MEMORANDUM OF ASSOCIATION

Summary: Limited liability company is the most used business structure. Establishing this type of company by adopting a set of documents as a constitutive assumption is common to most jurisdictions, but there are also certain variations. It is a type of company where the founder's limited liability was first introduced; doing business is based on the mutual trust between members. This paper examines the general characteristics of the memorandum of association of a limited liability company, comparing its contents in Serbian and several other jurisdictions. We discuss the weak points of the Serbian Companies Act framework which should be amended and improved, as well as the issue of adopting the Civil Code rules on civil partnership and legal entities.

Key words: *founders, memorandum of association, essential items, company, limited liability company*

1. INTRODUCTION

A company is a business structure which performs economic activities to make profit. Every company must become an entity to lawfully acquire rights and take on obligations from legal transactions.

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Therefore, a company acquires the status of a legal entity by adopting an application and delivering a decision on registration (Zakon o postupku registracije u Agenciji za privredne registre, Article 16; Zakon o privrednim društvima, Article 3; Gesetz betreffend die Gesellschaften mit beschränkter Haftung, Article 11) by the Companies' Register (Agency for Commercial Registers in Serbia, Chamber of Commerce Commercial Register in the Netherlands or Commercial Register of the District Court in Germany). To register and acquire legal subjectivity, a statement of the founders will in the memorandum of association is necessary. Until the entry, the persons establishing a company are founders and company's members from the registration (Ivanjko, Kocbek, 2003, p. 733).

A limited liability company is a suitable form of company combining the best features of a partnership and member's limited liability. Due to few members, the relatively stable membership, need for mutual trust for unanimous decision-making and low initial capital required for incorporation (Jankovec, 1999, p. 63; Arsić, Marjanski, 2018, p. 154; Vasiljević, 2023, p. 321), this structure combines the characteristics of a partnership and limited company adapted for family commercial companies. In addition, this structure has fewer obligations than a public joint-stock company, while management in a limited liability company is simpler. The widespread popularity of this structure is such that as of 31st December 2022, there were 115,888 limited liability enterprises in Serbia (Agencija za privredne registre, 2022, p. 9).

This paper examines the general characteristics of the memorandum of association of a limited liability company, its content in Serbian and a few comparative jurisdictions. We also discuss the weak points of the Serbian Companies Act framework to be amended and improved, as well as the issue of adopting the Civil Code rules on civil partnership and legal entities.

2. GENERAL CHARACTERISTICS OF THE MEMORANDUM OF ASSOCIATION

Since a limited company can be found by one natural or legal person, the memorandum of association should be drawn up in the form of a founding decision, and as the memorandum of association in case of multiple founders. Notwithstanding the number of founders, the memorandum of association should be in writing (*forma ad solemnitatem*) and their signatures certified by a notary public. The following passages refer to the memorandum of association.

With the memorandum of association, the company's members – the founders agree with the basic, legally prescribed elements necessary for the incorporation and bind themselves by the payment of a monetary or the entry of a non-monetary share. The general contract validity assumptions equally apply to this agreement. The contractors should possess the full legal capacity and express a mutual consent. The legal doctrine differentiates between general and qualified founding capacity, which exists if another law provides for the special requirements for a founder (Arsić, et al. 2018, p. 48). In addition, the contract must include a subject and cause – the goal of the incorporation in writing. The legal consequences of the contract focus on the establishment of a firm, the part of doctrine claims the memorandum of association creates a civil partnership of the founders regarding their rights and obligations before the company's registration (Jankovec, 1999, p. 44; Vasiljević, 2023, p. 64). In the former Serbian Civil Code 1844, a partnership meant that two or more partners agree "to invest their efforts or belongings to share the benefit obtained from it" (Srpski Građanski zakonik 1844, Article 723), and "intending to trade under a joint firm" (Srpski Trgovački zakonik 1860, Article 23(1)). In the Draft Civil Code of the Republic of Serbia 2019, that goal is determined as follows: "By way of a partnership agreement, two or more persons are mutually bound to combine means or their work to achieve a certain joint goal" (Prednacrt Građanskog zakonika Republike Srbije, Article 845(1)), while in the current law this is done to establish, i.e. register a company for performing activities **to make a profit**" (Zakon o privrednim društvima, Article 2).

With reference to the characteristics of partnership, a limited liability company is called "incorporated partnership" (Vasiljević, Jevremović Petrović, Lepetić, 2020, p. 153; Vasiljević, 2023, p. 321), "quasi-partnership" or "limited partnership, without general partners" (Jerinić, 2012, p. 161; Vasiljević, 2023, p. 321). Part of the foreign doctrine calls limited liability company as an "intimate enterprise" because it bonds few persons between whom there is a relationship of trust (Jankovec, 1999, p. 63). In Slovenia, rules of the Obligations Act (Articles 990–1008) on the partnership apply to a particular type of the company's agreement (memorandum of association) with essential items prescribed by the Slovenian Companies Act (Zakon o gospodarskih družbah, Article 474(3)). Accordingly, the memorandum of association of a limited liability company in Slovenia has the characteristics of a civil partnership. Likewise, the directors and the company in Netherlands are jointly and severally liable for the obligations undertaken in legal affairs on behalf of the company (limited liability company and joint stock company) before submission of the application to the Commercial Register, with all prescribed extracts and documents (Burgerlijk Wetboek, Boek 2 /Rechtspersonen/, Article 180(2)).

Doctrine also refers to the mutual trust of the founders (*intuitu personae*) as the ground of the memorandum of association (Jankovec, 1999, pp. 45, 63; Vasiljević, et al. 2020, p. 156; Vasiljević, 2023, p. 324). This stems from the rule that none of the firm members may transfer their share in the partnership to a third party, except when consented by the other associates. Equally, such authority is limited by the other members' pre-emption rights in a limited liability company or consent of the company's assembly.

The memorandum of association implies the establishment of the specific founder's rights and obligations, giving the Articles obligation nature. This is supported by the rules on civil capacity, agreement of the contractors' will, subject of the contract and cause. However, contractual theory on the origin of a company, prevailing in the 19th century, was replaced by institutional theory on the company origin (Jankovec, 1999, p. 46). Therefore, the minimum essential items in the memorandum of association are prescribed by the Law (on companies). To this end, memorandum of association is void if: 1) does not take the

legal form or 2) the company's activity is contrary to compulsory regulations or public order or 3) does not contain the business name, members' shares, the amount of the initial capital or the predominant activity or 4) contractors were legally or commercially incompetent when agreeing memorandum of association (Zakon o privrednim društvima, Article 13).

Currently accepted institutional theory about the company's creation claims the memorandum of association produces a status effect whereby the legal order recognizes the generation of the institution of a company whose position is regulated by law. In addition, a company is an independent organization in legal transactions which individual features distinguish it from other legal entities (Jankovec, 1999, p. 46). The firm's property and management are separate from the founder, because the company will in commercial dealing is expressed by its bodies and representatives. Essentially, creditors may not collect claims against the company from its members, which classifies the limited liability company into a corporation (Jerinić, 2012, p. 161). Therefore, a memorandum of association merely constitutes the basis for the creation of a company, while mutual relations of the founders are purposefully subordinated. Founders' failure to regulate the common interests in the memorandum of association does not produce its nullity if essential items for registration and, therefore, the company's creation is specified. With the comparable effect, the Slovenian Companies Act provides the "company agreement" should contain rules on the "potential obligations" of members to the company and vice versa (Zakon o gospodarskih družbah, Article 474(3), Article 5). One should be aware the founders may agree their relations in the memorandum of association or some other contract with regard to the dispositive provisions allowing them autonomy but are not permitted to depart from the mandatory statutory rules (Ivanjko, Kocbek, 2003, pp. 737– 738; Jerinić, 2012, pp. 163–164). The same is stated in Serbian legislation as follows: "Members of a limited liability company freely regulate their relations in and to the company, unless otherwise enacted by this Act" (Zakon o privrednim društvima, Article 140). The consistent application of the institutional theory transforms the contract features of the memorandum of association into status one. Consequently, contract properties disappear at the company registration, which view is also accepted by the Serbian highest courts (Vasiljević, 2023, p. 65).

3. ESSENTIAL ITEMS: TOO MANY OR TOO FEW?

Discussions about the essential items of the memorandum of association are limited by theoretical and practical assumptions regarding mandatory content. There is a prevailing agreement on the required items of the memorandum of association in comparative commercial law. Netherlands is a typical example where the Civil Code provides the memorandum of association of a limited liability company shall specify business name, seat and purpose (activity) of the company and a full or abbreviated form (Burgerlijk Wetboek, Boek 2 /Rechtspersonen/, Article 177), initial capital, nominal amount of shares, paid and entered (Burgerlijk Wetboek, Boek 2 /Rechtspersonen/, Article 178), founders, natural persons (name and surname, date and place of birth and residence) and legal persons (form of company, business name and registered office) (Burgerlijk Wetboek, Boek 2 /Rechtspersonen/, Article 196(2)b)c)).

There are also items in one legal system not mentioned in others. The legislation prescribing the mandatory components of the memorandum of association provides for some items of conditionally obligatory nature. For example, in Slovenia, these are the indication of the company duration when established for a definite period and the potential obligations of the members towards the company and vice versa. These comprise conditionally mandatory items applying when appropriate. Similarly, in Serbia the operation period a company is established is unessential in the incorporation document. In Serbian law, a company is founded for an indefinite period if the memorandum or Articles of association do not specify otherwise (Zakon o privrednim društvima, Article 10(2)). On the other hand, the memorandum of association has one conditional-mandatory provision. Among other things, it should provide for the company bodies and their competences. If founders do not agree on the competences of the company's bodies in a memorandum of association, they have the powers prescribed by the Companies Act. Serbian legal theory rightly pointed out one controversial provision of the Companies Act, which unnecessarily causes confusion. By Article 11(5) of the aforementioned law, the management of a limited liability company is structured by the memorandum, so the dilemma is

whether the company representative and the method of representation should be agreed upon in the memorandum of association (Vasiljević, 2023, p. 327). However, contradiction was resolved in the practice of the Business Register prior to the establishment of the Agency for Business Registers. It is now confirmed by appointing a company representative who must verify and deposit signature, which may be done either by the memorandum of association or decision. This is regulated by the bylaw on the documents required for registration with the Agency for Business Registers (Pravilnik o sadržini Registra privrednih subjekata i dokumentaciji potrebnoj za registraciju, Article 10(1)(3)). It has been shown in practice and accepted by the doctrine that it is more beneficial to name the representative and a range of authority by a separate decision. Appointing other representative in such a way prevents the necessity to amend the memorandum of association (Vasiljević, et al. 2020, p. 157). If, for some reason, founders wish to limit the representative range of authority, it is preferable to do so in one of the ways mentioned. The prevailing rule is that unregistered limitations of the representative's authority may not be asserted against honest third parties, unless the law provides otherwise (Prednacrt Građanskog zakonika Republike Srbije, Article 45(4)).

Besides the items prescribed by law, the founders may agree on numerous other aspects of the incorporation and their relationships and thereby expand content of the incorporation document. It is about the particular interests of the company members relating to additional restrictions for the transfer of shares, different rules on the profit distribution, the decision-making majority, etc. (Arsić, et al. 2018, p. 155; Jerinić, 2012, p. 163; Vasiljević, 2023, p. 327–328).

When it comes to the initial capital for the company registration, in the observed jurisdictions, there are differences ranging from the lowest possible (0.01 Euro in the Netherlands and 100 dinars in Serbia) to larger amounts (7,500 Euro in Slovenia or 25,000 Euros in Germany). Interestingly, German law distinguishes a limited liability company and an entrepreneurial limited liability company, the latter without a prescribed share capital sum. It can be concluded from this, the lower the initial capital, the scarcer the possibility for creditors to collect claims against the company. Therefore, in cases of a minor share capital, there is

no guarantee for protection of the creditor interests from the share capital of a limited liability company (Arsić, et al. 2018, p. 154; Vasiljević, 2023, p. 334). Weak guaranty function of the initial capital of a limited liability company is encouraged by the Serbian law, too. In Serbia, financial contribution at the company incorporation must be settled within the period specified in the memorandum of association, but no later than five years (Zakon o privrednim društvima, Article 46(2)(2)). However, there is no absolute security of creditors regarding the claims from limited liability companies, even when a larger initial capital is required, and prescribing this amount from the company revenue is practically impossible (Vasiljević, 2023, p. 333). In Serbian former commercial law, one natural person could establish only single member company with limited liability (Zakon o preduzećima 1996, Article 341 in conjunction with Article 196). This rule was supposed to reduce the danger of reckless establishment of unsound companies (Jankovec, 1999, p. 63). Since there is no such provision in current legislation, protection of conscientious persons remains questionable.

Founders can agree on other details in the memorandum of association without affecting its validity, because they are not compulsory by law for the incorporation. Those are additional payments and side performance.

Additional payments into the limited liability company assets represent an institute of contract law. Founders may agree on this in the memorandum or entrust such decision to the competence of the assembly. It should be borne in mind additional payments do not serve to increase the initial capital (Zakon o privrednim društvima, Article 178(3)), but to cover losses or company's creditors pay out (Vasiljević, et al. 2020, p. 161; Arsić, et al. 2018, pp. 175–176; Jerinić, 2012, p. 166). Founders may not agree on additional payments in monetary assessable things and rights, because it would be contrary to the nature of this institute (Arsić, et al. 2018, p. 174; Vasiljević, et al. 2020, p. 161).

Side performances refer to the specific tasks if necessary for the limited liability company's operations due to exceptional skills, know-how, knowledge of the market or "delivery of goods, provision of services to the company, corporate management, etc." (Arsić, et al. 2018,

p. 176–177; Vasiljević, et al. 2020, p. 162). Those represent the ordinary commercial activities of delivery of goods or provision of services, for which the member is entitled to market fare. Proportional share value for additional payments is inapplicable to them, but market value. Object of the side performance agreement can be anything not prohibited by compulsory regulations, public order or good customs, i.e. everything that may be a "valid subject of contractual relations" (Vasiljević, et al. 2020, p. 162).

One of the impermissible side performances of company members is granting a loan to the company. In the first version of the Serbian Companies Act, a member or a person related to him could give a loan to the company at any time (Zakon o privrednim društvima, Article 181). However, Serbian Banks Act 2005 introduced a rule that no one except the bank can engage in lending, unless authorized by law (Zakon o bankama, Article 5(2)). Company member is allowed to grant a loan to a limited liability company in Slovenia and Germany (Zakon o gospodarskih družbah, Articles 498 and 499; Gesetz betreffend die Gesellschaften mit beschränkter Haftung, Article 30), so it appears unusual such right was deleted from the Serbian Companies Act. Because of the aforementioned provision of the Banks Act 2005, granting a loan cannot be part of a memorandum of association of a limited liability company.

4. CONCLUSION

The Companies Act provides a sound framework for the incorporation of limited liability companies, where lower initial capital is merely one of the incentives for the establishment of family firms. However, the absence of legislation on civil partnerships significantly contributes to confusion as to which rules apply to the founders in the "pre-company" stage, i.e. before registration. Therefore, it appears necessary to regulate the partnership soon by adopting the Civil Code of the Republic of Serbia, which draft was decided at the end of May 2019. We believe inconsistency with the Companies Act regarding whether appointment of the company representative and the range of authority is required according to Article 11(5) or the dispositive wording of Article 141 on the determination of the company bodies competence, should be

interpreted as the founder's autonomy in the incorporation document or a standalone decision. Another solution would be to delete Article 11(5) or to amend wording. Analysis of the number of single-member limited liability companies of the same natural person and consequences of multiple founding status would indicate if restrictions on the incorporation capacity of an individual who is already the founder of an active limited-liability company are still needed. Optional items of the memorandum of association can be represented to a lesser or broader extent depending on the interests and needs of the founder. In doing so, the founders should check the applicable framework for choosing one or other provisions and rules of the incorporation document.

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