Raise of capital and financing

EU Company Law

Exam question

Discuss and explain how a **limited company** can **raise capital** and be **financed**, including the rules and principles concerning this issue.

Introduction

When does a company want to raise capital?

- During formation of the company, raising of funds to start of the

EU harmonization

Capital directive – 2nd directive

- Regulates the capital requirements, increase, reduction etc. of the ***public*** *limited liability* companies.
- Does not apply to ***private*** *limited liability* companies.

Capital requirements during formation – Public limited (A/S)

Capital requirement

Public limited liability companies must issue

- 25.000 EUR – art. 6 (1)
- At least 25 % must be paid up at the time of incorporation – art. 9 (1)

Distribution in cash

Easy valuated

Subscribers

- Def: A subscriber is a person who offers or agrees to buy shares in a company that is offering its shares to the public.
- Must paid up at least 25 % at incorporation time – art. 9 (1)
- May **not** be released from the obligation to pay up their contribution – art. 12.

Distribution in kind

Ex. contribute with real estate.

Time line

- 25 % must to transferred at time of incorporation. - art. 9 (1)
- The consideration (vederlag for aktier) must be transferred in full within five years of that time – art. 9 (2)

Valuation

- The outside world must be able to rely on the amount of capital stated by the company at the time of formation.
- A **report** on any consideration other than in cash shall be **drawn up** <u>**before**</u> the company is *incorporated*

        - by one or more independent experts appointed or approved by an administrative or judicial authority. - art. 10 (1)
    - The experts' report shall **contain** at least a description of each of the assets comprising the consideration. - art. 10 (2)
        - And the methods used to valuate the assets.
    - The report shall be **published** – art. 10 (3)
    - Not all kind of non-cash consideration are valid.
        - Only assets capable of economic assessment.
        - Ex: work-effort is not valuable.

The private limited liability company (ApS)

The capital directive does not apply to private companies

- => No minimum capital
- Different approaches in the MS.
    - UK → 0 EUR
        - With the Centros-case it was clarified that UK companies may establish branches in other MS, even if the mother-company was only established in UK to avoid the branch's home state's capital requirement.
        - Post Centros the incorporation in the UK is said to have exploded. (p. 146)
    - DE → 25.000 EUR ?
        - Modernization to lower the capital req. was not followed
            - Argued: "Even though capital requirements may **not play a fundamental role** in protecting creditors' interest, it *also functions* as a **threshold to ensure credibility** and **seriousness**, thereby **preventing to many unserious businesses**."
    - DK → 80.000 DKK

Increase share capital

Running a company requires funds.

Reasons to increase capital

- When funds run low
- Enlarge the company
    - More capital is needed for invesments etc.
- Also consolidating the company might leed to the need of more capital.
-

One way is the increase of share capital, another is loan and other third-party investments.

Difference of loans and share capital increase

- Loan vs. share capital
    - Loan must be paid back
    - Share capital is actually own by company
        - Share capital is normally "paid back" (indirectly) in form of dividend.
        - Also a share capital reduction will result in paying back the capital.
    - Lenders are creditors like others.
    - In the insolvency situation
        - Loans must by paid back before shareholders.

    - Loan normally doesn't give the lenders any direct nor indirect control of the company.
        - Shares normally do – voting rights.
        - Loans may involve special rights for the lender. (As a security for the loan)

Who decides?

Main rule – art. 25 (1):

- Any increase in capital must be decided upon by the **general meeting**.
    - And their decision and the increase must be published.

Modification – art. 25 (2):

- **The statutes** or **instrument of incorporation** or the **general meeting**, may authorize an increase in the subscribed capital
    - up to a maximum amount which they shall fix with due regard for any maximum amount provided for by law.
    - The authorization gives a **company body** the right to make the decision.
        - It's a right to decide, *never a duty*.
        - → important is that the share increase is decided upon in a concrete decision.
    - The power of such body in this respect shall be for a **maximum period of five years**
        - may be **renewed** one or more times *by the general meeting*, each time for a period not exceeding five years.

Payment by cash

- Must paid up with at least 25 % – art. 26
- Where provision is made for an issue **premium** (overkurs), it must be paid in full.

Payment in kind

Mostly like considerations during company formation.

- Must be **transferred in full** within a period of **five years** from the decision to increase the subscribed capital. - art. 27 (1)

Valuation: - art. 27 (2)

- The consideration must be subject to a report drawn up before the increase in capital.
    - The report must be written by one or more experts (natural or legal persons).
- Unless all the shareholders in the company which receive the consideration have agreed not to have an experts. (Optional for the MS) – art. 27 (4)

Preemption rights (Fortegningsret)

Preemption rights

- Whenever the capital is increased by consideration **in cash**, the shares must be offered on a pre-emptive basis to shareholders **in proportion** to the capital represented by their shares. - art. 29 (1)
- Right of first refusal.
- Every shareholder will have the right to buy shares during the increase in proportion.
    - This way each shareholder can maintain his power (voting right, ownership) over the company.
    - Increasing the amount of shares might else-wise dilute the rights of shares.

Only applies to contributions in cash! - art. 29 (1).

- Why?
  - Difficult to match non-cash contributions with contributions in cash.
- Each MS may decide to implement proportions on non-cash contributions to.
  - It is a minimum-directive.

Exemptions on the preemption right

- The right of preemption **may not be restricted** or withdrawn *by the statutes* or *instrument of incorporation*.
  - This may, however, be done by decision of the **general meeting**. - art. 29 (4)
    - GM consist of the shareholders. They may decide to dismiss their preemption right.
    - The minority is protected by the **quorum and majority rules**.
      - Decisions must be taken at least by a **majority of not less than two-thirds (⅔)** of the votes attaching to the securities or the subscribed capital represented. - art. 40 (1)
        - The laws of the Member States may, however, lay down that a simple majority of the votes specified in paragraph 1 is sufficient when at least half the subscribed capital is represented. - art. 40 (2)
- Delegate the decision right
  - A **MS may** provide that the statutes, the instrument of incorporation or the general meeting,
    - **may** give the power to restrict or withdraw the right of preemption **to the company body**
      - which is empowered to decide on an increase in subscribed capital within the limit of the authorized capital.
    - This power may not be granted for a longer period than the power for which provision is made in Article 25 (2). - **5 year periods**.

Exercise the right:

- Any offer of subscription on a preemptive basis and the period within which this right must be exercised **shall be published in the national gazette**.
  - The laws of a MS need not provide for such publication **where all a company's shares are registered (by name)**.
    - In such case, all the company's shareholders must be informed in writing.
- The right of preemption must be exercised within a period which shall **not be less than 14 days** from the date of publication of the offer or from the date of dispatch of the letters to the shareholders. - art. 29 (3)

Other financing

Loans

May be loans from specific lenders, banks, finance company etc.

- Loans are supposed to be repaid (normally at a fixed date) and attract interest payments rather than dividends.

Bonds

- Debt securities
- Tradeable on the financial market.

Convertible loans

Definitions:

- A **convertible loan** is a loan that can be exchanged at the lender's option at some date in the future for other securities, typically equity.
- A **convertible bond** gives the owner the right to convert the bond into shares at one or more future points in time and at an agreed price.

When convertible to shares in the company

- The **power to decide** issuance of convertible loans and warrants lies with the **general meeting**
  - They may also choose to *delegate* this power to another company body, cf. art. 25(4)
- When issuing convertible loans and warrants the provisions on proportional **preemption right must be observed** already *at the time of issuance* of these instruments, cf. art. 29 (6).

Warrants

Options vs. warrants

- Option to buy shares regards shares already issued.
- Warrants regards an option to by shares which are not yet issued

Like convertible loans, issuing a warrant must comply with the rules of capital increase by shares.

Where are they used

- Warrants can give incentives to work harder.
  - Ex Give the employees right to subscribe shares at nominel value of 200, value the current value is 100. Employees will properly use their right when the value reaches 200+.
    - The employee thereby have great incentives to work hard to let the warrant have some value.

Mezzanine / Subordinated loans

A subordinated loan is a type of loan which ranks after other debts.

- It is also known as subordinated debt, or as junior debt.

This form of loan is not mentioned in the Company Directives.

- → Therefore, the legal postion governing the taking up of subordinated capital contributions is dependent on national law
  - or in the absence of national regulation – the terms of the loan agreement.

Factoring

Transfers of non-paid