LESSON 6: FOUNDATION OF CORPORATE COMPANIES

SUMMARY:

1.-Procedure: public deed and articles of association
2.-Companies “being incorporated” and irregular companies
3.-Null companies

1.-Procedure: public deed and articles of association

As in all types of trading companies, two basic requirements must be met in order to form a public or private LLC or a partnership limited by shares: a public deed of incorporation must be granted and the company must be registered in the Trade Register (arts. 119 Cco and 20 LSC).

a) Public deed of incorporation

The public deed is a public document signed by a notary which contains the company’s operating agreement (art. 19.1 LSC). The public deed must be granted by the founders or their proxies and they will assume all the issued equity participations or subscribe all the shares (art. 21 LSC). The following information must be included in this document (art. 22 LSC):

1- Each partner’s identity.

2- The willingness of each partner or shareholder to form a public or private LLC. By including this information, all partners or shareholders are aware of the type of company they are forming and the legislation which will be applied to it.

3- Each partner or shareholder’s contribution and the number of shares which they acquire in return.

4- The articles of association of the company.

5- The name of the person(s) who will be in charge of the management and representation of the company at the beginning of its activity.

6- In the case of public LLCs, the approximate amount of money which will be necessary to meet the expenses of setting up the company.

7- In the case of private LLCs, the way in which the administrative body will initially be organized, if the articles of association provide different alternatives.

The **articles of association** are a set of contractual rules which govern the company's internal affairs and which can be modified by a resolution of the general meeting. The following information must be included in the articles of association (art. 23 LSC):

1.-The *corporate name*. Previously, the Central Trade Register must grant a certificate of uniqueness of the proposed corporate name. The chosen name cannot be contrary to the law and morality and cannot lead to confusion.

2- The *corporate purpose*. This is the commercial activity that will be developed.

3- The *registered address*. This must correspond to the place where the company's administration and management headquarters are going to be established.

4- The *share capital* of the company, the number of shares or equity participations into which it has been divided and the par value and number of each one.

The types of shares or equity participations and the series, where applicable, must also be specified. In the same way, it must be noted when and in which way the shareholders will pay the portion of the par value of each share which has not yet been paid (capital calls).

Finally, the articles of association must also inform about the way in which the shares are represented. The shares of a company shall be represented by certificates or book entries. The book entry is simply a share that is held by a transfer agent, rather than by the owner or client. The book entries are shown in the records which are maintained by the agent, so there is always a permanent record of the value of the shares, and who holds the rights to the shares.

5- The structure of the administrative body, the number of members or at least the maximum and minimum number of members, the term of office and the remuneration system.

6- The way in which the general meeting or the board of directors will debate and adopt resolutions.

7- Possible restrictions to share transfers, ancillary services and advantages of the founders or developers, where applicable.

8- Date of the fiscal year-end. If the articles of association do not include a date, it will be understood that the fiscal year ends on December 31.

9- Duration of the company. If the articles of association do not include a date, it will be understood that the company has been formed as a going concern.

10- Date on which the company will begin its activity. It is not possible to set a date prior to the granting of the public deed. If the articles of association say

nothing in this regard, it will be assumed that the company begins its activity on the day on which the public deed is granted.

11.- In partnerships limited by shares, the name of the general partners must be included.

The public deed or the articles of association can include any other agreements that the founders may reach, unless they are contrary to the law or to the main principles on which the regulations of the public or private LLCs are based.

The company's founders must ensure that the public deed and articles of association contain all the mentions set out by the law and that the amount of money used to meet the expenses of setting up the company has been correctly spent. The founders will be jointly and severally liable vis-à-vis the company, partners and third parties in case of breach of this obligation.

b) Registration of the company in the Trade Register

Public and private LLCs become a legal person at the moment in which the public deed is registered in the Trade Register (art. 33 LSC).

The directors, founders and developers of the company must submit the public deed to the Trade Register within two months from the day on which the public deed has been granted. If this obligation is not met, all of them will be jointly liable for damages.

Until its registration, no share or equity participation can be transferred (art. 34 LSC).

After its registration, the formation of the company will be published in the BORME.

c) Procedures on how to set up a public and private LLC

There are two different procedures on how to form a public limited liability company:

- **Simultaneous formation procedure (fundación simultánea).** The formation of the company occurs in one single act through an agreement reached by all the founders which is contained in the public deed. The founders are all considered to be the shareholders who sign the agreement and grant the public deed.

- **Successive formation procedure (fundación sucesiva).** This procedure is used when promoting the subscription of shares through advertising or financial intermediaries before granting the

public deed of incorporation. This procedure is suitable for large business projects which need a strong capital injection and a large number of shareholders.

A private LLC can only be founded through a simultaneous formation procedure in which one or several founders can participate. As in public LLCs, a one single-member private LLC is possible.

2.- Companies ”being incorporated” and irregular companies

The regulations for companies being incorporated and irregular companies are applicable to all types of corporate enterprises (public and private LLCs and *partnerships limited by shares*).

A) Company being incorporated

Between the moment in which the public deed of incorporation is granted and the moment in which the company is registered, a time period elapses. In this period, the company is not yet a public or private LLC, but a company “being incorporated”. This situation has been considered by the Spanish legislator as something ordinary and transitory. The problem arises when the company being incorporated needs to act in trade operations for different reasons: either because the articles of association allow the company to begin its commercial activity before the registration, or because the company needs to perform certain activities in order to act as a legal person and meet its main purpose in the future. In those cases, the actions of the company being incorporated must be regulated. We must remember that the company being incorporated is not a public or private LLC yet and, therefore, the regulations of both types of companies cannot be applied. For this reason, arts. 36, 37 and 38 of the LSC regulate the company “being incorporated”. These three articles set out who is going to be liable for the obligations assumed by the company “being incorporated” and how this person will be liable to third parties.

Liability of those who have entered into a relationship with third parties

As a general rule, those who have entered into a legal relationship will be jointly and severally liable for all the contracts signed on behalf of the company before its registration. This general rule will not be applicable only in one case: when the parties involved agree to make the effectiveness of the contract conditional upon the registration of the company and the subsequent assumption of liability for those legal relationships entered into by the company “being incorporated”.

In any case, the liability of those who have entered into a legal relationship on behalf of the company “being incorporated” ceases as soon as the company is registered and decides to assume the liability for those legal relationships. The

registered company has three months since the registration in order to decide whether or not it wants to assume the liability for those legal relationships.

Liability of the company "being incorporated"

As an exception, the company "being incorporated" will be considered liable for the legal relationships entered into before its registration in three cases:

- When the legal relationship entered into by the company "being incorporated" is necessary in order to register the company itself.
- When the legal relationship is entered into by directors of the company in compliance with the functions assigned by the public deed.
- When the legal relationship is entered into by a person who has been specially designated by all the partners for that purpose.

In these three cases, the company "being incorporated" has to respond with the assets which it owns at the moment of its formation.

Liability of the company once it has been registered

After the registration, the company must assume the liability for the three types of relationships mentioned above and for all the relationships entered into before the registration which it accepts in three months. If, at the time of the registration, the company has fewer assets than capital, all partners will be required to make an additional contribution to make up the difference.

B) Irregular companies (arts. 39 to 40 LSC)

A company "being incorporated" becomes an irregular company when the partners or shareholders have clearly no intention to have the company registered or, in any case, when a whole year has passed since the public deed of incorporation was granted without registration. The Spanish legislator considers that this is not an ordinary situation and, therefore, it must be avoided as far as possible.

For this reason, an irregular company will be treated as a kind of partnership regulated by the rules for general partnerships, if its purpose is commercial, and by the rules for civil companies, if it has a civil purpose. Apart from that, any shareholder will be able to request the judge to dissolve the irregular company and request the liquidation dividend after having liquidated the company.

If the company is registered after being declared irregular, the partners will keep their personal liability for the debts which the company took over while it was not registered.

3.-Null companies

A company is declared null when the company's operating agreement has a substantial mistake which has not been validated.

a) Causes for nullity

The article 56 of the LSC provides a list of causes for nullity which are applicable to all companies. According to that list, a registered company can only be declared null:

1. When the company's operating agreement is not accepted by at least two founders, or by the sole founder in the case of single-member companies.

2. When all the founders have no legal capacity

3. When the public deed of incorporation does not include each partner or shareholder's contribution.

4. When the public deed of incorporation does not include the corporate name.

5. When the public deed does not include the corporate purpose or the purpose is contrary to the law.

6. When the public deed of incorporation does not include the share capital.

7. When the share capital is not fully paid at the time of the foundation of the private LLC.

8. When, at the time of the foundation of a public LLC, the share capital is not fully subscribed or the shareholders have not paid the minimum part of the par value of each share set out by the law or the articles of association.

9. Apart from these cases, a company cannot be declared null

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b) Effects of the nullity declaration of a company

Null companies have special regulations due to the inefficiency of the general rules on contractual nullity when they have to be applied in commercial issues. According to those rules, contractual nullity has a retroactive effect. It means

that if something is declared null, it is considered as if it has never existed. Nevertheless, this kind of effect cannot be applied to a company's operating agreements because these kind of agreements enable a legal person to enter into legal relationships with many third parties, whose rights need to be protected. If a company nullity has retroactive effects, those third parties' rights, which have been acquired in accordance to good faith, would be considered as if they had never existed, and this would lead to a great legal uncertainty.

For this reason, the nullity declaration of a company has *ex nunc* effects. It means that all legal relationships which the company has entered into before the nullity declaration will be considered null and void and will have legal effects.

Once the Court has declared a company to be null, it has to be dissolved and liquidated according to the procedure set out by the LSC. While the dissolution and liquidation of the company is underway, the company keeps on being a legal person.

It must also be noted that, in the case of private LLCs declared null, because the share capital has not been fully paid, partners are obligated to pay the amount of share capital that remains. In the same way, shareholders of a public LLC are also obligated to pay the amount of share capital that remains when the null company does not have enough money to pay its creditors (art.57 LSC).

4.- Vocabulary

Corporate enterprises- Sociedades capitalistas

Public deed of incorporation- Escritura de constitución

To grant public deed of incorporation- Otorgar escritura pública

Articles of association- Estatutos de la sociedad

Corporate name- Denominación social

Corporate purpose- Objeto social

Capital calls- Dividendo pasivo

Ancillary services- Prestaciones accesorias

Founders- Fundadores

Developers- Promotores

Date of the fiscal year-end- Fecha de cierre del ejercicio económico

Company "being incorporated"- Sociedad "en formación"

Irregular company- Sociedad irregular

Null company- Sociedad nula