



PUBLIC DISCLOSURE REQUIREMENTS FOR PRIVATE COMPANIES: U.S. vs. EUROPE

The mandated disclosure regime for publicly traded companies is similar in the U.S. and Europe, and significant disclosure is required. By contrast, the requirements for U.S. companies that are not public companies required to register with the Securities and Exchange Commission (the “SEC”)¹ are significantly less than those for private companies in Europe (including private European subsidiaries of U.S. public companies).

DISCLOSURE REQUIREMENTS IN THE U.S.

The disclosure required of U.S. companies that are not public companies is governed by the laws of the state in which each such company is formed. State laws vary as to their specifics, but the level of disclosure required is generally very similar.² This is also the case in the European Union (the “EU”), where the European Institutions³ have issued a series of Directives on corporate law that apply to all countries within the European Union, albeit with opt-outs, exceptions, and allowances for variances in some cases.

U.S. companies are required to file their formation documents with the Secretary of State of the state in which they choose to be incorporated (domiciled), which is the U.S. equivalent of a central register, commercial register, or companies register. The formation documents consist of a “charter” (called a Certificate of Incorporation or Articles of Incorporation) for a corporation or a Certificate of Formation or Limited Partnership for other entities. The formation documents will include basic information, such as the company’s name and an address for its agent for service of process (a service that can be provided for a nominal fee by a number of professional Registered Agents with offices throughout the country). The charter is also required to contain the corporate purpose, which can be as broad as “any lawful act or activity,” and the total number of shares that the entity will be authorized to issue.⁴ Other provisions may be included, such as those providing for director and officer indemnification and certain corporate governance procedures, but these are not mandatory. The charter is not in fact meant to provide disclosure of business or financial information, but rather is the

contract between shareholders and the company that can be amended only with shareholder approval. The bylaws of a U.S. company, which are separate from the charter and contain more detailed governance rules, are not required to be disclosed by a private company.

After their formation, companies are not required to provide additional information other than to reflect amendments to the documents that have been filed. Furthermore, events that occur as a matter of state law, such as mergers, consolidations, conversions to a different form of entity, dissolutions, and winding-ups all require a filing with the Secretary of State in order to make the event effective under state law.

It should be noted, however, that the commencement of bankruptcy proceedings or any other type of litigation against the company would not be reflected in the records of the Secretary of State. Instead, this type of information would have to be discovered by means of a litigation search at the courts located in the state and county of the company's incorporation and, for certain types of litigation, would require a search of all state and federal courts.⁵ Furthermore, although some states require a private company to name its initial directors at the time of its formation, there is no requirement to update this information, and there is similarly no requirement to disclose the authorized representatives for purposes of dealing with third parties. A private company is under no obligation to make its accounts or other financial information publicly available.⁶

DISCLOSURE REQUIREMENTS IN EUROPE

In Europe, the Member States of the EU must implement EU law adopted in the form of Directives. This allows for a uniform system of minimum disclosure requirements across all EU countries, although Member States are usually free to implement stricter rules than required in the Directives and also have some leeway when implementing the reduced disclosure requirements for small and medium-sized businesses (discussed in more detail below).

The First Company Law Directive was promulgated in 1968,⁷ and since then every company with limited liability⁸ in the EU has had to open a file in a central register, commercial (or

trade) register, or companies register in the Member State of its incorporation. Such a file must contain information similar to what is required in the U.S., namely:

- The constitutive documents and any amendments thereto; and
- Information on the authorized representatives of the company for purposes of dealing with third parties.

But it must also contain the following:

- The names of the persons who take part in the administration, supervision, or control of the company;
- An annual statement of the capital subscribed (if the constitutive documents state the authorized capital);
- Details of, including any change to, the registered office of the company (which cannot be the address of a nominal service provider, as it can in the U.S.);
- Events signaling the termination of the company's existence, such as its winding-up, a declaration by the courts of nullity of the company, the appointment of liquidators, and the striking off the company from the register; and
- The accounting statements and reports required by the Fourth Company Law Directive described below.

This disclosure must be published in the official journal or national gazette designated for that purpose by the respective Member State.

The Fourth Company Law Directive⁹ requires every European company with limited liability,¹⁰ regardless of whether it is public or private, to publish:

- Its annual accounts, comprising its balance sheet, profit-and-loss account, and notes;¹¹
- An annual report; and
- The opinion of the person responsible for auditing the accounts, who must generally be a Statutory Auditor.

In addition to generally detailed rules regarding the content of the required documents, the Fourth Company Law Directive contains rigid valuation rules with respect to the annual accounts. The Directive also provides that the annual report must, at the very least, include a fair review of the development and performance of the company's business

and of its position, together with a description of the principal risks and uncertainties that it faces.

The Directive's requirements are more relaxed for so-called Small or Medium-Sized Enterprises ("SMEs"). Small Enterprises are those that fulfill at least two of the following three criteria:

- A balance sheet total of less than €4.4 million;
- No more than €8.8 million net turnover per annum; and
- Employment (on average during the financial year) of less than 50 employees.

Medium-sized establishments are those that fulfill at least two of the following three criteria:

- A balance sheet total of less than €17.5 million;
- No more than €35 million net turnover per annum; and
- Employment (on average during the financial year) of less than 250 employees.

Member States have the option of requiring Small Enterprises to publish only abridged balance sheets with abridged notes to the accounts, containing fewer disclosures than otherwise required. Member States may also waive the obligation with respect to Small Enterprises to prepare annual reports, provided that certain information concerning an acquisition by a company of its own shares is given in the notes to its accounts. Finally, Member States may relieve Small Enterprises from the obligation of having their annual accounts audited by a Statutory Auditor.

With respect to Medium-Sized Enterprises, Member States have the option, within certain limits, of requiring a different layout than the one set forth in the Fourth Company Law Directive. Member States also have the option of requiring abridged balance sheets showing only certain items of those otherwise required. Finally, Member States are allowed to limit the level of detail otherwise required in the notes of a Medium-Sized Enterprise's accounts as well as in its annual report.

As of March 2012, Member States now also have the option of exempting so-called Micro-Entities from complying with even more requirements of the Fourth Company Law

Directive.¹² In order to qualify as a Micro-Entity, a company must meet all of the following criteria:

- Its balance sheet total must not exceed €350,000;
- Its net turnover must not exceed €700,000; and
- The average number of employees during the financial year must not exceed 10.

Such Micro-Entities may be permitted not to draw up notes to their annual accounts¹³ or prepare an annual report,¹⁴ and they may even be exempted from the obligation to publish annual accounts,¹⁵ but each of these possible exemptions applies only if the otherwise-required information is disclosed elsewhere. Therefore, some basic substantive disclosure obligations will still always apply.

PUBLIC POLICY CONSIDERATIONS

Despite the recent efforts to simplify the business environment and reduce the administrative burden on SMEs and Micro-Entities established in the EU, the notion that a certain amount of disclosure is required, especially in order to protect the interests of third parties, has been recognized as a core principle in European law and regulation ever since the First Company Law Directive was promulgated in 1968. The theory is that if third parties are able to easily verify information, such as whether a certain person is authorized to act on behalf of a company, or whether a company is backed by an adequate amount of capital, there will be fewer instances when the obligations entered into by such an entity will not be valid or will be avoided.

The same public policy considerations exist in the United States, but for companies that are not large enough to require registration with the SEC, the disclosure requirements are significantly less burdensome. The theory here is that potential shareholders, creditors, and business partners of a private company will require the information they need as a condition to their investment or loan and that small enterprises, in order to thrive, should be free of expensive mandated disclosure requirements. For potential litigants against the company, the legal system provides for information through discovery, although that requires initiation of litigation. In addition, companies that seek to expand their

access to the debt and equity capital markets will have an incentive (and in many instances will be required) to register with the SEC, and upon doing so will become subject to a far more extensive set of disclosure requirements.

The European system makes this information available for private companies by a simple search of a country's central register. This information is available not only to persons who have negotiating clout with, or some sort of legal or contractual power over or rights vis-à-vis, the company but also to those constituents who do not have the same level of clout or other legal rights (or, for that matter, have none at all). From that point of view, the EU Directives have achieved their purpose of protecting the interests of third parties when dealing with companies established in the EU.

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ENDNOTES

- 1 The U.S. securities laws require periodic reporting generally only for companies that have sold securities in a public sale, are listed on a stock exchange, or have more than the 2,000 holders of record or 500 holders of record that are nonaccredited investors, plus more than \$10 million in assets. These are referred to as "public companies." Other regulatory regimes govern disclosure by financial institutions and investment entities.
- 2 For simplification, this *Commentary* assumes that Delaware law applies.
- 3 The three main institutions involved in EU legislation are the Council of the European Union, the European Parliament, and the European Commission.
- 4 The authorized share capital of a U.S. company is not a capitalization requirement. U.S. companies are not, generally speaking, required to have any specific amount of funds in their bank accounts, whether upon incorporation or thereafter, at least not as a matter of corporate law. The number of shares authorized is usually significantly higher than the number of issued and outstanding shares, and that latter number is not subject to a disclosure requirement for a private company.
- 5 Some courts now have searchable web sites that facilitate and reduce the cost of this process.
- 6 In specific industries, disclosure to a regulator may be required and therefore become available to the public, including by way of information request.
- 7 Dir. 68/151/EEC of Mar. 9, 1968, OJ L/65 of Mar. 14, 1968, at 8, restated by Dir. 2009/101/EC of Sept. 16, 2009, OJ L/258 of Oct. 1, 2009, at 11, with effect as of Oct. 21, 2009.
- 8 Art. 2 of Dir. 2009/101/EC, *supra* note 1, lists the following examples, among others: (i) in Germany: the *Aktiengesellschaft* (AG), *Kommanditgesellschaft auf Aktien* (KGaA), and *Gesellschaft mit beschränkter Haftung* (GmbH); (ii) in France and Luxembourg: the *société anonyme* (SA), *société en commandite par actions* (SCA), and *société à responsabilité limitée* (Sàrl), and in France alone, the *société par actions simplifiée*; (iii) in The Netherlands: the *naamloze vennootschap* (NV) and *besloten vennootschap* (BV); and (iv) in the United Kingdom, companies incorporated with limited liability (both Plc and Ltd.).
- 9 Art. 47 of Dir. 78/660/EEC of July 25, 1978, OJ L/222 of Aug. 14, 1978, as amended, at 11.
- 10 Article 1 of Directive 78/660/EEC, *supra* note 8, lists the following examples, among others: (a) in Germany: the *Aktiengesellschaft* (AG), *Kommanditgesellschaft auf Aktien* (KGaA), and *Gesellschaft mit beschränkter Haftung* (GmbH); (b) in France and Luxembourg: the *société anonyme* (SA), *société en commandite par actions* (SCA), and *société à responsabilité limitée* (Sàrl); and (c) in The Netherlands: the *naamloze vennootschap* (NV) and *besloten vennootschap* (BV).
- 11 It should be noted that as only annual accounts are required to be published, the publicly available information would be less current than that available for U.S. public companies submitting quarterly financials to the SEC. But, again, this is required of private as well as public companies in Europe; hence the trade-off. European public companies will also file more regular financials, based on other sets of laws and stock exchange rules.
- 12 Art. 2 of Dir. 2012/6/EU of Mar. 14, 2012, OJ L/2012/81 of Mar. 21, 2012, at 3.
- 13 Provided that certain information required to be disclosed in the notes is disclosed at the foot of the balance sheet. *Id.* at art. 2(c).
- 14 Provided that certain information required to be disclosed in the annual report is disclosed in the notes to the accounts or, in the absence of any notes, at the foot of the balance sheet. *Id.* at art. 2(d).
- 15 Provided that the balance sheet information contained therein is duly filed, in accordance with national law, with at least one competent authority designated by the Member State concerned. *Id.* at art. 2(e).

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