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The Legitimacy of Restrictions on the Functioning of Single-Member Limited Liability Companies

Abstract

The article discusses a vital problem of the legal restrictions imposed on single-member limited liability companies under the provisions in force. In the first part of the text, the author explores the binding regulations applicable to single-member companies and arranges them in a way that it is possible to classify them within the legal framework. In the second part, the author deals with the legitimacy of existence of the said restrictions on the functioning of single-member companies, analyses the superficiality of application of particular solutions, and defines the most significant directions of changes necessary to abolish the restrictions imposed on single-member limited liability companies.

Keywords: law, single-member companies, restrictions, superficiality, functioning

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Introduction

Every single-member limited liability company runs its business, in principle, in the same way as multi-member limited liability companies. However, there are several provisions of the CCC,² which impose certain restrictions on the functioning of single-member limited liability companies – either at the stage of their formation or their further operation. The legitimacy of these restrictions has been causing objections among both legal theoreticians and practitioners for a long time now, and the few arguments in favour of upholding them are increasingly fading, becoming often ostensible arguments at best. Therefore, it seems reasonable to review these restrictions and think whether their existence is justified in the present social and economic reality.

Current legal circumstances

Restrictions related to formation

The most severe restriction imposed under the provisions of the CCC is that a single-member limited liability company may not be formed solely by another single-member limited liability company as provided for in Article 151, § 2 of the CCC. The prohibition is limited essentially only to acts of formation of a single-member limited liability company. Meanwhile it is impossible to find a definition of “formation of a limited liability company” as the CCC does not name the moment in which a limited liability company is considered “formed”. This is opposite to the case of a joint-stock company, whose moment of formation has been expressly named in Article 310, § 1 of the CCC as the moment of the taking-up of all of its shares. There is no such clear specification of the moment of “formation” of a limited liability company, though. Thus, it is necessary to turn to a systemic interpretation and look into the occurrence of the phrase “formation of a/the company” in relation to limited liability companies in other provisions of the CCC. Article 169, § 1 of the CCC speaks of a deadline after which the articles of association are terminated if

² Act of 15 September 2000 – the Commercial Companies Code (Journal of Laws of the Republic of Poland of 2000 No. 94, item 1037).

the formation of a company is not filed with a registry court. The provision offers the phrase “formation of a company” exactly in the context of submitting an entry to a registry court. Based on the provision in question it can be then said that the formation of a company is the term from the moment the partners execute the articles of association of the company to the moment in which the company is registered at a registry court. It will rather be the very moment of execution of the articles of association since the content of the provision implies that it is the “formation” of a company alone that is to be registered. It is then necessary to assume that the moment in which a limited liability company is formed is the moment in which the company’s articles of association are executed. This proposition is supported by an analysis of Article 164, § 1, according to which the management board of a company shall notify the registry court of the formation of the company. We should not confuse the moment of formation of a company with the requirements for its establishment or its acquisition of a legal personality. Of course, according to Article 161, § 1 of the CCC, a limited liability company in organisation is considered formed upon execution of its articles of association. Such a company has full legal capacity to act as defined in Article 11, § 1 of the CCC, but the company acquires its legal personality – pursuant to Article 12 of the CCC – only with the said entry in the register.

Given the content of Article 16 of the CCC, according to which the disposal or encumbrance of a share effected prior to the entry of the company in the register shall be null and void, this eliminates the possibility of registering a single-member limited liability company in which the sole shareholder is another single-member limited liability company who had more than one shareholder at the moment of formation. In the light of the above, the restriction on the formation of a single-member limited liability company until the moment of its actual formation extends over the entire whole period of the functioning of a formed limited liability company in organisation.

It should be mentioned here that the above restriction is significant moderation to the rules in force under the Commercial Code of 1934 since according to its Article 158, the sole shareholder of a limited liability company could not be another limited liability company composed of one partner.³ The prohibition was thus extended over the whole period of the functioning and existence of a limited liability company, and did not cover only the moment of its formation.

³ Regulation of the President of the Republic of Poland – the Commercial Code of 27 June 1934 (Journal of Laws of the Republic of Poland No. 57, item 502).

Restrictions on making declarations

According to Article 173 § 1 of the CCC, if all shares in a company are held by a sole shareholder or by a sole shareholder and the company, a declaration made by such shareholder to the company shall be in written form, otherwise it shall be null and void unless the law provides otherwise. This means a significant restriction also at the stage of the functioning of such companies. The provision requires that each declaration of will made to a company by the sole shareholder of a single-member company be submitted in writing. In line with a view worthy of approval, the range of application of the provision in question shall not cover all declarations of will made in a company by the sole shareholder. This means that the provision shall not be extended to include resolutions of the sole shareholder exercising the rights of the shareholders' meeting. It can be assumed that such resolutions take the form of declarations of will,⁴ but according to the commonly adopted views, they should be considered made by a company's authorities and not its shareholder alone, and thus are not made to the company.⁵ Examples of declarations of will made by the sole shareholder in a company include termination or withdrawal from an agreement (e.g. a loan agreement concluded between the sole shareholder and the company).

Restrictions on representation

Another restriction for single-member limited liability companies under the provisions of the CCC is the lack of the right of the sole shareholder to represent a single-member limited liability company in organisation. The restriction does not concern registering the company at a registry court, and is included in the content of Article 162 of the CCC. This means that a single-member limited liability company in organisation may be represented just like any other limited liability company in organisation, which is by its management board or an attorney appointed by a unanimous resolution of the shareholders' meeting. It is important to remember that a management board or an attorney may represent a single-member limited liability company in organisation provided that neither any member of the management board nor the attorney is the sole shareholder of this limited liability company in organisation.⁶ Looking into the remaining provisions concerning the representation

⁴ Supreme Court's judgement of 13.4.2004, IV CK 686/04, "Monitor Prawniczy" 2006, 9, p. 485.

⁵ S. Sołtysiński, [in:] S. Sołtysiński, A. Szajkowski, A. Szumański, J. Szwaja (eds.), *Kodeks spółek handlowych, Tom II, Komentarz do artykułów 151–300*, Warszawa 2005, p. 263.

⁶ A. Szajkowski, M. Tarska [in:] *ibidem*, p. 163.

of companies and into the general provisions arising from the Civil Code,⁷ we arrive at a conclusion that the right to represent a single-member limited liability company is granted also to a holder of commercial power of attorney. Thus, according to Article 162 of the CCC, neither a holder of a commercial power of attorney being the sole shareholder of a single-member limited liability company has the right to represent it – except when the company needs to be registered with a registry court.

Additional registration duty

Article 166 of the CCC lists a range of data necessary to submit an application for the registration of a limited liability company at a registry court. § 1 of this provision includes elements that the court needs to be presented with at the moment in which an application for the registration of a limited liability company in the register is submitted. When the application is submitted by a single-member limited liability company, it is necessary to provide additional data, other than that given in § 1. These requirements are covered in § 2, and they include: identification details of the sole shareholder with a mention that they are the sole shareholder of the company. If the sole shareholder is a legal person or an organisational unit without a legal personality but with legal capacity based on separate provisions, it is necessary to provide their business name, registered office, and address. When the sole shareholder is a natural person, it is necessary to provide their name, surname, and address.⁸ It is important to bear in mind that an application to register a limited liability company in the register of entrepreneurs is to be submitted on a relevant official form – including all the appendices required under separate provisions.

Restrictions regarding foreign sole shareholders

As a side note to this discussion, it should be mentioned that the abovementioned restrictions concerning sole shareholders of limited liability companies also apply to limited liability companies where the sole shareholder is a foreign limited liability company. Membership of foreign legal persons in companies with their registered office in Poland is governed by the CCC, regardless of the country of origin (EU countries, non-EU countries).⁹ Thus, a foreign single-membership limited liability

⁷ Act of 23 April 1964 – the Civil Code (Journal of Laws of the Republic of Poland of 1964 No. 16, item 93 as amended).

⁸ M. Chomiuk, *Komentarz do Art. 173*, [in:] Z. Jara (ed.), *Kodeks spółek handlowych. Komentarz*, 2nd ed., Warszawa 2017.

⁹ *Ibidem*.

company may not form another single-membership limited liability company in Poland – even if such a possibility is provided for in the legislation of its country of origin.¹⁰

Practice and the changes called for

Legitimacy of restrictions related to company formation

Many authors speak of an absolute illegitimacy of the restrictions imposed on the procedure of formation of single-member limited liability companies by other single-member limited liability companies. The argument raised is that the imposition of the prohibition under Article 151, § 2 with a simultaneous revocation of Article § 3, which prohibited the existence of single-member limited liability companies at every stage of its functioning is pointless. A. Kidyba even argues that this solution is simply wrong.¹¹ A prohibition limited only to the formation of a limited liability company gives no legal restrictions on the formation of a single-member limited liability company taking advantage of ‘figureheads’. As proven by A. Kidyba, a multi-member company formed by a single-member limited liability company and a figurehead is a “fictitious company.”¹² Establishing such artificial legal constructs only to form a limited liability company leads to many negative consequences, including making the figurehead dependent on the single-member company by the figurehead accepting an order to join the company together with a single-member limited liability company for a consideration. This way, “a limited liability company is formed secretly by one entity.”¹³ The relationship between a single-member company and a figurehead may last until the moment of registration, when the figurehead “leaves” the company and their shares are redeemed, or when they sells their shares to the single-member company which becomes then a sole shareholder.

It is not hard to imagine a situation in which a single-member limited liability company is formed with the involvement of another single-member limited liability company and its sole shareholder is a natural person or another single-member

¹⁰ This is what the Supreme Court pointed to in its decision of 28 April 1997 (II CKN 133/97, OSP 1998, vol. 4, item 87), issued with the then-applicable Commercial Code being in effect, but which remains valid also under the current CCC.

¹¹ A. Kidyba, *Spółka z ograniczoną odpowiedzialnością. Komentarz*, 6th ed., Warszawa 2014.

¹² Idem, *Atypowe spółki handlowe*, Warszawa 2011, p. 24.

¹³ Idem, *Spółka...*

limited liability company. Actually, such a chain relationship could take on an infinite form, leading to the conclusion that if the provisions of Article 151, § 2 were to restrict the possibility to form single-member limited liability companies by entities embracing the entire ownership of so formed single-member companies, the implemented solution is completely ineffective.

No rational arguments to justify such a state of affairs can be found although some authors suggest that the discussed solution's purpose is to "protect the interest of the company's creditors",¹⁴ or to prevent "vertical holdings" from being established, which seems to be hardly convincing.¹⁵ It is therefore correct to regard this restriction superficial, especially considering the possibility for a single-member company to be formed by another single-member company and the sole shareholder of the company, and for a single-member limited liability company to be formed by a single-member joint-stock company,¹⁶ and the provision of Article 151, § 2 itself shall be considered highly problematic,¹⁷ and thus completely redundant when there is an option to form a single-member limited liability company by other single-member legal entities.

Legitimacy of restrictions related to making declarations

According to a view shared by S. Sołtysiński and W. Pyziół, the very possibility to form single-member limited liability companies brought about a need to implement a regulation to protect the interest of the company establishing a relationship with its sole shareholder as a third party.¹⁸ Moreover, the provision of Article 173 of the CCC is an expression of adaptation of Polish regulations to the Twelfth Council Company Law Directive (89/667/EEC).¹⁹ The requirement for the declarations to be in written form and being null and void if made otherwise makes any declarations of will made by a sole shareholder to a company made, in fact, on the condition of any such declaration being made in writing. It is then *ad solemnitatem* a form, which needs to be expressed in writing, as a notary-certified signature, or as a notary deed to render a unilateral declaration of will of a sole shareholder valid. The present wording of the provision of Article 173 had § 2 and 3 repealed by means of the Act of 23.10.2008 (Journal of Laws of the Republic of Poland No. 217, item 1381), which

¹⁴ Z. Jara, *Komentarz do Art. 151*, [in:] idem (ed.), op. cit.

¹⁵ J. Naworski, *Komentarz do Kodeksu spółek handlowych*, Warszawa 2001.

¹⁶ M. Rodzynkiewicz, *Kodeks spółek handlowych Komentarz*, 7th ed., Warszawa 2018.

¹⁷ W. Pyziół, *Kodeks spółek handlowych. Komentarz*, Warszawa 2008.

¹⁸ S. Sołtysiński, op. cit. and W. Pyziół, op. cit., p. 351.

¹⁹ A. Kidyba, *Spółka...*

entered into force on 08.01.2009 as a result of adaptation of the provision to Article 5 of the Twelfth Directive. Hence, the requirement of written form with a notary-certified signature was removed from the legal framework for cases beyond the scope of ordinary acts. The change was criticised in the doctrine. It was argued that the liberalisation of the provisions concerning the relationship between a sole shareholder and a company in the Polish legal and economic circumstances could lead to various acts of abuse, e.g. to the backdating of documents.²⁰ On the one hand, it is hard to disagree with the presented view. On the other hand, it is important to emphasise the facilitation given in the area of the relationships established between a single-member company and its shareholder. Single-member limited liability companies in which the sole shareholder is also the sole member of the management board are quite common in business trading after all. And this is where we should turn our attention to Article 210, § 2, which requires the sole shareholder of a single-member limited liability company, being the sole member of the management board, to perform legal acts expressed in the form of a notary deed. Hence, it seems that the protection of the interest of a company in its relationships with its sole shareholder is manifested precisely in the content of Article 210, § 2. The requirement in question is absolute in demanding the form of a notary deed for the performed legal acts, and this is a sufficient measure to protect companies from having their interest breached.²¹ This is why, given the requirements under EU regulations and the need to protect the interest of companies' as necessary, it is hard to question the legitimacy of the restriction under Article 173 of the CCC.

Legitimacy of restrictions on representation

It is not easy to justify the intention behind Article 162 of the CCC in its present form. It seems that like Article 151, § 2, it is a makeshift solution to protect the interest of single-member limited liability companies while the reality is that it is an obstacle to the functioning of such companies. If the CCC allows for the formation of a single-member limited liability company, it does not seem reasonable to restrict the possibility to represent such a company in organisation except for the possibility to register it at a registry court. The sole shareholder will be able to appoint an attorney, who will act according to the former's instructions anyway. And this does

²⁰ Ibidem.

²¹ Z. Jara, *Komentarz do Art. 210*, [in:] idem (ed.), op. cit.

not guarantee certainty of business relations, but it does generate unnecessary expenses to be borne by the company.²²

Legitimacy of restrictions on additional registration duty

It is hard to disagree with A. Kidyba who claims that “except for the registration of a single-member company formed for the first time, the provision of Article 166, § 2 of the CCC shall be applied also in secondary situations, with non-formation-related acquisition of shares by the company’s sole shareholder after the company has been registered.”²³ Such a broad restriction concerning the duty to provide the registry court with additional information related to the sole shareholder of a limited liability company also results from the adaptation of Polish regulations to the Twelfth Council Company Law Directive (89/667/EEC). The purpose of the registration is to reveal a company’s single-member composition, regardless of the origin of its formation.²⁴ An analogous solution is applied to joint-stock companies. According to Article 319, § 2, if all shares in the company are acquired by the shareholder following the registration of the company, it is also necessary to provide the detailed information concerning the company’s sole shareholder as specified in § 1 of the provision. Both solutions are universally approved in the doctrine despite some interpretational doubts related to the reasons behind such registration in situations of the secondary formation of a single-member limited liability company.

Legitimacy of restrictions concerning foreign shareholders

The prohibition on the formation of single-member limited liability companies by other single-member limited liability companies under the Polish CCC applies to both Polish and foreign companies. It is therefore necessary to reach for the same argument of the illegitimacy of this restriction as in the case of the analysis of the company formation prohibition imposed on Polish companies. It should be mentioned, by way of supplementation, that there are additional difficulties in defining the qualities that are to determine which foreign companies are limited liability

²² R. Pabis, *Komentarz do Art. 162*, [in:] J. Bieniak et al., *Kodeks spółek handlowych. Komentarz*, 5th ed., Warszawa 2017.

²³ A. Kidyba, *Spółka...*

²⁴ M. Chomiuk, *Komentarz do Art. 166*, [in:] Z. Jara (ed.), op. cit.

companies in the light of Polish regulations,²⁵ which becomes another argument for doing away with the prohibition under Article 151, § 2 of the CCC.

Conclusion

To summarise, provisions regulating single-member limited liability companies can be found in many parts of the CCC, and they fail to offer a uniform regulation for this legal form in question. Several major restrictions on the functioning of this construct have been reviewed and analysed critically based on their legitimacy and utility to both the security and functionality of business trading. While it is hard to question the legitimacy of restrictions that directly adapt the CCC to EU regulations, it is still possible to challenge and prove the restrictions related to the formation of a single-member limited liability company by another single-member limited liability company and to the representation of companies in organisation to be groundless and superficial. Given the effects of the functioning of these provisions, not only providing no protection to business trading but also considerably hindering the operations of the companies in question, it seems that it is reasonable to call for the elimination of the discussed restrictions from the current legal framework.

²⁵ R. Potrzeszcz, *Komentarz do Art. 151*, [in:] R. Potrzeszcz, T. Siemiątkowski (eds.), *Kodeks spółek handlowych. Komentarz. Tytuł III. Spółki kapitałowe. Dział I. Spółka z ograniczoną odpowiedzialnością*, Warszawa 2011.