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The Spirit of Corporate Law

Core Principles of Corporate Law in Continental Europe

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Preface

Reading the Company Law Action Plan of the European Commission (issued on 21 May 2003) one cannot help having the impression that European company law policy has a certain focus on listed companies and will try to enhance their efficiency by way of state competition if possible, and by harmonisation only if need be. The same is true under the new Action Plan on European company law and corporate governance (issued on 12 December 2012). Furthermore, as to substance, a certain inclination to Anglo-American concepts is prevailing. Just one example is the idea to develop a wrongful trading rule, whereby directors would be held personally accountable for the consequences of the company's failure, if it is foreseeable that the company cannot continue to pay its debts and they don't decide either to rescue the company and ensure payment or to liquidate it (*sub* 3.1.3.b). In the field of legal research, some influence can be ascribed to the important monograph on *The Anatomy of Corporate Law*, again focused on listed companies and the Anglo-American perspective, defining efficiency and the so called shareholder value as the centre of corporate law (2nd ed., 2009, p. 28–29).

Our book, to the contrary, is first of all based on the fact that throughout Europe only a small number of corporations are listed at all – the reality of corporate law is dominated by small and medium-size enterprises. Therefore legal standards pertaining to control transactions or investor protection and other topics of capital market law in our eyes are not part of the core principles of corporate law. Furthermore, law is not that much about efficiency. Law is first of all about justice. As to corporate law, the question is not how to protect best the interests of shareholders but rather the interests of *all* parties affected by a firm's activities, including its creditors and other third parties. The Treaty on the Functioning of the European Union reminds us not to forget that when drawing the attention of the European legislator in the field of corporate law and freedom of establishment to "the protection of the interests of members *and others*" (art. 50). The book is focusing on the perspective of key jurisdictions in continental Europe, such as (in an alphabetical order) Austria, France, Germany, Italy, Spain, Switzerland, and analysing seminal inputs from Belgium, the Netherlands, Portugal and Scandinavian countries.

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Innsbruck and Munich, June 2013

Günter H. Roth
Peter Kindler

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Selected Abbreviations

ABGB	Allgemeines Bürgerliches Gesetzbuch (Austrian Civil Code)
AcP	Archiv für civilistische Praxis (German law journal)
AHGB	Allgemeines Handelsgesetzbuch (General Austrian Commercial Code)
ADHGB	Allgemeines Deutsches Handelsgesetzbuch (General German Commercial Code)
AG	Aktiengesellschaft, Public Limited Company (Germany, Austria, Switzerland)
AG	Die Aktiengesellschaft (German law journal)
AGG	Allgemeines Gleichbehandlungsgesetz (German General Non-Discrimination Act)
AktG	Aktiengesetz (Stock Corporation Act)
AnwBl.	Anwaltsblatt (German law journal)
Art.	Article
AWD BB	Außenwirtschaftsdienst des Betriebs-Beraters
BAG	Bundesarbeitsgericht (German Federal Labour Court)
BB	Betriebs-Berater (German law journal)
BDA	Bundesvereinigung der Deutschen Arbeitgeberverbände (Confederation of German Employers' Associations)
BDI	Bundesverband der Deutschen Industrie (German Industry Assocation)
BeckRS	Beck-Rechtsprechung
BetrVG	Betriebsverfassungsgesetz (Works Constitution Act)
BGB	Bürgerliches Gesetzbuch (German Civil Code)
BGBl	Bundesgesetzblatt (Federal Law Gazette in Germany and Austria)
BGH	Bundesgerichtshof (German Federal Court of Justice)
BGHZ	Entscheidungen des Bundesgerichtshofes in Zivilsachen (German Federal Court of Justice, Decisions in civil cases)
BeurkG	Beurkundungsgesetz (German Authentication Act)
BNotO	Bundesnotarordnung (German Federal Regulation on Notaries)
BR-Dr.	Bundesratsdrucksache (Official documents of the German Federal Council)
BT-Dr.	Bundestagsdrucksache (Official documents of the Parliament of the Federal Republic of Germany)
BT-PlPr.	Bundestagsplenarprotokoll (Plenary protocoll of the Parliament of the Federal Republic of Germany)
BVerfG	Bundesverfassungsgericht (German Federal Constitutional Court)
BVerfGE	Entscheidungen des Bundesverfassungsgerichts (Decisions of the Federal Constitutional Court)

Cass Crim	Cour de cassation (Chambre criminelle)
CC	Codice civile (Italian Civil Code)
CCom	Code de Commerce (French Commercial Code)
c.d.a	consiglio di amministrazione, Administrative Board
cf	confer
Ch	Chapter
CJEU	Court of Justice of the European Union[1]
COMI.....	Centre of main interest
Common Market L. Rev ..	Common Market Law Review
Cornell L. Rev.	Cornell Law Review
CP	Codice Penale (Italian Criminal Code)
dAktG	deutsches Aktiengesetz (German Stock Corporation Act)
DAV	Deutscher Anwaltverein (German Lawyers Association)
DB	Der Betrieb (German law journal)
DCFR	Draft Common Frame of Reference
DCGK.....	Deutscher Corporate Governance Kodex (German Corporate Governance Codex)
dGmbHG	deutsches GmbH-Gesetz (German Private Limited Company Act)
dHGB.....	deutsches Handelsgesetzbuch (German Commercial Code)
dUWG	deutsches Gesetz gegen den unlauteren Wettbewerb (German Act against unfair Competition)
DJT	Deutscher Juristentag (German Lawyers Forum)
DNotZ	Deutsche Notar-Zeitschrift (German law journal)
DStR.....	Das deutsche Steuerrecht (German law journal)
DZWiR	Deutsche Zeitschrift für Wirtschaftsrecht (German law journal)
EBOR	European Business Organization Law Review
EC.....	European Commission
ECFR.....	European Company and Financial Law Review
ECJ	European Court of Justice
ECL	European Company Law (Law journal)
ECR	European Court Reports
EEC	European Economic Community
e .g.....	exempli gratia (for example)
EIRL	Entrepreneur Individuel à Responsabilité Limitée, Limited Liability Individual Enterprise (France)
EKEG	Eigenkapitalersatz-Gesetz (Austrian Act on Substitute Equity)
EMCA.....	European Model Company Act
EP	European Parliament
EPC	European Private Company
Erg.-Bd.	Ergänzungsband (supplement)
et al.	et alii (and others)
etc.	et cetera (and so on)
et seq.	et sequens (and the following)

[1] Official denomination since 2009, see also ECJ below, formerly the common abbreviation.

EWiR	Entscheidungen zum Wirtschaftsrecht (German law journal)
EU.....	European Union
Eur. J. Law & Econ.	European Journal of Law and Economics
EURL	Entreprise Unipersonelle à Responsabilité Limitée, Single Person Limited Company (France)
EuZW	Europäische Zeitschrift für Wirtschaftsrecht (German law journal)
FS.....	Festschrift (honorary publication)
fn.	footnote
GenG.....	Genossenschaftsgesetz (German Cooperatives Act)
GeS	Zeitschrift für Gesellschaftsrecht und angrenzendes Steuerrecht (Austrian law journal)
GesAusG	Gesellschafter-Ausschlussgesetz (Austrian Act on the Squeeze-out of Minority Shareholders)
GesRZ	Der Gesellschafter (Austrian law journal)
GG.....	Grundgesetz (Basic Law for the Federal Republic of Germany)
GLJ	The German Law Journal
GmbH.....	Gesellschaft mit beschränkter Haftung, Private Limited Company (Germany, Austria, Switzerland)
GmbHG.....	Gesetz betreffend die Gesellschaften mit beschränkter Haftung (Private Limited Companies Act)
GmbHR.....	GmbH-Rundschau (German law journal)
GPR.....	Zeitschrift für Gemeinschaftsprivatrecht (European Community Private Law Review)
GrünhutsZ	Zeitschrift für das Privat- und öffentliche Recht der Gegenwart (German law journal)
GWR.....	Gesellschafts- und Wirtschaftsrecht (German law journal)
HGB	Handelsgesetzbuch (German Commercial Code)
HRegV	Handelsregisterverordnung (Austrian Commercial Register Ordinance)
ibid., id.	ibidem, idem (at the same place, the same)
i. e.	id est (that is)
InsO	Insolvenzordnung (German Insolvency Statute)
IntGesR	Internationales Gesellschaftsrecht (international company law)
IPRax	Praxis des Internationalen Privat- und Verfahrensrechts (German law journal)
JBl.	Juristische Blätter (Austrian law journal)
JZ	Juristenzeitung (German law journal)
JCP/E	La Semaine juridique – Entreprise et affaires (French law journal)
KG	Kommanditgesellschaft (limited partnership)

LSC	Ley de Sociedades de Capital (Spanish Capital Corporations Act)
MDR	Monatsschrift für Deutsches Recht (German law journal)
MiFID	Markets in Financial Instruments Directive
MitbestErgG	Gesetz zur Ergänzung des Gesetzes über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie (one of the German Codetermination Acts)
Modern Law Rev.	Modern Law Review
MoMiG	Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (German Act to modernise the Law on Private Limited Companies and to Combat Abuses)
Montan-mitbestG	Gesetz über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie (one of the German Codetermination Acts)
NJW	Neue Juristische Wochenschrift (German law journal)
NJW-RR	Neue Juristische Wochenschrift-Rechtsprechungsreport (German law journal)
NZ	Notariatszeitung (Austrian law journal)
NZA	Neue Zeitschrift für Arbeitsrecht (German law journal)
NZG	Neue Zeitschrift für Gesellschaftsrecht (German law journal)
öAktG	österreichisches Aktiengesetz (Austrian Stock Corporation Act)
öGmbHG	österreichisches GmbH-Gesetz (Austrian Private Limited Companies Act)
OGH	Oberster Gerichtshof (Austrian Supreme Court)
OJEU	Official Journal of the European Union
ÖBA	Zeitschrift für das gesamte Bank- und Börsenwesen (Austrian law journal)
ÖJT	Österreichischer Juristentag (Austrian Lawyers' Forum)
öKO	österreichische Konkursordnung (Austrian Bankruptcy Act)
OLG	Oberlandesgericht (German Court of Appeals)
öUGB	österreichisches Unternehmensgesetzbuch (Austrian Commercial Code)
OR	Obligationenrecht (Swiss Code of Obligations)
Portuguese CSC	Portuguese Código das Sociedades Comerciais (Code of Commercial Companies)
RabelsZ	Rabels Zeitschrift für ausländisches und internationales Privatrecht (The Rabel Journal of Comparative and International Private Law)
RdW	Recht der Wirtschaft (German law journal)
RGBl	Reichsgesetzblatt

Riv. Soc.	Rivista delle Societá (Italian law journal)
RIW.....	Recht der Internationalen Wirtschaft (German law journal)
SA	Société Anonyme, Joint Stock Company (France)
S.A.R.L.	Société à responsabilité limitée, private limited company (France)
SCE.....	Societas Cooperativa Europaea, European Cooperative Society
SE.....	Societas Europaea, European Corporation
SLNE.....	Sociedad Limitada Nueva Empresa, Limited Liability Company (Spain)
SME.....	Small and medium-sized enterprises
SPE	Societas Privata Europaea, European Private (Limited) Company
S.r.l.	Societá a responsibilitá limitata, limited liability company (Italy)
Stanford Law Rev.	Stanford Law Review
StGB.....	Strafgesetzbuch, German Criminal Code
StGBl.	Staatsgesetzblatt
TEU.....	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
U.Chi.L.Rev.	The University of Chicago Law Review
UG.....	Unternehmergesellschaft, Entrepreneurial Company (Germany)
URG.....	Unternehmensreorganisationsgesetz (Austrian Company Re-organization Act)
WM.....	Wertpapier-Mitteilungen (German law journal)
WpHG.....	Wertpapierhandelsgesetz (German Securities Trading Act)
ZEuP	Zeitschrift für Europäisches Privatrecht (German law journal)
ZGS	Zeitschrift für Vertragsgestaltung, Schuld- und Haftungsrecht (German law journal)
ZgS.....	Zeitschrift für die gesamte Staatswissenschaft (German law journal), since 1986 Journal of institutional and theoretical economics
ZHR	Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (German law journal)
ZIP.....	Zeitschrift für Wirtschaftsrecht (German law journal)
ZRP	Zeitschrift für Rechtspolitik (German law journal)
ZVglRW	Zeitschrift für vergleichende Rechtswissenschaft (German law journal)

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Chapter 1. Introduction

I. Freedom and responsibility in European Corporate Law

1. European Company Law at a crossroads

Two paths lead to the future of European company law, and precedents for the development of these paths have already been sketched out in the field of the corporation. One path is harmonisation and the creation of uniform law by having EU institutions establish standards; decision-making "from above". The other path is the choice between different national offerings – competition among legal systems – in which citizens are guided by their preferences; decision-making "from below". Harmonisation initially stood in the foreground. This was reflected in company law directives starting in 1968[1] which primarily addressed the **public limited company** and, from a substantive standpoint, followed the high level of regulation and legal certainty provided by the Aktiengesellschaft [AG = corporation, respectively public limited company] in the German legal system. The best example of this is the Second or Capital Directive of 1976.[2]

The **private limited company** has served as the alternative model for free choice according to decisions of the ECJ since 1999. Its decisions in Centros, Überseering and Inspire Art[3] were and are primarily understood to mean that the founder of an enterprise located in a specific European Union Member State can avail itself of foreign entity forms even if there is no factual relationship to the respective country.[4] Even if this interpretation rests since Cadbury-Schweppes (2006) and Vale (2012)[5] on shaky ground[6], the practice has been to quickly act based upon this interpretation, especially in Germany as well as Denmark and the Netherlands.[7] What thus became clear is a preference for legal systems with a low degree of regulation in general and of formation requirements in particular, resulting in a strong preference for the English private limited company. This selection was made in approximately 50,000 instances for German enterprises through 2010.[8] This legal trend strikes to the core of the Continental European private limited

[1] First or Disclosure Directive 68/151/EEC dated 9 March 1968.

[2] 77/91/EEC dated 13 December 1976.

[3] Matter C-212/97, *Centros* (1999) ECR I-1459 = ZIP 1999, 438; matter C-208/00 *Überseering BV/Nordic Construction Company Baumanagement GmbH [NCC]* (2002) ECR I-9919 = ZIP 2002, 2037; matter C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam/Inspire Art Ltd* (2003) ECR I-10155 = ZIP 2003, 1885.

[4] BGH NZG 2005, 508; Austrian OGH RdW 1999, 719; from the German literature among others, Behrens, in: Ulmer, GmbHG, Annex. B marginal no. 39; Bayer, in: Lutter/Hommelhoff, GmbHG, § 4 a marginal no. 9; Lutter/Bayer/Schmidt, EuropUR, § 6 marginal no. 30, 49 et seq.; Raiser/Veil, Recht der Kapitalgesellschaften, § 58 marginal no. 5.

[5] ECJ matter C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas* (2006) ECR I-8031 = ZIP 2006, 1817; matter C-378/10, *Vale Epitesi kft,* ZIP 2012, 1394 = NZG 2012, 871.

[6] Additional information at fn. 34.

[7] Lutter/Bayer/Schmidt, EuropUR, marginal no. 31, with additional citations.

[8] Figures based on Niemeier, in: FS Roth, p. 533; previously Westhoff, GmbHR 2007, 474; Bayer/Hoffmann, GmbHR 2007, 414.

company (GmbH = Gesellschaft mit beschränkter Haftung) which had been designed as a regulatory alternative to the Limited as early as 1892.[9]

This is because Anglo-American law embodied and still embodies a regulatory philosophy which is not very demanding, at least in relation to the requirements for formation. The capital requirements provide a striking model case of this point. For example, Austria requires a minimum capital of EUR 35,000 and Germany required EUR 25,000 through 2008 (for details see p. 33, 39). By contrast, an English Limited could always be formed with one Penny. This is not only attractive to founders, but the legal policy approach as such has not missed making an impact on European institutions. This is most likely because it may be equated with deregulation in a general sense, which for example, may be seen in the efforts to liberalise the Capital Directive.[10]

At the same time, Anglo-American law stands for the second path of the legal trend described at the outset: that of a liberal fundamental philosophy regarding the choice of legal form and, accordingly, of the associated legal system, the law applicable to a company. Where companies are involved, English law and closely related legal systems employ the so-called incorporation theory for conflict of laws purposes. In doing so they consequently leave private autonomy a great deal of latitude in both aspects – that of substantive law as well as conflicts of law: **Freedom of design** on the one hand and **free choice of legal form** on the other. Similarly consistently, Germany, Austria, and other countries which attach importance to a high level of mandatory law in order to provide effective legal protection for all interests involved, demanded (and demand to the extent possible) of their domestic enterprises that they subject themselves to national company laws using a company form under domestic law; the so-called real seat theory for conflict of laws purposes. They place the **responsibility** on the parties for complying with the governmental **regulatory framework** at both levels.

In this manner, European legal policy currently finds itself faced with the decision of whether to follow one or the other regulatory philosophies or, by way of compromise, to provide more room for one or the other. This fundamental question presents itself not only along the way to further standardisation of European corporate law, with the Anglo-American tradition and the Continental European tradition struggling for substantive influence by claiming to offer superior solutions,[11] but also with regard to the decision for or against free competition among legal systems. The latter involves impediments to free competition provided by legal standards that the Continental European Member States view as essential.

The **European Commission** appears to be perfectly aware of this crossroads. In its February 2012[12] consultation paper on the future of company law it presented

[9] Cf. Fleischer, ZHR 174 (2010), 385, 411.

[10] See also alternatively Merkt, in: Müller-Graff/Teichmann, Europäisches Gesellschaftsrecht auf neuen Wegen, p. 81; Lutter/Bayer/Schmidt, EuropUR, § 8 marginal no. 14, § 20 marginal no. 236 et seq. The Amending Directive 2006/68/EC introduction modest deregulation primarily in Art. 10 a, b and 19 et seq. For corresponding tendencies in national law see Bayer, report to 67. DJT 2008, Kalss/Schauer, report to 16. ÖJT 2006.

[11] On further development of the Community law in the sense of better regulation or best practice approach Weber-Rey, ECFR 2007, 370, 28, Deutscher Notartag Köln 2012 (DNotZ 2013, special issue).

[12] European Commission, Internal Market and Services Directorate General, Consultation on the future of European company law.

the question of what objectives should EU company law have[13] and, among others, provided the following responses to this question:
- Setting the right framework for regulatory competition allowing for a high level of flexibility and choice.
- Better protection for employees.
- Better protection for creditors, shareholders and members.

Competition among legal systems also brings new theoretical concepts related to European company law to the fore. For example, Grundmann writes: "In any event I support – normatively – well-regulated competition among regulators as a means of modernisation",[14] and more forcefully: "Competition among regulators is … permitted from an EC constitutional perspective".[15] A more reserved Teichmann writes: "Competition among legislators in the field of company law is a … part of integration in the European single market".[16] By contrast, Wiedemann was aware thirty years ago: "The principle of competition is not an appropriate benchmark for the legislator".[17]

Although it is not in dispute that the single market is a guiding principle of EU law (Art. 3 (3) TEU) which in turn is bound by principles of competition, however if this appears to many to suffice as justification to entrust it with developing the law as well[18], this neglects the difference between market and competition as space to manoeuvre and the legal regulatory framework in which it operates.

2. The purpose of Corporate Law

a) Regulatory philosophies. In fact, the interrelations are more complex. The competing regulatory philosophies rest on two differing theories of the purpose of corporate law; for illustrative purposes they are referred to here as the **freedom to contract** theory and the **state regulatory policy** theory. The former understands the law, simply put, as a model provided in order to simplify privately negotiated agreements and the latter understands the law as the governmental specification of a regulatory framework which can neither be waived nor opted out of. The latter is the tradition followed by Continental European corporate law and core elements of its regulatory framework will be the subject of the following discussion.

The **Anglo-American** inspired standard work on comparative corporate law, The Anatomy of Corporate Law, summarises the freedom to contract theory with memorable clarity and presents it otherwise as a significant explanatory model with global application:

> *"… the defining elements of the corporate form could in theory be established simply by contract …*
> *Corporate law … offers a standard form contract that the parties can adopt, at their option … it simplifies contracting among the parties involved …."*[19]

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[13] Under heading II., Objectives of European company law, question 5.
[14] NZG 2012, 420.
[15] Grundmann, Europäisches Gesellschaftsrecht, p. 82.
[16] In: Müller-Graff/Teichmann, Europäisches Gesellschaftsrecht auf neuen Wegen, p. 43.
[17] Gesellschaftsrecht Vol. 1, 1980, p. 783.
[18] Accord – even if some accents are placed elsewhere – Eidenmüller, JZ 2009, 641 et seq.; Grundmann, ZGR 2006, 783 et seq.; Kieninger, Wettbewerb der Privatrechtsordnungen im Europäischen Binnenmarkt, 2002; Klöhn, RabelsZ 76 (2012), 276 et seq.
[19] Kraakman et al., The Anatomy of Corporate Law, pp. 19/20.

The corporation is presented here as a network of contracts which the parties can design entirely on their own; the law is a model agreement which the parties may use at their discretion in order to simplify the organisational task which they otherwise perform on their own. This also means that the participants can take all necessary precautions to protect their own interests by allocating the economic risks in the manner desired or accepted by them and/or by hedging them with risk premiums, to guarantee their rights of involvement and control[20] and to exercise these rights in their own interests, and it means that the law merely offers non-binding proposals for all of these issues. According to another publication, the assumption is "that no regulation should be proposed if market solutions seem available".[21]

Admittedly the theory underlying this premise is on the whole more complex than is reflected in the excerpts quoted;[22] and admittedly it does not ignore the existence of compulsory law. However, the existence of such compulsory law is again explained as acting to compensate for a feared "contracting failure", i. e. a break down in the contract process. Standards such as accounting laws are seen as fulfilling a standardisation function, creating legal clarity through uniformity, similar to rules requiring driving on the right side of the road, or mandatory law is even claimed to increase private autonomous free choice and legal certainty at the same time; namely if a "broad range of alternative forms to choose from" is offered. In such cases, the specific entity form is dispositive to a lesser extent. Instead, the sphere in which private autonomy may be exercised is created by the breadth of the spectrum itself. This may likewise be further increased by the ability "to choose among different jurisdictions' laws", i. e. the ability to choose among several legal systems.[23]

On the other hand, **Continental European** company laws also allow for autonomy in structure and choice of legal form, namely the choice already provided for under national laws to choose between two forms of corporate entities – adopted much later by American law – which allow the standards set out in the respective statutes to be deviated from to different degrees. Accordingly, freedom to contract has a place here as well and national laws already provide for that variety of legal forms and structuring options which citizens may expect[24] without the need to be enhanced by foreign offerings. On the contrary, the latter may represent an alien element within the Continental European system as the efficiency of the market and of private autonomy is met with more scepticism within this system which places comparatively greater importance in its company laws on the regulatory framework

[20] Decades ago, at the height of the co-determination debate, this was likewise the central idea of the primarily Anglo-American and legal-economics inspired criticism of employee co-determination rights in the supervisory board; citation in Roth, ZGR 2005, 348, 360.

[21] Eidenmüller/Schön, The Law & Economics of Creditor Protection, following Eidenmüller, Effizienz als Rechtsprinzip, 1995, p. 58.

[22] Regarding the American literature, see Fleischer, ZHR 168 (2004), 673, 685.

[23] The Anatomy p. 23. On the topic of expanding the range of available legal entity forms by means of vertical regulatory competition with legal entity forms supplied by Community law such as the SPE: Bachmann, in: FS Hommelhoff, 2012, p. 21; Bachmann, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 196; Klöhn RabelsZ 76 (2012), 276; Fleischer ZHR 174 (2010), 385, 413; Jung (ed.), Supranationale Gesellschaftsformen im Typenwettbewerb.

[24] The BVerfG [German Federal Constitutional Court] believes a reasonable choice among a sufficient number of legal entity forms to be appropriate, BVerfGE 50, 290 = NJW 1979, 699 (Co-determination ruling) sub C III 2 a.

provided by mandatory law and its legal protective function.[25] And we do not hesitate to add that this is done with a claim to legitimacy which need not stop in the face of European legal developments.

b) Regulatory competition. Nevertheless, these countries want to, even if not voluntarily, defy international competition among legal systems – and they should as well if they are convinced of the advantages of their respective legal frameworks. This is to say that the regulatory policy model should have no problem holding its own in international competition if it is equal to or superior to the alternative models, based on the standard of social efficiency, i. e. taking all affected interests into account. Once founders determine that they are better received based on higher degrees of creditor protection, these models should increase in acceptance. For example, founders may borrow funds more easily and on better terms thanks to better creditworthiness which in turn provides them with an advantage.

In a joint collaboration, Germany and France – effectively representing all of Continental Europe to certain degree – are marketing their "Roman-Germanic" company law under the title:

Continental Law – global • predictable • flexible • cost-effective.[26]

Among others, "*the values of security, predictability and efficiency*", the range of "*flexibility and entrepreneurial freedom of design in connection with legal and investment security for business partners, creditors and investors*" are emphasized as advantages ensured last but not least by the responsible role played by the civil law notary.

Nevertheless, Germany's experience after five years of competing against the Limited (from Inspire Art in 2003 to the birth of the *Unternehmergesellschaft* [entrepreneurial company] in 2008) leads to the sobering conclusion that the founders' interest in as comfortable a formation process as possible is the decisive factor. The market of legal systems and corporate forms is apparently not efficient enough such that all parameters of concern can be adequately taken into account.[27]

However, the critical debate needs to take place at a still deeper level. Ideally, the framework for a market needs to be created in such a manner so that market actors cannot pass along – "externalise" – costs to uninvolved third parties. For this reason, proponents of Continental European regulatory policy rightly oppose having standards of creditor protection, employee protection, etc., which are seen as essential, being made subject to the discretion of the founder. Can Anglo-American law sensibly view this otherwise? An explanation of perhaps not all, but indeed many, inconsistencies may be found in the fact that although these countries

[25] For details see Haberer, Zwingendes Kapitalgesellschaftsrecht, 2009; there p. 721 on the conflict between protective interests and private autonomy. In general on the protective function of mandatory law Möslein, Dispositives Recht, 2011, p. 164.

[26] Brochure from the lawyers' organisations of both countries under the auspices of both ministries of justice Berlin/Paris 2011.

[27] See formerly Roth, ZGR 2005, 348. Regarding competition among legal systems/company law statues in the EU: Kieninger, Wettbewerb der Rechtsordnungen, 2002; Heine, Regulierungswettbewerb im Gesellschaftsrecht, 2003; Westermann, GmbHR 2005, 4; Schön, 43 Common Market L. Rev. 331 (2005): Röpke, Gläubigerschutzregime im europäischen Wettbewerb der Gesellschaftsrechte, 2007; Fleischer, ZHR 174 (2010), 385; Sachdeva, Eur.J.Law&Econ. 30, 137 (2010); Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 201 et seq. Regarding limited market rationality, see text accompanying fn. 40.

make their company law subject to discretion, this applies by no means to the protective standards which they likewise have enacted and see as indispensable. Rather, many of these rules have been placed in **other fields of law** within their legal systems, i. e. given another "label". For example, creditor protection is found in laws on insolvency, employment law protects the interests of employees, capital market legislation provides in part for shareholder and creditor protection in the form of investor protection, etc., and at the same time eliminates freedom of choice with regard to conflict of laws rules.[28] In other cases, other forms of the protective instruments found in our company law have developed as functional substitutes, such as administrative and criminal sanctions in the event of wrongdoing (e. g. wrongful trading under English law) rather than the preventative justice functions performed by civil law notaries and registry courts (see Ch. 5), and in turn the preventative effect of personal disqualification attaches to such alternative forms.[29]

It was not by chance that the German MoMiG reform [German Act to Modernise the Law on Private Limited Companies and to Combat Abuses] of 2008 took the first steps to transfer creditor protection rights traditionally found in company law – shareholder loans, obligation to file for insolvency[30] – to the *Insolvenzordnung* [German Insolvency Statute]. And one could easily toy with the idea of replacing the minimum capital requirements contained in the respective laws governing the public limited company and the private limited company with a rule on commitment amounts for shareholders within insolvency laws in order to remove these requirements from the shareholders' ability to choose among legal options.[31] However, reclassifications within the legal system or re-labelling can hardly be the solution.[32] This is entirely apart from the fact that the traditional systematic is not arbitrary but rather its elements are interrelated and coordinated and their context is assigned its own value to this extent. This in turn promotes transparency and therefore legal certainty, which ultimately has solidified to dogma.

In truth, what is involved is the substance of the regulatory policy of the **Continental European system of legal protections**. In the international comparison, this substance must be made clear, and having survived a critical review, it will derive a claim to legitimacy based upon this review, which not only wants to be taken into account in future European company law but which also refuses to permit discretionary waiver through an exchange of company statutes.

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[28] Regarding English creditor protection through insolvency laws, see e. g., Bachner, in: Lutter, Das Kapital der AG in Europa, p. 526. For purposes determining the COMI (Center of main interest) for purposes of insolvency law, see Art. 3 European Insolvency Regulation; on the topic of its arbitrary transfer, see ECJ IPRax 2006, 149 with comments by Kindler 114; ECJ ZIP 2010, 187; 2011, 2153.

[29] England: Company Directors Disqualification Act 1986.

[30] On the latter, see Roth/Altmeppen, GmbHG, prior to § 64 marginal no. 2.

[31] Regarding interfaces between corporate law and insolvency law, see the similarly entitled contribution by Kienle, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, p. 137; more comprehensive Kindler, Die Abgrenzung von Gesellschafts- und Insolvenzstatut, in: Sonnenberger (ed.), Vorschläge und Berichte zur Reform des europäischen und deutschen internationalen Gesellschaftsrechts, 2007, p. 389 et seq.

[32] Accord, Trenker, Insolvenzanfechtung gesellschaftsrechtlicher Maßnahmen, Innsbrucker Schriften zum Unternehmensrecht Vol. 1, 2012, p. 132.

Nonetheless, the misgivings about a free choice of company statute[33] appear to resound most recently with the ECJ itself when it makes their legal basis, the primary-law principle of freedom of establishment, expressly dependent upon actual establishment in the country of choice.[34] In regard to further deregulation in secondary law based on the Anglo-American model, the European Commission noted "a lack of progress on some simplification initiatives" in its December 2012[35] Action Plan and did not announce any substantive realignment for the continued development of company law but rather limited itself to a plan to create an overarching codification by means of "merging existing company law Directives", the declared intent being to eliminate inconsistencies and to make the texts more "reader friendly".

3. Key issues of legal protection in Continental Europe

The worthiness or need for protection taken into consideration in a legal system relates to standardised interests and therefore to categories of persons who – under company law – have an interest in or are affected by a company or its entrepreneurial activities. This primarily involves **creditors, shareholders and/or partners** already referred to in the EU consultation paper, including investors seen as future shareholders or creditors as well as employees. This is to be distinguished from instruments intended to protect persons or interests which are defined either more specifically (e. g. the public sector as creditor), or in a much broader sense (e. g. as benefiting from director's liability in general). We will concentrate on the four categories representing the core elements of Continental European company law as set out below. At the same time they are exemplary of four methods of resolution of a different nature compared to their Anglo-American counterparts.

Our approach leaves out other similarly important categories: In particular, these include employee co-determination rights because they are already sufficiently known as a controversial issue across Europe, capital markets-related investor protection because this has already become very self-contained vis-a-vis company law, laws related to corporate groups because they play only a subordinate role in many national legal systems as well as at the Community[36] level to date and accounting because international standardisation here has already begun path of its own. Finally, it must be made clear that we will limit discussion to laws related to **corporations**, or corporate law, which needs no further explanation with regard to currency and practical relevance. However, as already made clear by the exclusion of laws regulating capital markets and corporate groups, our focal point – even if without the topical exclusivity of the just-published anthology by Bachmann et al., Rechtsregeln für die

[33] Still expressed by the Advocate General in his opinion in the Vale matter, ZIP 2012, 465.

[34] See above, fn. 5 and also MüKoBGB/Kindler, IntGesR marginal no. 128; identical NZG 2009, 130; IPRax 2010, 272; EuZW 2012, 888; Roth/Altmeppen, GmbHG, § 4 a marginal no. 43; Roth, Vorgaben der Niederlassungsfreiheit für das Kapitalgesellschaftsrecht, p. 12; identical EuZW 2010, 607; ZIP 2012, 1744; König/Bormann, NZG 2012, 1241; Schopper/Skarics, NZ 2012, 321. The European Commission also took the key passage of the Vale judgment, marginal no. 34, into account in its Action Plan 2012 (next fn.): fn. 43.

[35] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Action plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies, Brussels, 12.12.2012, COM (2012) 740/2.

[36] The previously-mentioned Action Plan 2012 also limited itself to cautious steps toward convergence in point 4.6.

geschlossene Kapitalgesellschaft[37] – is that form of enterprise which actually is in the foreground in Continental Europe, namely the non-listed, personally-oriented enterprise, i. e. the variety of smaller corporations and the even larger number of private limited companies. They not only dominate in numbers, but in a majority of countries (exception, e. g. Switzerland) in terms of economic significance as well. In Germany for example, the private limited company exceeds the public limited company by nearly a 2:1 relationship both as to turnover and capital.[38]

a) Capital structure. First and foremost we will address the capital structure of the corporations. Differences of opinion are at their greatest in this regard and this is perhaps also the case because it may be illustrated in figures; they have been the subject of discussion for a long time and the controversy has created the greatest stir within legal academic and policy circles. A common starting point may be expressed here as well: The capital structure of a corporation is important for protecting creditors – primarily – and – secondarily – for the individual shareholder in relation to his or her co-shareholders and potential investors.[39] However, the primary focus of Anglo-American law is on capital maintenance, whereas the focus is conventionally on raising capital especially in the German legal tradition and here, pars pro toto, has made a specific figure, the required minimum capital, the lynchpin, a feature that is met with rejection to incomprehension in foreign legal systems. This is also the reason for efforts to reform the Capital Directive in this respect for the public limited company, primarily driven by the Anglo-American camp.

By contrast, on the Anglo-American side, capitalization is the topic perfectly qualified for illustrating as well as for criticizing its theoretical base, the contract model; since it is here that the idea that not only shareholders but also every creditor can and must protect its own interests by making the relevant contractual arrangements unmistakeably meets the reality of the parties' limited rationality and cognition, the dynamics of long-term legal relationships, imbalances in the parties' bargaining power, information deficits, transaction costs, etc. Indeed, that is the fundamental problem of the freedom to contract theory. Behavioural theory and risk research have similarly shown the limits on the validity of the private self-protection idea advanced by this theory;[40] both will be addressed in further detail in Chapter 2 on Capital Structure.

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[37] Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft.

[38] Roth/Altmeppen, GmbHG, Intro. marginal no. 8. Sweden and Finland distinguish between two forms of stock corporation, the "public" and the "private", which leads some to believe that they have no counterpart to the GmbH (Sjösted, in: Ars Legis (ed.), Kapitalgesellschaften in Europa, country report Sweden, p. 297). Nevertheless, they do have differing minimum capitalisation requirements. The Disclosure Directive lists them separately for Finland – but not for Sweden – and in Denmark they are regulated in their own laws under different names (see Moll, in: Ars Legis (ed.), Kapitalgesellschaften in Europa, report Denmark p. 19, and regarding Finland, van Setten, in: Ars Legis (ed.), Kapitalgesellschaften in Europa, report Finland, p. 97).

[39] Other priorities related to creditor protection: Schön, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, pp. 123, 155.

[40] Williamson J. Law & Econ. 22, 233 (1979), identical ZgS 1981, 675, 676; Fleischer/Zimmer, Beitrag der Verhaltensökonomie zum Handels- und Wirtschaftsrecht, 2011; Roth/Bachmann, in: MüKoBGB 6th ed., § 241 marginal no.144; Roth, in: MüKoBGB 5th ed., § 313 marginal no. 38 et seq.; Weber, Behavioral Finance, 1999; Bense/Bechmann, Interdisziplinäre Risikoforschung, 1998; Luhmann, Soziologie des Risikos.

b) Organisational structure. With respect to our second topic, organisational structure, the underlying problem, now known as the principal-agent conflict, is fundamentally familiar to all legal systems; the concept of "corporate governance" is driving current discussion here and abroad.[41] There is also likely consensus that a two-track solution is expedient in order to establish as close a harmonisation of interests as possible. This could be accomplished through suitable incentives in conjunction with as effective control over agents as is possible in order to prevent opportunism and indolence. The paths first part when implementing a promising organisational structure, a fact which is also the case within Continental European legal systems. Germany and Austria have devised a dualistic structure which has the executive body supervised by an independent control body, the supervisory board – both in the case of the public limited company and the large private limited company. Several other countries have adopted this as an option. However, the fact that control of company management cannot solely be left to the shareholders as a whole has also been recognised in the alternative, monistic system where hopes have been placed on independent members within the governing body or board.

This independence in turn is also the principal problem of the supervisory board within the German legal system and it now appears that it can be assessed from different points of view. The conflicting interests of management and shareholders are borne in mind in Germany and the independence of management remains an issue.[42] Within the Anglo-American sphere of influence, independence of the majority shareholder is also desired in the interests of the minority shareholders. Within its own monistic system, this goal is seen as being better insured through independent directors on the board rather than by a supervisory board.[43]

c) Protection of minority interests. The overlaps in both analysing the problem and attempted solutions appear to be greatest on this issue. One is aware of the fundamental need for majority decision-making by the shareholders and one does not turn a blind eye to the resulting threat to the interests of the minority. This is on blatant display in cases where the voting majority pursues its own interests at the expense of the remaining shareholders, but even in the case of day-to-day conflicts of interest as well, for example differences in financial capacity or business policy conflicts such as different attitudes toward risk. An entire bundle of various possible solutions employed in a variety of combinations and with divergent emphasis are seen as providing a remedy. What is involved here are formal minority rights on the one hand, starting with graduated majority requirements progressing to guaranteeing participation, as in "outvoted but not ignored", through to guaranteeing access to information which in turn is intended to assist in making appropriate decisions (which is of little use to the outvoted minority) but which also effects transparency and supervision. The supervision issue leads to the other side of the coin: the substantive protection of the minority with its focus on providing a substantive analysis of the decisions of the majority which the minority can also assert before a court by way of litigation. The assessment is likewise universally accepted here as

[41] The European Commission likewise places significant accents here in its Action Plan 2012.

[42] Roth/Wörle, ZGR 2004, 565 et seq.

[43] Enriques/Hansmann/Kraakmann, in: Kraakmann et al., The Anatomy of Corporate Law, pp. 65, 95; Davies/Enriques/Hertig/Hopt/Kraakman, in: Kraakmann et al., The Anatomy of Corporate Law, p. 311.

well that, at a minimum, obligations on the part of the majority for loyalty and consideration should be enforced through substantive controls, however at the same time it is accepted that justiciability and the ability to litigate business decisions must be countered.

Such a consensus on fundamental issues would be remarkable because it involves the relationship among shareholders and thereby, from the perspective of the Anglo-American legal system as well, genuine corporate law,[44] the design of which could be left to the parties in precisely this instance based on the freedom to contract theory. Of course, the fundamental objections to this approach, which have already been alluded to above under the heading of limited rationality, become especially clear in this instance in the form of a typical problem caused by excessive optimism and/or an underestimation of risks.[45] However, Anglo-American statutory law frequently leaves formal minority rights to the discretion of the parties[46] and substantive protections are primarily implemented by means of judicial decisions based on general clauses.[47] Accordingly, the Anglo-American system may also be seen here as expressing a lower level of regulation in this area; still the effectiveness of minority protection – and that is the contradiction which appears surprising at first glance – receives better notes in this system.

However, this is subject to the assumption that such effectiveness may meaningfully be measured using the parameter of a control premium. The lower the premium on the general stock price paid for a "block" of stock which promises a controlling majority, the more effective the protection of minority interests supposedly is. Based on that premise, Continental European rights do not score well (perhaps with the exception of the Scandinavian systems). Worst-scoring are the Latin countries with an average premium of 25 %–30 %, whereas at 10 %–15 % Germany may be under the European average of 20 % but should be above levels in Great Britain and the USA (and Japan).[48] However, the control premium factor could be driven to a greater degree by other circumstances such as market scarcity or shareholder structure.[49] Premiums are paid in cases where there are blocks of stock which yield a majority. Consequently, the block premium is a yardstick for the need

[44] However, in the U.S., capital market law provides stimulus for important elements of voting rights and their exercise, e. g. with regard to proxy voting.

[45] Accord on this point, Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, pp. 35 et seq., 50 et seq., 73.

[46] On the issue of minority representation in the administrative/supervisory board which is placed very much at the fore, see Enriques/Hansmann/Kraakman, in: Kraakmann et al., The Anatomy of Corporate Law, pp. 90 et seq., 105 et seq.; other focus on the topic of participation rights under English law Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz in Deutschland, England und Frankreich, p. 109. Similarly on the topic of subscription rights, which is a significant instrument for protecting minority participation rights in the U.S. but is largely dispositive, see Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 35 and fn. 58; see below Ch. 4 III 3 for a comparison to Continental Europe.

[47] Accord Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz in Deutschland, England und Frankreich, pp. 170 et seq., 233 for England, in principle Hofmann, Der Minderheitsschutz im Gesellschaftsrecht, for the U.S. However, a general right to nullify resolutions is unknown in England, Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 57.

[48] Figures from Schäfer/Ott, Ökonomische Analyse des Zivilrechts, p. 646; Enriques/Hansmann/Kraakman, in: Kraakmann et al., The Anatomy of Corporate Law, p. 107; Hofmann, Der Minderheitsschutz im Gesellschaftsrecht, p. 16.

[49] Enriques/Hansmann/Kraakmann, in: Kraakmann et al., The Anatomy of Corporate Law, p. 108.

for, but not the quality of, minority protection because it indicates the presence of established majority blocks. For this reason, the problem of protecting minority interests may be more easily removed in Anglo-American countries where stocks tend to be widely-held, but this is of little help in countries with other shareholder structures.[50] Finally, to reach the conclusion that mere dominance of majority blocks within a country results from deficits in its legal system related to management controls, and thus to ascribe deficits in minority protection to the general principal-agent problem (Ch. 3),[51] appears to be a bit of a reach. This is also the case for similar hypotheses which see this dominance as resulting from deficits in minority protection or vice versa which see these deficits as resulting from the policy influence of dominating majority blocks.[52]

d) External control. The fourth of our general topics concerns protective legal mechanisms with regard to which both legal traditions are the furthest apart from the outset on two of the three points. On the one hand, this has to do with the legacy of the Latin **notary** which may be found in the corporate laws of most Continental European countries (with the exception of Scandinavia),[53] and on the other with the fundamental attitude toward preventative control on the part of public authorities. Although the Disclosure Directive[54] prescribes either preventative administrative control or official authentication for the formation of a corporation (Art. 11) for all of the EU, it nevertheless allows not only the waiver of the latter, but also under its mandatory **publication in registries** apparently permits various degrees of strictness related to monitoring such registrations (Art. 3 of the Disclosure Directive). For example, in the case of the AG and the GmbH, the German *Registergericht* [registry court] must review the correctness of the applied-for entries through to the value of in-kind contributions, whereas the English Companies House expressly states with regard to the information it publishes:

> *We do not have the statutory power or capability to verify the accuracy of the information that companies send to us. We accept all information that companies deliver to us in good faith and place it on the public record.*[55]

By contrast, Germany, Austria and other Continental European Countries require notarial authentication in addition to review of entries in the registry and accordingly expose themselves time and again to the criticism that they make business formations unnecessarily expensive. This has been disproved by empirical studies[56] and it is likely more accurate to speak of an interest-driven struggle for the competence to control

[50] Hofmann views minority protection in the U.S. equally as not providing an example, ibid. p. 699. What is remarkable is that, at 25 %-33 %, the minority discount – the flip side of the block premium – for closely-held corporations in the U.S. is likely higher than in Germany, see Fleischer, ZIP 2012, 1633, 1653 and fn. 30 et seq.

[51] Accord Schäfer/Ott, Ökonomische Analyse des Zivilrechts, p. 646.

[52] On both topics, see Davies/Enriques/Hertig/Hopt/Kraakman, in: Kraakmann et al., The Anatomy of Corporate Law, p. 306, 309.

[53] Among the Latin countries, France fundamentally dispenses with authentication by a notary. As an alternative, Portugal now allows verified signatures to suffice.

[54] See above, fn. 1.

[55] Disclaimer on the homepage of the Companies House (www.companieshouse.gov.uk). See also Bock, ZIP 2011, 2449.

[56] Knieper, Eine ökonomische Analyse des Notariats, 2010.

corporate formations which is not only being waged between different professional groups within the legal field in a given country, but also – which is not always recognised – to increase the attractiveness of certain countries and their professionals for formations from abroad.[57] Last but not least, this also reflects the antithesis of the two fundamental theories: A legal system obligated by governmental regulatory policy will also gladly place compliance with its guidelines under the responsibility of impartial public institutions; the contract theory reflects the contradictory principle of mutual negotiation resting with members of the legal profession where each party is advised by its own counsel. The validity and reliability of publication in registries in any event are weighted entirely differently if a court or civil law notary, or both, is responsible for the correctness of the entries.[58] Inasmuch as this is not a part of the English system, a more complete picture must take into account the fact that the U.S. has long prescribed a regulatory agency in the form of the Securities and Exchange Commission which also intervenes to an extensive degree in corporate law in order to exercise a preventative function from the capital markets side.

The third – and first in our sequence of Ch. 5 – external control institution, the **auditor**, presents yet another picture. On the one hand, its control function is standardised to a large degree via accounting guidelines and, on the other, other economic nations outside of the EU have realised such a comparable standard[59] that Europe though not having to shy from a comparison may have an edge in effective legal protection at best due to the professionalism and integrity of its relevant professional groups.

II. Regarding the selection of legal systems under review

The regulatory approach worked out in I. has been given more emphasis in Continental European legal systems than in their English-American counterparts. "Shareholder value" is at the fore of corporate law in the latter with less emphasis on protecting minority shareholders and third parties.[60] Accordingly, the current study will concentrate on Continental European legal systems. Of course, the authors had to make a choice from among these systems. The principle of sober self-restraint thus plays a role in the comparison of corporate law[61] just as it does in

[57] See Triebel, AnwBl. 2008, 305; Roth, Vorgaben der Niederlassungsfreiheit für das Kapitalgesellschaftsrecht, p. 35.

[58] Accord Embid Irujo, in: Lutter, Das Kapital der AG in Europa, p. 686.

[59] Regarding audits of GmbHs under Swiss law, Art. 818 with 727 et seq. OR and Schindler/Töndury, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Switzerland marginal no. 152 et seq.

[60] Modern Company Law – For a Competitive Economy – The Strategic Framework – A Consultation Document from the Company Law Review Steering Group, 2/1999, p. 35, 49 et. seq.; Hopt, in: Markesinis (ed.), The Clifford Chance Millennium Lectures: The Coming Together of the Common Law and the Civil Law, 2000, p. 105, 118 (German in ZGR 2000, 779 et. seq.); Mülbert, ZGR 1997, 129 et. seq.; providing a summary Grundmann, Europäisches Gesellschaftsrecht, marginal nos. 461, 462.

[61] **Standard works:** Andenas/Wooldridge, European Comparative Company Law, 2009; Ars Legis (ed.), Kapitalgesellschaften in Europa; Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft; Kraakmann et al., The Anatomy of Corporate Law. **Earlier works:** Hallstein, Zeitschrift für ausländisches und internationales Privatrecht 12 (1938/39), 341 et. seq. (Regarding the reception of the German GmbH in various countries).

the comparison of legal systems in general.[62] As is generally known, the scientific benefit of a comparative law analysis bears a disproportionate relationship to the amount of effort expended if the group of legal systems to be compared is made all too large. The conclusion drawn by comparative legal analyses[63] is that mature legal systems are at least in part adopted or copied by less developed legal systems. Sufficiently original solutions which would warrant an in-depth comparative analysis are lacking as long as the imitative system is not yet emancipated from its reference legal system. The originality of the "subsidiary legal system" almost always lags behind that of the "parent legal system". If that is the case, one can be content with including only the "parent legal system" in the comparative legal analysis. This is of course not true across the board. For example, it is generally recognised today that Italy, originally a "subsidiary legal system" based on French law, has now emancipated itself to such a degree that it is worthy of analysis in its own right.[64] This book applies the rule-of-thumb that for purposes of "micro-comparison" – that is the comparison of specific legal institutions – limiting review to France and Italy is permissible within the Latin legal tradition and German and Swiss law may be used representatively for the German legal tradition.[65] We have supplemented the circle of Continental European legal systems formed in this manner to include Austria, which appeared sensible based on its close affinity to Germany in the field of corporate law, but also because of solutions it has itself worked out. Additional legal systems were included on a case-by-case basis, such as Spain's progressive Ley de Sociedades de Capital of 2010 (LSC), which combines the rules governing the public limited company and the private limited company into a coherent set of laws in an exemplary manner,[66] and every so often striking examples have been drawn from Belgium, the Netherlands, Portugal and the occasional Scandinavian country. As will be shown presently, the choice of countries presented above based on rules-of-thumb generally-applicable to comparative legal analysis is confirmed precisely by the comparison of corporate law principles undertaken here. We believe the selection criteria employed by Grundmann[67], i. e. the economic weighting of specific countries and their reference to European law, to be less informative in relation to the purpose of this study – establishing general principles for evaluating Continental European corporate law.

Within the **Latin legal tradition**, the current study is accordingly limited primarily to France and Italy. **France** must be included in the comparative analysis from the outset because it is the cradle of the **modern law of public limited liability companies**: The first statutory rules for the société anonyme (SA) in a purely private form may be found in the French Code de Commerce from 1807.[68] Its roots

[62] Zweigert/Kötz, An Introduction to Comparative Law, § 3 IV, p. 41.

[63] On this topic, specifically from the perspective of corporate law, see von Hein, Die Rezeption des US-amerikanischen Gesellschaftsrechts in Deutschland; see also Kindler, ZHR 174 (2010), 149.

[64] Zweigert/Kötz, An Introduction to Comparative Law, § 3 IV, p. 41.

[65] Zweigert/Kötz, An Introduction to Comparative Law, § 3 IV, p. 41.

[66] Previously supported by Roth, Das System Kapitalgesellschaften im Umbruch, p. 1.

[67] Grundmann, Europäisches Gesellschaftsrecht, marginal no. 67 et. seq., 72 et. seq.

[68] The colonial corporations of the 17th century will not be considered here in their role as the first real forerunners of the public limited liability company whose example was the Dutch East-India Company of 1602. It was not formed by means of a contract but rather by an act of state which also governed its internal structure; for additional information see Raiser/Veil, Recht der Kapitalgesellschaften, § 2 marginal no. 1.

reach back to the 17th century ordinances from Colbert governing trade on land and at sea. In the process, the SA descended from the pre-revolutionary (Ancien Régime) compagnies royales.[69] Today, French corporate law may be found laid out in orderly fashion in the second book of the Nouveau Code de Commerce dated 18 September 2000 (CCom).[70] The CCom consists of a statutory part (partie legislatif, Art. L223-1 et seq. governing corporate law) and a corresponding part containing regulations (partie règlementaire, Art. R223-1 et seq. relating to corporate law) each of which employs its own numeration of articles. The CCom regulates the public limited liability company (société par actions[71]) and – introduced in 1925 patterned after the German model[72] – the company with limited liability (société à responsabilité limitée) as separate legal entity forms. In addition, Art. 1832 to 1844–17 Code Civil apply to all companies. Shareholders may choose from among two organisational models in the case of public limited liability companies: The classic, monistic model with an administrative board (conseil d'administration) and an executive officer and the newer, dualistic model with a board of directors (directoire) and a supervisory board (conseil de surveillance). What is striking is that corporate formation requires only the simple written form (Art. 1835 Code Civil), that is the agency maintaining the registry is solely responsible for reviewing formation.

As explained, in addition to France as the parent legal system, **Italy** must be included when establishing the group of Latin legal tradition countries for purposes of a comparative legal analysis in the field of private law.[73] The ingenuity of the civil law theory as well as that of the lawmaker is particularly impressive here. Commercial law originally developed based on the **French model**: The first Codice di Commercio of the just-founded Kingdom of Italy was enacted in 1865 and largely followed the Code de commerce of its previous occupying power, France.[74] However, the introduction of the, like its French example, relatively undeveloped, pre-industrial Codice di commercio of 1865 immediately faced significant opposition from commercial circles in the Venetian provinces after their annexation (1866). The modern German codifications, amongst others the ADHGB after 1863, had

[69] Sonnenberger/Classen/Großerichter, Einführung in das französische Recht, No. 157. Spanish public limited liability company law likewise finds its roots in the 17th century, see Hierro Anibarro, El origen de la sociedad anonima en Espana.

[70] For a critical view of the new CCom, see Licari/Bauerreis, ZEuP 2004, 132 et seq.; Comprehensive overview in: Sonnenberger/Classen/Rageade, Einführung in das französische Recht, No. 145; Grundmann, Europäisches Gesellschaftsrecht, marginal no. 77; current statutory text at http://www.legifrance.gouv.fr/.

[71] In the alternative forms of société anonyme, société en commandite par actions and société par actions simplifiée; for additional information see Sonnenberger/Classen/Großerichter, Einführung in das französische Recht, No. 157.

[72] The reason for this was the need to offer mid-sized businesses a corporate form subject to personalisation. In fact, this was already available in the form of the "société par actions fermée": as a public limited liability company with shares with limited transferability and rights of pre-emption. For additional information, see RabelsZ 12 (1938/39), 341, 364 et seq.

[73] On this and the subsequent issue, see Zweigert/Kötz, An Introduction to Comparative Law, § 3 IV, p. 41.

[74] Regarding the development of commercial and corporate law in Italy, see Kindler, Einführung in das italienische Recht, § 8 marginal no. 2 et. seq.; Kindler, Italienisches Handels- und Wirtschaftsrecht, § 4 marginal no. 1 et. seq.; Spada, Diritto commerciale, I, Parte generale: storia, lessico e istituti.

only recently been in force in these previously Austrian territories.[75] Thereafter, the Codice di commercio was completely revised and re-enacted in 1882 ("Codice Zanardelli"). Since that point, the influence of **German** commercial legislation and jurisprudence has dominated substantively. For example, plans to create separate legislation for corporate law were abandoned – subject to the influence of German commercial law jurisprudence. This grouping retained its placement in the first book. The concession system was abolished as one of many innovations. Today, Italian corporate law is set out in the fifth book of the Codice civile (CC) of 1942.[76] The public limited liability company (società per azioni) and the – introduced in 1942 based on the German model – company with limited liability (società a responsabilità limitata) comprise two separate legal entity forms. Italian corporate law shows originality, amongst others, with its three options to choose from for the organisational structure of a public limited liability company[77] and with the complete transfer of the substantive review function for corporate formations to the civil law notary (Art. 2330 (3) CC).

German law is primarily taken into consideration among the **countries of the German legal tradition**. The history of German public limited liability company law is virtually the story of **protecting minority shareholders and third parties**, especially creditors. In Germany, the starting point for a standardised law on public limited liability companies was the ADHGB from 1861.[78] The ADHGB still included a provision in Art. 208 that a public limited liability company could only be formed with governmental approval (concession system) but at the same time empowered state legislators to waive this provision in Art. 249. The concession system was abolished by the public limited liability company law reform of 11 June 1870 and replaced by the "**system of normative conditions with compulsory registration**" which is still in place today. Based on this system, a corporation attains legal personality following satisfaction of the statutory conditions and entry in the commercial register. Lawmakers were aware of the associated potential for abuse from the outset: The fear that the abolition of the concession system and the transition to the system of normative conditions could trigger a "period of stock-based fraud" had already been expressed in the explanatory statement to the public limited liability company law reform of 1870 – a fear that would prove itself true.[79] A series of public limited liability companies were formed during the "*Gründerjahre*" following the Franco-Prussian war (1870/71) which ultimately collapsed leading to the loss of amounts invested by numerous savers or even to the destruction of livelihoods. The regulatory intent of the public limited liability company law reform of 18 July 1884, enacted in reaction to these circumstances, was accordingly to codify the first legal mechanisms to protect shareholders by means of a tightening of the

[75] As "AHGB" cf. fn. 89, below.

[76] Regarding the codified unit of civil and commercial law in Italy, see Kindler, Einführung in das italienische Recht, § 8 marginal no. 6; texts of current Italian statutes at www.altalex.com.

[77] Kindler, ZEuP 2012, 72 et seq.

[78] On the historical development of public limited liability company law in Germany, see e. g., Habersack, in: MüKoAktG, Intro. marginal no. 12 et. seq.; Reich, Die Entwicklung des deutschen Aktienrechts im 19. Jahrhundert, Ius Comune II, 1969, 239 et. seq.; for comprehensive treatment, see Bayer/Habersack (eds.), Aktienrecht im Wandel, vol. 1; see also e. g. Kübler/Assmann, Gesellschaftsrecht, 6th ed. 2006, § 2.

[79] Habersack, in: MüKoAktG, Intro. marginal no. 16 et seq.

foundation requirements and the introduction of **minority rights** (special audit, assertion of claims for compensation against administrative board members). The transition of public limited liability company law from the ADHBG to the newly-created HGB of 10 May 1897 did not include any substantive changes.

The result of the 1884 reform measures was that the public limited liability company was no longer suited to small enterprises with a modest number of shareholders. The **private limited company (GmbH)** was developed in Germany in order to provide these enterprises with an appropriate entity form as well.[80] The GmbH was designed as a small public limited liability company, took on however – primarily with respect to the principle of freedom to structure company statutes as between shareholders (section 45 GmbHG [German Act on Private Limited Companies]) – important characteristics of commercial partnerships and accordingly developed as a hybrid entity.[81] Since its enactment in 1892, the German GmbHG has served as a model for numerous corresponding arrangements in other countries, including Austria, Switzerland, France and Italy, among the legal systems included in the present study.[82] The development of GmbH law was and is characterised by **protection of the shareholders and of third parties** who enter into a contractual obligation with the entity or who enter into some other form of legal transaction.[83]

In the realm of public limited liability company law, further reforms related to shareholder and creditor protection were included in the emergency decrees of 19 September 1931 and 6 October 1931 (compulsory audit of the annual financial statements by an auditor; new structure for the annual financial statements; limitation on the acquisition of treasury shares; simplification of capital reductions). These rules were included in the new **Public limited liability company Act of 30 January 1937 (AktG 1937)** which, amongst others – in the spirit of the times – required that in the event of differences of opinion on the management board, the chairman could make a decision in a matter even against the will of all other members ("Leadership Principle"). At the same time, however, an idea developed following the First World War related to the social obligation of an enterprise[84] resulting from its economic significance found its way into the AktG 1937 in the form of the codification of an obligation on the part of the management board to manage the company in a manner "required for the overall benefit of people and Reich" (Section 70 AktG, public interest obligation).

Following the Second World War, co-determination laws[85] effected further intrusions into organisational structures. The "small reform" to the laws governing public limited liability companies from 1959 was intended to facilitate the acquisition of stock for large segments of the population. This was to be accomplished via capital increases from company funds, the structuring of the income statement and by allowing companies to purchase own stock for purposes of distributing them to their

[80] Cf. Schubert, in: Lutter/Ulmer/Zöllner (eds.), FS 100 Jahre GmbH-Gesetz, 1992, 1 et. seq.; Text of the GmbHG at www.bmj.bund.de (also available in English).

[81] Raiser/Veil, Recht der Kapitalgesellschaften, § 2 marginal no. 4.

[82] Cf. regarding an earlier report on the reception of the GmbH in various countries of the world Hallstein, RabelsZ 12 (1938/39), 341 et seq.

[83] Cf. most recently Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen vom 23.10.2008, BGBl I, S. 2026; providing an overview Kindler, NJW 2008, 3249 et seq.

[84] Rathenau, Vom Aktienwesen, 1918; Geiler, Die wirtschaftlichen Strukturwandlungen und die Reform des Aktienrechts, 1927; Haussmann, Vom Aktienwesen und Aktienrecht, 1928.

[85] MontanMitbestG 1951, BetrVG 1952, MitbestErgG 1956.

employees (employee shares). On the other hand, the 1965 AktG was characterised by a strengthening of shareholder rights, the final elimination of the "leadership principle" and the realisation of three particular protective mechanisms: Increased influence on the part of shareholders and the annual general meeting, improvement of disclosure and information rights on the part of the shareholders and regulation of the power of control and responsibility for the protection of minority shareholders within a corporate group.[86]

In the interim, considerable shortcomings in the area of GmbH law had become evident, primarily due to **low capitalisation** on the part of many private limited companies and the resulting **risk of insolvency**. The "small" GmbH reform of 1980 confronted this issue by increasing minimum share capital, tightening formation requirements and subordinating repayment claims related to shareholder loans in the event of insolvency. The legal position of the shareholders was strengthened by the introduction of a mandatory right to information. Additional important reforms followed as part of the previously-mentioned[87] Act to Modernise the Law on Private Limited Companies and Combat Abuses dated 23 October 2008. They primarily resulted in a tightening of demands on members of the executive bodies of a GmbH (section 6 (2) GmbHG) and directors' liability in the case of breaches of the capital commitment requirements (section 30 (1) in conjunction with section 43 (2) first sentence GmbHG) and in the case of a crisis on the part of a GmbH (section 64 third sentence GmbHG, liability for bringing about insolvency).

Further developments in the law of public limited liability companies after 1965 need not be set out here in detail. From an organisational standpoint, it is primarily characteristic that the German public limited liability company continues to employ a dualistic management structure (management board and supervisory board) even though the monistic "board system" likely prevails on an international level and numerous legal systems have introduced shareholder options between various organisational structure models.

Austrian law has been included in the comparative analysis in addition to German law.[88] This even though Austria adopted the primary laws related to public limited liability companies from Germany and may accordingly be described as a subsidiary legal system in this regard. Austria (Cisleithanian part of the Monarchy) initially introduced the ADHGB, which regulated the public limited liability company in Art. 207 et seq., under the title **Allgemeines Handelsgesetzbuch** [Universal Commercial Code].[89] The AHGB was replaced by the dAktG 1937 [German Public limited liability company Act of 1937] and the dHGB [German Commercial Code] upon the occupation of Austria by the German Reich.[90] However, the Austrian GmbHG of 1906,[91] which was based on the dGmbHG [German Private Limited Company Act], remained in force. After Austria regained independence in 1945,[92] commercial law

[86] Text of the AktG 1965 at www.bmj.bund.de (also available in English).

[87] Fn. 83.

[88] Texts of current statutes at http://www.ris.bka.gv.at/Bundesrecht/.

[89] EC dated 17 December 1862, RGBl. 1863/1; see Doralt/Diregger, in: MüKoAktG, Intro. to § 1 marginal no. 220.

[90] Doralt/Diregger, in: MüKoAktG, marginal no. 225.

[91] RGBl. 1906/58; regarding the motivation for the adoption of the German GmbHG Hallstein, RabelsZ 12 (1938/39), 341, 360 et seq.

[92] On the following topic, see Doralt/Diregger, in: MüKoAktG, marginal no. 227 et seq.

already in place, in particular the dHGB and the 1937 AktG, were subsumed into the body of laws of the Republic of Austria.[93] The hardly-changed, yet "Austrianised" – i. e. excised of National Socialist influences and modified to reflect Austrian legal terminology – public limited liability company law was enacted on 31 March 1965 as the **öAktG 1965** [Austrian Public limited liability company Act of 1965]. The small number of substantive changes to the AktG 1937 related primarily to the status of the supervisory board and the management board, accounting rules and bolstered minority rights by introducing a minority representative on the supervisory board (section 87 (1) öAktG 1965).[94]

In addition, **Switzerland** is part of the German legal tradition to the extent general questions of civil law are involved.[95] It is represented here because it has a highly-sophisticated corporate law and the inclusion of a non-EU legal system potentially prevents a certain degree of "Euro-centrism". Switzerland's corporate law is set out in the third part of the Swiss Law of Obligations (OR).[96] The small corporation is the – first introduced in 1936 – GmbH (Art. 772 et seq. OR),[97] the large corporation is the AG (Art. 620 et seq. OR). Among others, special features of Swiss corporate law include the exercise of supervisory responsibilities by the administrative board and by an "audit committee" in matters concerning the annual audit.

III. The current legal policy background of this study

1. Diversity in the laws governing small corporations and the state of EU legal policy in the area of corporate law

a) Starting point. All EU Member States regulate public limited liability companies in their respective national laws and most of them regulate the private limited company as well.[98] The latter is – as a small corporation – characterised by a lesser degree of stringency in relation to form, a greater degree of contractual freedom and the ineligibility to be traded on an exchange. European legal harmonization does not encompass large and small corporations in equal measures due to these characteristic differences. If one compares for example the state of European company law with that of European capital markets law, one reaches the conclusion that the latter has since almost become universally-applicable European law, whereas important segments of the organisational regulations for large corporations have remained part of national corporate laws, not to mention laws regulating the private limited company and partnerships. The European Commission apparently wants to change this. It has obtained a comprehensive report on the issue (Report of the Reflection Group on the Future of EU Company Law, April 2011, below p. 22 et seq.) and has announced a

[93] RÜG dated 1 May 1945, StGBl. 1945/6.

[94] Regarding the further development of Austrian public limited liability company law since 1965, see Doralt/Diregger, in: MüKoAktG, marginal no. 231 et. seq. For the minority representative, see in more detail ch. 4.

[95] Zweigert/Kötz, An Introduction to Comparative Law, § 3 IV, p. 41, § 13, p. 167 et. seq.

[96] Current version at www.gesetze.ch.

[97] Original statutory text of Art. 772–827 OR with a brief introduction in: RabelsZ 11 (1937), 545 et. seq.

[98] Cf. table setting out an overview of corporate forms represented in the EU in: Lutter/Bayer/Schmidt, EuropUR, § 11 marginal no. 6.

new Green Paper on the core issues of company law. However, caution is warranted if primarily for the reason that the European financial and capital markets, which must be regulated at the European level due to the international interrelations inherent in the system, are not involved here. By contrast, the goal of European company law is solely to ensure the required degree of shareholder and creditor protection (Art. 50(2)(g) TFEU) to the extent this is warranted. Indeed, in many cases national regulations would be more appropriate for small and medium-sized enterprises (SME). This follows from the principle of subsidiarity (Art. 5 TFEU).[99]

b) Low degree of "Europeanization" of the small corporation. European legal harmonization in the field of company law is directed almost exclusively at the large corporation; the private limited company is only addressed in parts. Of relevance to the private limited company are the Disclosure Directive on the topic of commercial disclosures, restraints on grounds for invalidity and the (unrestricted and non-restrictable) representational powers of the executive bodies, the Accounting Directive on the topic of annual financial statements, the Consolidated Accounts Directive on the topic of consolidated financial statements and furthermore the Branch Directive on the topic of commercial disclosures related to branches. The directive on single-member private limited liability companies, after all, is primarily aiming at small corporations. The Cross-Border Merger Directive also applies to the private limited company because such Directive refers to the corporate definition from the Disclosure Directive. The European legislative harmonisation programme has yet to address the small corporation to the extent formation rules and capital (Capital Directive) or laws related to corporate transformations (Merger Directive, Demerger Directive) are involved. By its nature, the Shareholder Rights Directive limits its scope to large corporations.

Based on the above discussion, it should be apparent that large segments – if not the core – of laws affecting small corporations have not been "Europeanised" to date.[100] This relates to central issues such as **corporate capital**, which is why there is no statutory minimum capital at all in the United Kingdom or France, whereas other legal systems impose requirements in this regard which may definitely represent barriers to access for under-capitalised entrepreneurs (for example the minimum capital requirements set out in section 5 (1) dGmbHG: EUR 25,000). Laws regulating small corporations are similarly characterised by diversity from a comparative legal analysis perspective in relation to **formation rules**. In this regard, significant differences may be noted in minimum contents of the company statutes or controls related to the use of in-kind contributions when raising capital. The same applies to membership rights, where mandatory statutory limitations on assignability may be found in some cases as well as standardisation in the maximum number of shareholders.[101] To be sure, the implementing rules related to the Disclosure Directive (related to commercial disclosure and the unrestricted and non- restrictable representational rights of the executive bodies) now provide a certain degree of minimum protection for commerce in the case of cross-border

[99] Hopt, EuZW 2012, 481, 482.

[100] Likewise the assessment in: Lutter/Bayer/Schmidt, EuropUR, § 11 marginal no. 3.

[101] For more information, see Lutter, Limited Liability Company, in: Conard/Vagts (eds.), International Encyclopedia of Comparative Law, Vol. XIII/1, 2006; identical in: FS 100 Jahre GmbH-Gesetz, 1992, p. 49 et. seq.

transactions. However, uniform basic principles regarding capital requirements or capital preservation are completely absent. Similarly, the **attributes of membership** in a small corporation are regulated differently at the national level. It is an open issue – discussed in this book on the basis of central corporate-law related protective measures – whether and in what form the secondary law-based harmonisation of private limited company law should be continued. In addition, a gradual convergence of private limited company laws on the initiative of individual Member States may be noted due to increased competitive pressures and this in the form of downward spiral ("race to the bottom"). For example, this may be seen in the downward adjustment of corporate capital. French law may serve as an example here where the minimum capital requirements for the SARL were abolished in 2003 with a view to the English Limited and an example may be found in Germany where the 2008 corporate reform introduced the "*Unternehmergesellschaft*" [Entrepreneurial Company] which may be formed with minimum capital of only one euro.[102] The initiative to create a European private company (see 4. below p. 23 et seq.) is causing additional harmonisation pressure.

c) State of EU legal policy. European corporate law has regained momentum since the turn of the last century after the harmonisation process related to corporate laws within the EU had reached a certain degree of stagnation[103] in the 1990's.[104] To date, the primary results of the harmonisation process have been the following: The SE in 2001, the SCE in 2003, the Takeover Directive and recommendations on board compensation in 2004, recommendations related to non-executive directors and committees as well as the Cross-Border Merger Directive in 2005, the new Statutory Audit Directive and the reform of accounting rules in 2006 (Accounting Directive, Consolidated Accounts Directive), the Shareholders' Rights Directive in 2007, the proposal for an SPE in 2008, two additional recommendations regarding compensation in 2009, the Green Paper on corporate governance for financial institutions in 2010 and the draft Directive to link company registries in 2011 and furthermore the Green Paper on a general corporate governance framework. The legislation and measures referred to above are based in large part on the action plan "Modernisation of Company Law and Enhancement of Corporate Governance in the European Union" dated 21 May 2003 (**"Action Plan 2003"**)[105] in which the Commission set out a comprehensive and extremely ambitions programme of reform measures.

2. The EU Action Plan 2003 on the modernisation of Company Law and improvement of Corporate Governance

a) Overview. The core elements of the Action Plan 2003[106] are based on the recommendations of the "High Level Group of Company Law Experts" (Winter

[102] Cf. on the entire issue Lutter/Bayer/Schmidt, EuropUR, § 11 marginal no. 5.

[103] For more detailed information see, Bayer/J. Schmidt, Überlagerungen des deutschen Aktienrechts durch das europäische Unternehmensrecht: Eine Bilanz von 1968 bis zur Gegenwart, in: Bayer/Habersack (eds.), Aktienrecht im Wandel, Vol. 1, Ch. 18 marginal no. 11 et seq.

[104] On the following issue, cf. Bayer/Lutter/Schmidt, EuropUR, § 18 marginal no. 1 et seq.

[105] COM (2003) 284, to be discussed immediately subsequent.

[106] Communication from the Commission to the Council and the European Parliament. Modernisation of Company Law and Enhancement of Corporate Governance in the European Union – Action

Group). The expert group's[107] final report, submitted on 4 November 2002, contained a comprehensive list of recommendations for the further development of European corporate law, in particular in the area of company management (corporate governance) as well as with regard to capital accumulation and preservation, corporate groups, restructuring and European legal entity forms. The intended purpose of the Action Plan 2003, developed on the basis of this report, is to increase the global efficiency and competitiveness of EU enterprises, to bolster shareholders' rights and to improve the protection of third parties.[108] From a legal policy standpoint, it is significant that at the same time the Action Plan 2003 represented the final farewell to the original plan for "full harmonisation" in the realm of corporate law.[109] A few individual elements which are of interest for purposes of comparative legal analysis, especially with respect to the core elements of laws related to small corporations, will be addressed below.

b) Election between monistic and dualistic management structure. The first of these special issues is the recommendation to introduce a choice between a monistic and dualistic system in the management structure of – listed – corporations.[110] This proposal will be subject to more detailed analysis later in this book – including implications for small corporations.[111]

c) Capital maintenance and changes in capital. A proposed Directive on simplifying the Capital Directive[112] based on the Action Plan 2003, proposed general – i. e. independent of an acquisition – rules for squeeze-outs and sell-outs (Art. 39 a, 39b). However, the Commission dropped the proposals following opposition in the European Parliament and as part of the consultation on the Action Plan 2003. Nevertheless, the result of the Action Plan 2003 in this realm was amending Directive 2006/68/EC which contained a significant easing of the rules regarding the review of in-kind contributions, the acquisition of treasury shares, advance payments or collateral, as applicable, when acquiring treasury shares (financial assistance).

3. Reform Initiative 2011/12

a) The EU Green Paper "European Corporate Governance Framework". Following on its sector-specific Green Paper on "Corporate Governance in Financial Institutions and Remuneration Policies[113]", the Commission presented a comprehen-

Plan, 21 May 2003, COM (2003) 284, also printed in NZG 2003, special supplement to Issue 13; on this issue, see Habersack, NZG 2004, 1 et seq., identical ZIP 2006, 445, 447 et seq.; Hopt, ZIP 2005, 461 et seq.; Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 6 et seq.

[107] Final Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe dated 4 November 2002, accessible at ec.europa.eu/.

[108] Action Plan (fn. 106), Introduction (p. 3).

[109] Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 9.

[110] Action Plan (fn. 106), 3.1.3 (p. 18 et seq.) and Annex 1 (p. 29).

[111] Cf. Ch. 3, IV.6 p. 95 et seq.

[112] Proposal for a Directive of the European Parliament and of the Council amending Council Directive 77/91/EEC, as regards the formation of public limited liability companies and the maintenance and alteration of their capital, COM (2004) 730; see Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 82.

[113] COM (2010) 284; see Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 72 et seq.; Bayer/J. Schmidt, BB 2012, 3, 8, et seq.

sive Green Paper, "European Corporate Governance Framework"[114] on 5 April 2011. In light of lessons learned from the financial crisis, its intent is to improve management not only for financial institutions but that of European enterprises in general. The Green Paper addresses four topics: (**1**) European corporate law systems (including the usefulness of a distinction based on company size; measures applicable to non-listed enterprises as well), (**2**) Organisational structure (including the creation of professional, international and gender-based diversity; mandate ceilings; regular external evaluation; disclosure of remuneration and "say on pay"; improvement of risk management), (**3**) Shareholder protection (including measures directed at asset managers and intended to simplify collaboration on the part of shareholders; legal framework for proxy advisors; improving the identification of shareholders; a legal framework for protecting minority shareholders; promotion of equity participation on the part of employees) and (**4**) the "comply or explain" principle (including an obligation to explain deviations in detail and, where applicable, alternative solutions chosen; review by supervisory authorities). The Green Paper was and is subject to wide discussion.[115]

b) "Reflection Group" and Action Plan 2012. During 2011 – almost eight years following the Action Plan 2003 on corporate governance, discussed above under 2. – the EU Commission initiated a new phase in legal harmonisation in the realm of corporate law. To this end, the Commission engaged a "Reflection Group On the Future of EU Company Law" at the end of 2010 which quickly submitted a report[116] containing extensive recommendations for legislative measures in April 2011. A consultation on the future of European corporate law based on this report was concluded in May 2012.[117] Many are now asking – a decade after the High Level Group of Company Law Experts report of 2002 and the Commission Action Plan of May 2003 – whether a new law on corporations is in store for us from Brussels.[118]

In substance, the Reflection Group report addresses three general issues: (**1**) Cross-border mobility, transparency and EU legal entity forms (rule on cross-border transfer of registered office expected in the near future, improvement of cross-border transparency, creation of additional European legal entity forms), (**2**)

[114] Green Paper European Corporate Governance Framework, COM (2011) 164. Overview in: Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 76 et seq.

[115] Cf. e. g. Bachmann, WM 2011, 1301 et seq.; Hennrichs, GmbHR 2011, R 257 et seq.; Hopt, EuZW 2011, 609 et seq.; identical in Liber amicorum M. Winter, 2011, p. 255 et. seq.; additional citations in Bayer/J. Schmidt, BB 2012, 3, 9 in fn. 148; see also the statement of the German Federal Council [Bundesrat], BR-Drs. 189/11(B); statement of the German parliament [Bundestag], BT-Drs. 17/6506 (enancted: BT-PlPr. 17/13936); statement BDI/BDA, 21.7.2011, BDI D 0451; Commercial Law committee of the DAV, NZG 2011, 936 et. seq.; statement of the Government Commission DCGK (accessible at: http://www.corporategovernancecode.de/ger/download/Stellungnahme_Gruenbuch.pdf).

[116] Report of the Reflection Group on the Future of EU Company Law, 5 April 2011, accessible at http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en. pdf; see Bachmann, WM 2011, 1301 et. seq.; Hellwig/Behme, AG 2011, 740 et. seq.; Jung, BB 2011, 1987 et. seq.; Lenoir/Conac, Recueil Dalloz 2011, 1808; Lutter/Bayer/Schmidt, EuropUR, § 18 marginal nos. 5, 100 et seq.; J. Schmidt, GmbHR 2011, R177 et seq.; Bayer/J. Schmidt, BB 2012, 3, 13 et seq.

[117] Cf. EuZW 2012, 203; see the "Feedback Statement – Summary of responses to the public consultation on the future of European Company Law" accessible at http://ec.europa.eu/internal_market/consultations/docs/2012/companylaw/feedback_statement_en.pdf (Current as of 17 July 2012).

[118] Hopt, EuZW 2012, 481, 482.

The long-term survivability of enterprises (including goal of sustainable business management, improvements in risk management, promotion of long-term commitment on the part of shareholders, measures related to institutional investors, additional improvements related to the exercise of shareholder voting rights, mechanisms for identifying the shareholders by the company, evaluation of the legal instrument of independent board members, in general a "neutral position related to co-determination" on the part of the European legislator, free selection of management structures at least in the case of non-listed companies, additional simplification measures specifically related to the SME) and **(3)** Laws related to corporate groups (recognition of a "group interest", creation of a simplified single-member company to be used as the basis for a corporate group, problems of transparency related to corporate groups). At the same time, the Reflection Group welcomed the competing scientific project for a European Model Company Act (EMCA).[119] The European Commission published an additional Action Plan on European Company Law and Corporate Governance (Action Plan 2012) based on the foregoing on 12 December 2012.[120]

4. European private company (SPE)

a) Status of preliminary work. At present, the future fate of the European private company (Societas Privata Europaea – SPE) is an open question. The Commission draft[121] of 2008 was met with reservations on the part of many Member States due to its extremely liberal line and the European Parliament[122] likewise had already proposed an entire series of modifications in 2009. After proposed compromises from the French (2008), Czech (start of 2009) and Swedish Council presidencies (end of 2009) had failed,[123] the Hungarian Council presidency next used its best efforts during the first half of 2011 to reach consensus. The final of its total of three proposed compromises appeared particularly promising.[124] However, when a Council vote was held on 30 May 2011, Germany and Sweden voted against this proposed compromise based on concerns, particularly regarding employee codetermination.[125] In addition to the co-determination issue, the main points in dispute remained rules regarding corporate domicile (in particular in cases of a split between the registered

[119] For additional information, see Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 107 with additional citations; current information on the EMCA project website: http://www.asb.dk/emca/; see also, e. g. Krüger Andersen, The European Model Company Act (EMCA): A new way forward, in: Bernitz/Ringe (eds.), Company Law and Economic Protectionism – New Challenges to European Integration, Part IV.

[120] COM (2012) 740/2, fn. 35 above; see Bremer, NZG 2012, 817; Hopt, ZGR 2013, 165 et seq.

[121] Proposal for a COUNCIL REGULATION on the Statute for a European private company, 25 June 2008, COM (2008) 396; see citations in Lutter/Bayer/Schmidt, EuropUR, § 43 marginal no. 3.

[122] European Parliament Resolution dated 10 March 2009 on the Proposal for a COUNCIL REGULATION on the Statute for a European private company, AB1EU dated 1 April 2010, C 87/E300; see Lutter/Bayer/Schmidt, EuropUR, § 43 marginal no. 4.

[123] Individual citations in Bayer/J. Schmidt, BB 2012, 3.

[124] Docs. 8084/11, 9713/11 and 10611/11; see the extensive discussion of the 3rd Hungarian proposal for a compromise in Lutter/Bayer/Schmidt, EuropUR, § 43 (with citations to now very comprehensive literature on the topic of the SPE).

[125] Cf. Doc. 10547/11, p. 9; see Lutter/Bayer/Schmidt, EuropUR, § 43 marginal no. 4; a final attempt to place the SPE on the agenda of the extraordinary Council meeting of 27 June 2011 failed as well (Doc. 11786/11) due to German opposition; Hellwig/Behme, AG 2011, 740, 741.

office and the actual administrative office),[126] cross-border elements and minimum capitalisation.[127]

b) Registration formalities and control of legal conformity. With regard to the specific issues of the SPE project, the rules governing registration formalities and the associated control of legal conformity are initially of interest for purposes of the current study. Uniform rules on this topic are likely impossible to achieve as the regulations in this regard – in particular with respect to the need of authentication by a civil law notary – vary widely within the Member States. Accordingly, the draft refers to the national law in connection with this issue. In this manner, it should be possible to design the SPE in harmony with established German traditions and those of other Member States as well which provide for the involvement of the civil law notary in the interests of the public and of the participating shareholders.[128] One reads that the guiding principle for the registration process is to make formation as fast, non-bureaucratic and cost-effective as possible and to limit registration formalities to the extent necessary to ensure legal certainty.[129] This guideline however results in a rule which no longer permits formation to be subject to serious review. Pursuant to Art. 9 (4) of the planned SPE statute, legal conformity may be reviewed by a notary, a judicial body, another competent authority and/or by self-certification – including by authorised signatory. It is obvious to say that the self-certification option is associated with serious risks of abuse.[130] As part of the legal policy considerations, these risks of abuse should carry more weight than the undesirable pursuit of self-interest (of trade unions, civil law notaries, etc.) which allegedly underlies the demands for an expansion of authentication requirements within EPC law.[131]

c) List of shareholders. Pursuant to Art. 15 (1) of the SPE statute, the management body must maintain a list of shareholders, which must comply with minimum information requirements set out in paragraph 1(a) as to identity, number of shares held and contributions made by the shareholder. The entries must be dated, and deleted information and documents must be retained for ten years (Art. 15 (2)). For reasons of legal certainty, the management body may only make changes to the list if provided with written notice and documentation of the relevant circumstances; although based on its text, the applicable provision in Art. 15 (4) applies only on the transfer of shares, it should be extended to apply to other changed circumstances in the interest of maintaining the accuracy of the list, such as changes in name or

[126] The EP stated its opposition to a split domicile in its initiative report 2012: P7_TA-PROV (20120019) European Parliament: Plenary session document A7-0008/2012 dated 9 January 2012. Report with recommendations to the Commission on a 14th company law directive on the cross-border transfer of company seats 2011/2046 (INI), p. 5, Recitial H of the draft resolution, text accessible at http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2012-0008&language=DE (last accessed: 29 October 2012).

[127] For a scientific overall assessment of the EPC project and specific suggestions for its further development, see Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft.

[128] Wicke, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, § 8 marginal no. 19; see also Matyk, GPR 2009, 2, 5; Krejci, Societas Privata Europaea, 2008, marginal no. 165 et seq.

[129] Cf. Recital 8 to the planned ESP statute; see also Lutter/Bayer/Schmidt, EuropUR, § 43 marginal no. 42.

[130] Accord Wicke, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, § 8 marginal no. 19.

[131] Overemphasised from Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 197–200.

address, transfers on death, consolidation of shares.[132] The disclosure requirements of the shareholder list reflect a compromise: According to Art. 15 (6) of the proposed regulation, in principle only the shareholders have right to inspect the list; however, the Member States may extend this inspection right to third parties.[133] Furthermore, the list of shareholders must be filed with the competent registry and must be disclosed, whereby the Member States may however waive disclosure of information in whole or in part. According to Art. 15 (1), entry in the list of shareholders has a legitimizing function in that only persons entered on the list may exercise the rights found in the SPE statute and the articles of association as against the association. Insofar as national laws provide for the possibility of a good faith acquisition, they may also assign the list of shareholders the function of a basis for legal appearance (see next section).

d) Transfer of shares. The unclear provision on the list of shareholders's function as a basis for legal appearance is unsatisfactory but consistent; because the proposed SPE statute does not even require the transfer of shares to be in writing but rather, with regard to form, refers to applicable national law.[134] The proposed rule is likewise unsatisfactory in this regard as merely a notarial authentication would be suited here to act as a barrier to trading in shares – as is typical in the case of small corporations – and to ensure reliable documentation of the respective shareholdings.[135] The rule as currently proposed similarly does not ensure the necessary degree of **investor protection** in the form of providing advice to the participants upon a transfer of shares. Of course, one needs to be realistic here: The involvement of a notary cannot generally be required if only for the reason that not all Member States have the office of notary. However, at the least an obligation – based on Art. 11 of the Disclosure Directive – which ensures the reliable confirmation of shareholdings by a notary or other administrative or judicial body should be codified.[136]

e) Raising capital. Based on the latest status of the preliminary work, raising capital on the part of the SPE conforms to the principles of the Continental European system of preventative creditor protection introduced to public limited liability companies across the EU by the Capital Directive.[137] Nevertheless, there are gaps in protection, in particular in relation to formation by means of in-kind

[132] Lutter/Bayer/Schmidt, EuropUR, § 43 marginal no. 58.

[133] Critical with regard to the compromises contained in the proposed regulation in this regard Maschke, BB 2011, 1027, 1029; Wicke, GmbHR 2011, 566, 573 et seq.

[134] See Art. 11 of the Rome I Regulation on the law applicable to contractual obligations; for a more detailed discussion see Kindler, Geschäftsanteilsabtretungen im Ausland.

[135] Wicke, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, § 8 marginal no. 38 citing BGH GmbHR 2008, 589, 590; NJW 1999, 2594; NJW 1996, 3338, 3339.

[136] Accord, Wicke, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, § 8 marginal no. 40; for another opinion, see Eidenmüller, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 176 according to which the purpose of capital market laws is to exclude the free tradeability of shares in small corporations. What this view disregards is that limitations on transferability in the form of the authentication requirements of section 15 (3), (4) GmbH must be classified as capital market law based on a functional analysis: Kindler, Geschäftsanteilsabtretungen im Ausland, p. 21et seq. citing Bungert, DZWiR 1993, 494, 497.

[137] See Hommelhoff/Teichmann, GmbHR 2010, 337, 339; Lutter/Bayer/Schmidt, EuropUR, § 43 marginal no. 74.

contributions where review of values by an external expert is merely optional for the Member States.

f) Status and powers of the general meeting. The general meeting is the SPE's most important decision-making body (Art. (7)(1a) Draft Regulation). A distinction must be made between **obligatory and optional powers**. In the case of the former, Art. 28(1) provides a series of decisions subject to obligatory approval. Beyond that, the drafters of the articles of association are free to grant the general meeting additional powers pursuant to Art. 8 (1a). Pursuant to Art. 28 (1), mandatory powers include, amongst others, decisions regarding the redemption of shares, capital measures, amendments to the articles of association and winding up the company. These fundamental decisions require a resolution of the shareholders with a qualified majority of at least 2/3 of all voting rights attached to the shares issued by the SPE. The following decisions – apparently viewed as less important – require a shareholder resolution with simple majority of all voting rights attached to the shares issued by the SPE, whereas the statute may however require a higher or lower majority: Approval of the annual financial statements, distributions to the shareholders, appointment and removal of directors and their terms of office, removal of the auditor. Furthermore, the general meeting's mandatory powers include the ability to appoint the managing director and the auditor. As is the case in the respective national legal systems, the shareholders' freedom of choice when assigning decision-making authority to the general meeting reaches its limit in the case of responsibilities which must be assigned to the management body. For example, this applies to representing the SPE in dealings with third parties (Art. 34).[138]

[138] For a more detailed analysis of the powers of the management body as well as its rights and obligations (also in relationship to the general meeting), see Lutter/Bayer/Schmidt, EuropUR, § 43 marginal no. 144 et seq.

Chapter 2. Minimum Capital and Capital Protection

I. Limitations on liability and transfer of risks

1. Entrepreneurial liability

To act in an entrepreneurial capacity means to take entrepreneurial risk, i. e. risk in its Janus-faced form: the opportunity for financial success and the risk of failure.[1] In the rudimentary form of a self-sustaining economic actor, the entrepreneur himself applies his efforts – his productive factors, capital and work – toward the end of generating added value[2] and earning his living from these efforts, toward providing for a family, making provisions for bad times, etc. However, in the process he is exposed to the risk of failure, i. e. failing to create added value but rather wasting his efforts for nothing. But these consequences affect him alone and those who depend upon him; society is only affected in that aid may be sought from the social safety net.

In its more sophisticated form of participating in the market as an enterprise, acting in an entrepreneurial capacity also entails entering into business transactions with other legal actors. By their nature, these interactions give rise to **liabilities** to the extent they are not limited to purely cash transactions. Liabilities may arise due to non-contractual actions as well. This brings the entrepreneur's ability to pay his debts to the fore. The extent to which economic failure limits his solvency also draws his **creditors** into the realm affected by his entrepreneurial risk. Of course, willingness to pay is also a second factor and to exhaust the ability to pay without consideration of the former is a question of legal liability and its compulsory enforcement. In the case of an individual acting as an entrepreneur, this is traditionally simplified by the fact that all of his assets are subject to attachment by his creditors, if necessary even the arrest of his person for this purpose – even if this no longer means life and limb but merely compulsion of the "oath of disclosure", the statutory oath of disclosure.

Unlimited personal liability may have been originally viewed as self-evident as a characteristic of the "royal" merchant; however the merchant himself has likely always sought ways to avoid this. Even when viewed objectively, there are good reasons to justify limiting this liability. Within the legal system, this view has initially been able to assert itself in cases where a larger number of participants have come together to conduct business as associates or shareholders. If each individual has only a minimal say in the management of the undertaking, or his interests are diversified via a number of ownership interests in several enterprises, he can hardly accept the risk of unlimited personal liability from one and/or every ownership interest. Nevertheless, there do appear to have been trading and shipping companies in the seventeenth and eighteenth centuries where 1,000 or more partners affiliated themselves despite this liability, and Lloyd's of London

[1] On the topic of risk from an economic standpoint, see Schredelseker, Grundlagen der Finanzwirtschaft, p. 202 et seq.; from a sociological standpoint, see Luhmann, Soziologie des Risikos; on entrepreneurial risk see Roth, in: FS Säcker, 2011, p. 459. The terminological distinction between risk and uncertainty is neglected, see thereto most recently Gigerenzer, Risk Savvy, 2013.

[2] Previously Wieland, HandelsR Vol. 1, 1921, p. 145.

provides a more recent example where syndicate members have been exposed to personal liability (actually or nearly) as a result of massive loss events.[3] However our modern system of exchange traded shares, in which investors seek to substantively diversify their investments in a flexible manner, can only function if each share is not associated with any liability risk beyond what the holder has paid for its acquisition.

However, in the context of the regulatory framework of modern, interdependent and state-controlled economic activity, placing **limitations on the liability** of fellow entrepreneurs who hold a majority interest, or even the sole proprietor, also appears to be justified as part of a weighing of interests[4] and to be necessary for purposes of stimulating private entrepreneurship[5] which is desirable both from an economic and a socio-political perspective. Several possibilities present themselves for realising this from a legal standpoint, from a fixed cap on the amount of personal liability set at the outset[6] to segregating a special fund subject to liability from personal assets (so-called separation principle), at best using those assets dedicated to the enterprise[7] – the path chosen by the Portuguese and French alternative to the single-member private limited company[8] – or a still more narrowly defined asset pool,[9] up to hiving off such a special fund into its own entity, as a company. The best option for the latter is in the form of a **corporation** with its own legal personality; this may exist even with only a single shareholder (as a single-member company), and formed by law in this constellation in all Member States since the implementation of the Twelfth Council Company Law Directive of 1989. Most recently, France has made both choices available with a single-member company and the segregation of assets: the EURL (entreprise unipersonnelle à responsabilité limitée) as a special form of the SARL (private limited company)[10] and since 1 January 2012, the EIRL (entrepreneur individuel à responsabilité limitée) with liability limited to business assets. The forerunner of the latter was the Portuguese sole trader with limited liability, likewise abbreviated EIRL, which has been in place there since 1986[11] and which has been in competition with the single-member private limited company since the implementation of the Twelfth Council Company Law Directive of 1989. However, according to reports, it has not gained wide acceptance in practice, neither before nor since the Directive.[12]

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[3] See also Armour/Hansmann/Kraakman, in: Kraakman et al., The Anatomy of Corporate Law, p. 9 and fn. 25.

[4] Roth/Altmeppen, GmbHG, Intro. marginal no. 17.

[5] See also CJEU Case C-81/09, *Idryma Typou,* (2010) ECR I-10161 = ZIP 2010, 2493; Schall, Kapitalgesellschaftlicher Gläubigerschutz, 2009. The facilitation of company formations for purposes of creating new jobs is a mantra even of socialist governments who are not otherwise very business friendly.

[6] Cf. previously Pisko, Die beschränkte Haftung des Einzelkaufmanns, GrünhutsZ 37 (1910), 699.

[7] Dubarry/Flume, ZeuP 2012, 128.

[8] See immediately following.

[9] As is the case in maritime law liability "ship and cargo", section 486 HGB [German Commercial Code].

[10] Loi of 1 July 1985.

[11] Legislative Decree No. 248/86 dated 25 August 1986.

[12] Stieb, in: Süß/Wachter, Hdb des internationalen GmbH-Rechts, country report Portugal marginal no. 5.

2. Limited liability and creditor protection

The statutory options for limiting risk and liability by forming a corporation have become established with great success in all European countries, namely in the form of a binary system comprised of two pillars, the public limited liability company and the private limited liability company.[13] In this system, the **public limited company** is intended for large enterprises with access to the capital markets and also primarily attracts such enterprises (Germany: approx. 15,000 Aktiengesellschaften)[14] not in the least because they are subject to greater and stricter regulation by lawmakers;[15] whereas the **private limited company**, intended as an entity form for small and mid-sized businesses with its simplifications and reduced requirements, has practically reached the largest total figure everywhere: the range of 1 million in Germany, Italy, Spain, even more in France, 500,000 in the Netherlands, 400,000 in Portugal, 100,000 in Austria, double that figure in Poland, etc.[16] By contrast, only in Switzerland does the public limited company, at just under 200,000, dominate the field of small and medium-sized enterprises (SMEs). The private limited company has traditionally led a shadowy existence in Switzerland but has experienced an impressive upswing since the last tightening of stock corporation law twenty years ago and in the meantime has reached a total of 125,000.[17]

However, in the mind of economists, this statutorily-enabled limitation on liability conjures up fears of the much-abhorred externalisation of costs:[18] The entrepreneur who has limited liability enjoys all of the benefits and passes along the losses to his creditors in whole or in part if and because the liable sum or the segregated assets are not sufficient for their satisfaction. Of course theoretically, there is a simple remedy for this which may be provided through **laws on insolvency**. A continuous, dynamic comparison must be made between debt levels and the sum of available liable assets (balance sheet totals) and as soon as liabilities have risen to the level at which they completely exhaust liable assets (= impending over-indebtedness), business operations are stopped and assets, which just cover 100 % of the debts, are used for their satisfaction. Personal liability on the part of the manager of the business for failing to initiate insolvency proceedings in a timely manner ensures compliance with this system.[19]

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[13] On Continental European private limited company forms, see Lutter/Bayer/Schmidt, EuropUR, § 11 marginal no. 6, on the special cases of Sweden and Finland, see ibid. marginal no. 7 and Ch. 1 fn. 38; see also Bayer, in: Lutter/Hommelhoff, GmbHG, § 4 a Annex 1 marginal no. 9.

[14] Statistics of company forms in Germany in: Roth/Weller, Handels- und Gesellschaftsrecht, marginal no. 145.

[15] However, France has created a deregulated special form of the Société par actions simplifiée (SAS); see Ch. 1 fn. 71 and Feuerbach/Victor-Granzer, in: Ars Legis (ed.), Kapitalgesellschaften in Europa, country report France, pp. 67, 73.

[16] According to Wachter, in: Schröder, Die GmbH im europäischen Vergleich, 2005, pp. 27, 39. More recent figures also in: Lutter/Bayer/Schmidt, EuropUR, § 8 marginal no. 5. For purposes of comparison: There are more than 2 million private limited companies in Great Britain, thereof likely approximately 100,000 letter box formations with foreign business focus.

[17] Schindler/Töndury, in: Süß/Wachter, Hdb des internationalen GmbH-Rechts, country report Switzerland marginal no. 3; Wachter still speaks of 50,000 GmbHs in 2005 in: Schröder, Die GmbH im europäischen Vergleich, fn. 50. Similar development shortly before in Spain: Embid Irujo, in: Lutter, Das Kapital der AG in Europa, p. 686.

[18] See alternatively Lehmann, ZGR 1986, 345; Hirsch, Law and Economics, p. 10.

[19] K. Schmidt, in: Lutter, Das Kapital der AG in Europa, p. 188.

However, in practice this may not function in this manner for a variety of reasons of which only two important reasons will be highlighted by the following example.[20] Assume that E forms a company with EUR 10,000 of own equity and EUR 90,000 of borrowed funds. Of this amount, he invests EUR 80,000 in fixed assets and uses EUR 20,000 as working capital. Insolvency from an accounting standpoint occurs as soon as losses amounting to EUR 10,000 are incurred. However, if operations cease at that moment ("insolvency is opened"), a certain period of time will first pass until things come to an actual standstill during which additional losses amounting to EUR 10,000 are incurred, and second the remaining assets of now only EUR 80,000 are tied up in fixed assets the sale of which, experience tells us, will not even come close to generating proceeds equal to the acquisition costs of EUR 80,000 but rather just half that figure. Because they are tangible assets, the assets are used, tailored for a particular purpose (so-called "asset specificity") and, if they proved to be a bad investment because market opportunities were missed (formation of a business at the wrong place, at the wrong time, for the wrong purpose), they are not subject to their best use for other purposes. Result: Liabilities of EUR 90,000 stand opposite liquidation proceeds of EUR 40,000.

Accordingly, expected scrap value should be used for purposes of establishing over-indebtedness in relation to assets. However, in that case, the same start-up business, now relatively solidly financed with EUR 40,000 of own equity, would already be over-indebted after three days due to minor yet unavoidable start-up costs (EUR 60,000 of borrowed funds stand opposite assets of EUR 40,000 plus EUR 20,000) and would need to cease operations without consideration of the perhaps good, and in any event untried, chances of success.

This may be subject to the criticism that the first of the financing alternatives is unrealistic because such imprudent lenders who would finance of 90 % of start-up capital may not be found. This even though one of the basic assumptions of (neo) classical economic theory is that for every degree of risk there is a lender who includes a corresponding risk premium as part of the interest rate demanded.[21] However, that hardly appears to be reflected in the largely standardised lending practices of European banks. Accordingly, this theoretical assumption plays no role for practical purposes.[22] That notwithstanding, the crucial legal issue is hidden behind this assumption.

The question is: What is the role of **self-protection** on the part of the attentive business partner who makes rational decisions? Since, from a contractual standpoint, not only may adequate risk premiums be negotiated but also all other precautions may be taken in order to create an allocation of risk desired or accepted by the parties. The first creditors of a start-up business must then assess its chance of success for themselves – and they will presumably do this more realistically than

[20] See Roth/Altmeppen, GmbHG, Intro. marginal no. 29; Roth, in: FS Koppensteiner, 2001, p. 141; Roth, ZGR 1993, 170. Making further distinctions, see Schön, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 135 et seq.

[21] Posner, 43 U.Chi.L.Rev. 491, 503 (1976); Kronman/Jackson, 88 Yale L.J. 1143 (1979); Easterbrook/Fischel, 52 U.Chi.L.Rev. 89, 104 (1985); see also Easterbrock/Fischel, The economic structure of corporate law, p. 51.

[22] On this issue, see Roth, ZGR 2005, 348, 374, and even earlier ZGR 1986, 371, 376. Contra Walter, AG 1998, 370.

the founder himself[23] – and will not only decide on this basis what share of start-up capital, from an absolute and percentage standpoint, they will finance on what conditions, but will also seek for themselves rights to on-going monitoring and perhaps even participation in management of the business **by contractual agreement** and they will finally protect themselves against future dilution of the financing facility as a result of later, then-competing risky loans.[24] But will they also want that? Will they also be able to do that? Should a legal system be based on the premise – turning an old German adage on its head – "he who doesn't want to get left holding the bag should open his eyes".

From a comparative legal analysis perspective, opinions in corporate law are sharply divided on this issue.[25] For on the one hand, independently safeguarding interests results in tremendous **transaction and monitoring costs** which the business partners could also have used to participate in risk, including the risk of success, in the same manner as the shareholders – a position which they are decidedly not striving toward. On the other hand, contract design then of necessity takes on such a high degree of complexity that it exceeds the **rational and cognitive capacity** of the parties or at least has a disproportionate relationship to the associated costs. Theoretically, "all economic exchange could be effectively organized by contract. Given bounded rationality, however, it is impossible to deal with complexity in all contractually relevant respects".[26]

Nevertheless, Anglo-American corporation law draws its theoretical underpinnings from this body of thought and radiates it across the globe, which the collaborative work "The Anatomy of Corporate Law" vividly illustrates.[27] The Continental European legal tradition places more emphasis on protecting interests by means of **mandatory legal standards** and, in this regard, consideration is given to the creditors – and that is to creditors in all categories – including employees and recipients of public levies (the state, social insurance institutions, etc.) and secondary consideration is given to the shareholders, namely to associated and minority investors or shareholders as the case may be, in their relationship to a dominant shareholder or to a

[23] Psychological risk research has found that founders, whether due to limited cognition or based on irrational optimism (Bense/Bechmann, Interdisziplinäre Risikoforschung, 1998; Roth, in: MüKoBGB, 5th ed., § 241 marginal no. 128, § 313 marginal no. 38), underestimate the probability of a business failure. See DER SPIEGEL 2012 No. 1, pp. 117, 124.

[24] See Roth, ZGR 1993, 170, 192. On the issue of so-called loan, bond or financial covenants, see Bratton and K. M. Schmidt, EBOR 7, 39 and 89 (2006); Kalss, in: Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 35; Nouvertné, ZIP 2012, 2139. For the Italian perspective, see Miola, in: Lutter, Das Kapital der AG in Europa, p. 635.

[25] See Fleischer, ZHR 168 (2004), 673: Gesetz und Vertrag als alternative Problemlösungsmodelle im Gesellschaftsrecht. See even earlier Lehmann und Roth, ZGR 1986, 345 and 371.

[26] Williamson, ZgS 1981, 675, 676. On the issue of risk calculation on the part of lenders, cf. also H. Schmidt, Jb. Sozialwiss. 37 (1986), 354; see also Fleischer, EBOR 7 (2006), 29, 35. For additional citations, see above Ch. 1 fn. 38. A prominent dissenting voice from recent times is Posner, Stanford Law Rev. 50, 1551 (1998), who however significantly neglected the most important aspects in our view of the limited cognition and rationality – the complexity of life circumstances. On the reduction of complexity as a core function of the law see Luhmann, Rechtssoziologie vol. 1, 1972.

[27] A refined presentation of the status of American discussion may be found in Fleischer, ZHR 168 (2004), 685. For the reception in German jurisprudence, see among others Schön, in: Bachmann et al., Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 118 et seq. as well as the contributions from Fleischer and Mülbert in EBOR 7 (2006), 29 and 357, reprinted in: Eidenmüller/Schön, The Law and Economics of Creditor Protection.

majority as well as to potential purchasers of shares.[28] And because the satisfaction of creditors may apparently no longer effectively be ensured by or following the initiation of insolvency proceedings, regulations must take effect prior to insolvency and in the best case already at the time of formation. This is the case anyway for the interests of the (fellow) shareholders. Specifically, the concern is initially with the formation in general and the raising of capital in particular, and then various provisions for protecting capital thereafter. In the case of the public limited company, this regulatory philosophy found its way into the European Directives – namely the First and Second Directives – which came into being between 1968 and 1976 still subject to Continental European influence and still later is reflected in the European (Public Limited) Company (SE). These protective provisions are, on the one hand, material in nature, that is they place specific substantive requirements on capitalisation and its maintenance, and on the other, create a formal framework for capitalisation and possible changes which is intended to ensure compliance with these requirements by means of parallel procedural mechanisms and professional controls.

II. Fixed capital and minimum capital

Entrepreneurial risk is transferred to a separate entity, the corporation. The shareholders are not liable for its obligations to the extent they do not assume such liability at their initiative, but rather undertake only to make specific capital contributions to the company. The assets or liable capital of the corporation, the so-called liability fund, is created primarily from these contributions and constitutes the corporation's assets available to its creditors. Entrepreneurial creditworthiness depends entirely on this (to the extent additional security is not provided) and is important to the creditors and reflexively also for the shareholders. The legal system must ensure that a certain amount of liable capital is accumulated within the corporation and should ensure that this liable capital is retained over time as best as is possible. With that, the two fundamental pillars of the legal system, **raising capital** and **capital preservation**, have been introduced.

1. Liable equity capital levels

The amount of the liable capital is determined by two regulatory principles which are firmly anchored in the corporate laws of Germany, Austria and Switzerland as well as the Latin countries.[29] The principle of **fixed capital** implies that the founders

[28] In the course of the historical development of the law of stock corporations, focus was on the latter, investor protection, see explanatory note to Aktienrechtsnovelle 1884, in: Schubert/Hommelhoff, Hundert Jahre modernes Aktienrecht, p. 415, Kalss, in: Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 309; Fleischer, EBOR 7 (2006), 31; Ekkenga/Bayer, in: Lutter, Das Kapital der AG in Europa, p. 342. The second recital in the Capital Directive also places protection of shareholders ahead of that of the creditors. In fact, the shareholder making a derivative purchase (on an exchange) is particularly dependent upon statutory protection because he has no contractual relationship to the company at the time of purchase in which he could even theoretically assert his interests. By contrast, the partners to an agreement to form a company can negotiate its contents. Interests worthy of protection are only then implicated at the next level of the contributions where the concern is that the other shareholders also comply with their obligations.

[29] Lutter, in: Nobel, Internationales Gesellschaftsrecht, 1998, pp. 129, 142. Limitations in Spain and Portugal: Lutter/Bayer/Schmidt, EuropUR, § 8 marginal no. 13. Not in the common law jurisdictions:

have agreed to a set amount of share or registered capital in the company agreement (statutes) and must promise to actually contribute this amount or to be responsible therefore and to leave it in the business.[30] The law prescribes a lower limit for the capital to be fixed by means of **minimum capital** requirements which vary between the public limited company and private limited company forms as well as between the various legal systems. The Capital Directive sets EUR 25,000 as the minimum amount for a public limited company and the Member States go significantly beyond this in some cases: Italy 120,000, Spain 60,000, Austria 70,000, Germany 50,000, the Netherlands 45,000, France 37,000, but 225,000 in the case of listed public limited company, the Czech Republic even (converted) EUR 80,000 and 800,000 respectively, Finland EUR 80,000, Sweden and Denmark 500,000 krone (approx. EUR 55,000 and EUR 66,000 respectively); Switzerland requires CHF 100,000. The minimum capitalisation for the SE is EUR 120,000.

In the case of the private limited company, Austria at EUR 35,000 (as of 1 January 2013) and Germany at EUR 25,000, i. e. in each case one-half of the amount required for the public limited company, have the highest standards, however there is another exception here in the case of the German Unternehmergesellschaft [entrepreneurial company] with limited liability. Italy places the threshold at EUR 10,000, the Czech Republic, Poland and Denmark (converted) approximately EUR 8,000, 12,000 and 16,000 respectively, the Netherlands until 2012 at EUR 18,000 and Portugal until 2011 at EUR 5,000. At EUR 3,000, Spain has one of the lowest minimum capitalisation requirements for a private limited company, however, more recently (since 2003) in addition and ahead of Germany other countries have introduced 1 euro options based on the British example (see 4., below). Finland is satisfied with 2,500 for its private corporation. By contrast, converted to euros, Sweden demands EUR 11,000.[31] Switzerland requires CHF 20,000 of its private limited company. Spain introduced a type of private limited company which may be formed on an especially expedited basis called the SLNE (nueva empresa).[32] Portugal did the same in 2005 even including the public limited company[33]; however both countries without any special features related to minimum capitalisation.

In only rare cases is an upper limit set for the capitalisation of a private limited company (Switzerland: CHF 2 million) or a maximum number of shareholders (France: 100) because the public limited company entity form, with its high degree of regulation, is desired for large enterprises. In the case of the Spanish SLNE, which was created as a second form of private limited company for faster and easier formation, the upper limit on capitalisation amounts to EUR 120,000 and the shareholder limit is actually only five.

Armour, EBOR 7 (2006), 5, 7, 10. On the particular features of legal developments in Spain, see Embid Irujo, in: Lutter, Das Kapital der AG in Europa, p. 682.

[30] Roth, Kapitalverfassung, presentation to 16. ÖJT 2006, pp. 100, 104.

[31] Data for the Czech Republic and the Scandinavian countries taken from the respective country reports in Ars Legis (ed.), Kapitalgesellschaften in Europa, as of 2007.

[32] Sociedad Limitada Nueva Empresa, see Hierro Anibarro, La sociedad limitada Nueva Empresa; on the legal situation following the 2010 reform of the foregoing see Hierro Anibarro, Sociedad Nueva Empresa, see also Alfaro, EBOR 5 (2004), 467; Wachter, in: Schröder, Die GmbH im europäischen Vergleich, 2005, pp. 27, 34; Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain marginal no. 41 et seq.

[33] Stieb, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Portugal marginal no. 4.

There is a connection between these two requirements in so far as the statutorily set minimum capitalisation presupposes the requirement of a fixed capital amount but not vice versa.[34] The regulatory goals being pursued by both requirements are not in fact identical.[35] The principle of fixed capital requires the company to begin its life with a **defined amount of initial capital** which – described as share or registered capital – forms the foundation of its equity. The founders are free to set the amount of this capital, however they must have a binding agreement as to a fixed amount and obligate themselves to make contributions which constitute the sum of this amount (accordingly also referred to as: subscribed capital). This achieves a three-fold purpose: The company is assured a certain capitalisation at the start of its existence, the public is informed thereof through its disclosure (at least: in public registries),[36] and the individual shareholder knows the binding capital commitments he may expect of the other shareholders.

The two pillars of capital raising and capital preservation referred to above, that is the legal assurance that the capital promised the company is in fact paid in in full and is not then withdrawn again, are the required accompanying measures to this principle so that business partners and fellow shareholders can in fact rely on this level of capitalisation. This purpose is served by more or less sophisticated – in German law very sophisticated – regulations on the manner in which the contributions must be made on the one hand and on retaining capital within the company on the other. The latter is ensured though the legal commitment (therefore also referred to as: tied-up capital) of all or certain equity items, the core of which represents initial capital.

The determination of this capital by private decision is simply a necessary component of the act of formation and its disclosure; it is just this private autonomy which also allows changes at a later time with the same degree of formality and disclosure, namely both in the case of an increase or decrease in capital. A capital increase is then subject to the same requirements and commitments; in the case of a reduction in capital, the tied-up amount is reduced accordingly.

Statutory **minimum capitalisation** serves the purpose of setting restrictions on the founders' ability to set their fixed capital by establishing a mandatory lower limit thereby providing for a minimum amount of initial capital for all companies of the relevant legal form. A later reduction in capital may likewise not fall below this floor.

2. Analysis

a) Capitalisation. The common central theme for fixed capital as well as statutory minimum capitalisation may have originally been the creation of a liability buffer or **risk buffer** for purposes of protecting borrowed capital[37] because losses initially are charged to equity and only thereafter do creditors participate in the risk of loss, i. e. feel the consequences of limited liability once equity is exhausted. With

[34] Eidenmüller/Grunewald/Noack, in: Lutter, Das Kapital der AG in Europa, p. 20; Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 306.

[35] Frequently overlooked as part of the critical discussion, e. g. von Armour, EBOR 7 (2006), 5, 7, 10; Triebel/Otte, ZIP 2006, 311.

[36] Regarding more comprehensive (and more effective) disclosure in business correspondence and the like see p. 37 below.

[37] Roth, ZGR 1993, 170, 177; Spremann, Investition und Finanzierung, pp. 92, 252.

this in mind, the 1980 GmbH reform wanted to "increase the threshold for reliance on limitations on liability" by increasing minimum capitalisation requirements from DM 20,000 to DM 50,000.[38] In fact, it is immediately obvious that the up and down of entrepreneurial risks as well as pure fluctuations in asset values may be better absorbed where the share of equity financing is higher. It is not without reason that the real property mortgage business generally has lending limits of 80 % to 90 %. This is in addition to the fact that equity reduces debt service charged against operating results and in this manner has a reverse leverage effect in bad times.[39] The equity ratio is one of the cornerstones of assessing the creditworthiness of an enterprise for both of these reasons.

However, this also demonstrates the differences compared to the statutory regulatory approach especially in relation to minimum capitalisation. This is not specified as a ratio for overall financing and is not set on a sector or business-specific manner but rather as an absolute amount applicable to all enterprises which have opted for a given legal entity form. This amount may be comparatively high for some smaller private limited companies in relation to total assets but must appear very low to most companies starting from the time of formation and in particular after several years of expansive operations. It is here that the idea of capital fixed by company statute proves to be the superior approach because it aims to set liable capital on a case-by-case basis, tailored to the specific enterprise, dependent upon the discretion of its founder and subject to public controls by means of transparency. However, the founder then needs just as specific an assessment of this parameter and the key question is whether a functional control can be expected in legal relations.

The idea of enterprise-specific minimum capitalisation, which must thus be established on a case-by-case basis, as an alternative or supplement to a generally-applicable fixed amount has repeatedly been discussed in the past under the term **initial undercapitalisation**.[40] In this view, the company must be endowed with initial capital appropriate to its business purpose. Otherwise, there is an imminent risk that limitations on liability will be lost. This approach is generally rejected for economic (this criterion cannot be reliably quantified)[41] and legal grounds (too high a degree of legal uncertainty).[42] Nevertheless it has found some reception in Belgium. Belgium requires detailed financial calculations for the coming years which later, if they do not prove to be viable, may provide the basis for personal liability on the part of the founder.[43]

However, the core problem of a regulatory approach focused on the formation phase is another one: By its nature, it is static whereas the enterprise acts over time

[38] Report of the legal committee, BT-Drucks. 8/3908, p. 69.

[39] Roth, ZGR 1993, 178.

[40] Cf. Ulmer, GmbHG, Intro. A, marginal no. 45; Meyer, Haftungsbeschränkung im Recht der Handelsgesellschaften, p. 522; Kluiver/Rammeloo, in: Lutter, Das Kapital der AG in Europa, p. 659.

[41] See also Armour/Hertig/Kanda, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 130 fn. 83 on establishing an equity ratio. Eidenmüller/Grunewald/Noack discuss a ratio of 5 % for smaller enterprises in: Lutter, Das Kapital der AG in Europa, p. 28.

[42] Substantive undercapitalisation appears to have gained in importance in Spain: Embid Irujo, in: Lutter, Das Kapital der AG in Europa, pp. 679, 682.

[43] Code des Sociétés Art. 215, 229; see Kocks/Hennes, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Belgium marginal nos. 8, 44; Heitkamp, in: Ars Legis (ed.), Kapitalgesellschaften in Europa, country report Belgium, pp. 1, 4, 11.

and its risks develop dynamically. For this reason, a capital guarantee based on the time of formation appears very differently following a short number of years or even months of business operations. Shareholders' equity may have increased on a relative and absolute basis through the creation of reserves, thereby improving the chances of creditor satisfaction. However it may also be **exhausted through losses** resulting in the capital guarantee becoming worthless. Ultimately, the law cannot prevent the latter development; indeed it can provide that losses must be offset by subsequent profits and it can build in alert thresholds in advance of complete exhaustion which is the case in many countries where the loss of one-half of the initial capital (Germany section 49 (3) GmbHG, France Art. L223-42, 225–248 CCom;[44] Belgium Art. 332 Code des Sociétés; Capital Directive Art. 17; Spain Art. 363(e) LSC; in Italy upon the loss of one-third: Art. 2446 f Codice civ.) triggers a variety of reactions. However, there is no cure for the occurrence and accumulation of losses[45] and, as experience has shown, neither the absolute nor relative amount of the equity buffer provides much of a barrier. Accordingly, if business partners want to be sure, they cannot orient themselves on the original capitalisation but rather must be interested in the then-current financial situation. However, financial statement disclosure presents only an incomplete picture in this regard and that is not even in "real time".

b) Sharing the risk. These inadequacies of fixed capital in general, and minimum capitalisation in particular, are long-known.[46] Thus this principle is today maintained and justified primarily as an **indication or threshold of seriousness and respectability**.[47] What is meant is that the founders and owners of an enterprise share in the entrepreneurial risk by making a significant equity contribution, namely in the amount of the statutory minimum or a greater amount chosen voluntarily, which prevents all too reckless entrepreneurial risks at the costs of the public and which signals to the public trust and responsibility on the part of the founders for their enterprise. If shareholders can already exclude their personal liability by forming a company with one euro, there is a certain incentive to try out entrepreneurial risks once without a relevant contribution of equity and to transfer the entire risk of failure to business partners and lenders[48] – to the extent such may be found on this basis. If by contrast, a not insignificant contribution of equity is demanded of the founders, they will consider the prospects of success more carefully, whereby the relevance or pain thresholds of course vary by individual and a law which pursues this philosophy of seriousness can of necessity only act in a standardised manner. This raises the

[44] Urbain-Parleani, in: Lutter, Das Kapital der AG in Europa, correctly points out that the application of this rule to 1-euro companies is pointless (p. 589). Section 5 a (4) dGmbHG diverges for this reason. Of course, the problem presents itself in similar form in the case of over-indebtedness as the grounds for insolvency; see also Urbain-Parleani ibid.

[45] On point, Urbain-Parleani, in: Lutter, Das Kapital der AG in Europa, p. 586 with quote from Guyon.

[46] See formerly Roth, in: Roth/Altmeppen, GmbHG, 1st ed. 1983, Intro. 3.2.2; more recently e. g. Mülbert/Birke, EBOR 3 (2002), 695; Krüger, Mindestkapital und Gläubigerschutz; Engert, GmbHR 2007, 337; Eidenmüller, ZGR 2007, 168, 183 und ZHR 171 (2007), 644, 660; most recently Schön, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 156.

[47] Ballerstedt, ZHR 135 (1971), 384, v. Caemmerer, in: FS Pieter Sanders, 1972, p. 18; K. Schmidt, Gesellschaftsrecht, § 18 II 4 a. Similarly for Italy Miola, in: Lutter, Das Kapital der AG in Europa, p. 614.

[48] Eidenmüller/Grunewald/Noack, in: Lutter, Das Kapital der AG in Europa, p. 23.

second question again as to whether it would be possible to leave this assessment of seriousness to the public. The applicable legal systems are consistent by not wanting this to be the sole standard, but rather offer legislative assistance which can otherwise only offer an indicator or signal of legitimacy the assessment of which continues to be the responsibility of the public.

In particular, a distinction must also be made between the contribution of own liable capital and self-financing of the enterprise by means of working capital.[49] A certain amount of start-up capital is needed as working capital and generally this may only be financed to a limited extent with borrowed funds. It is conceivable on the one hand (if even more likely to be the exception) that the founders set a higher amount of liable capital in the form of capital contributions than would otherwise be needed to start operations in order to underscore their seriousness. On the other they could finance business operations above and beyond liable capital by other means, such as supplementary payments into uncommitted reserves, to the extent permissible, or by means of shareholder loans and would be subject to legal obligations beyond those applicable to borrowed funds only to a certain extent.[50] In our opinion the assessment that the share of corporate financing the market demands of the shareholders should also determine their share of the risk (or the minimum amount) cannot be dismissed out-of-hand.

The correctness of an idea of seriousness which is based on own **risk sharing** is confirmed by research on risk, according to which willingness to take operational risks rises on the part of entrepreneurs and management bodies during a crisis[51] because they having nothing left to lose once equity has been exhausted and can now speculate at the cost of the creditors.[52] By contrast, one can practically describe it as the guiding principle of liability limitation that there is a consensus or community of risk between shareholders and creditors – incidentally just as is the case between shareholders themselves – (they "are all in the same boat") because both groups share in the risk with a not insignificant investment and in this regard the creditors enter into a passive commitment with the enterprise, i. e. they forego active monitoring.[53] At the same time, however, the crisis example also shows that the legitimacy signal in relation to the persons contributing capital relates to the formation and/or a later increase in capital and can similarly be devaluated over time as the liability guarantee of equity is exhausted. To a certain extent, the creditors, just as is the case with the individual (minority) shareholder, are at the mercy of the subsequent development of their debtor or enterprise, as applicable, and have only limited options for action even in the case of continuous monitoring.

The specific capital selected must however be made known to the public in order for it to have this signal effect. For this purpose, legal systems require this to be entered in a registry (e. g. section 10 (1) dGmbHG). Permanent disclosure on business correspondence or the like, which laws likewise already provide for as a

[49] See also Armour/Hertig/Kanda, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 131; Schön, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 15 citing Ferran Eur. Company & Financial L. Rev. 3, 178 (2006).

[50] See V 4. below on the topic of shareholder loans.

[51] Kraakman, EBOR 7 (2006), 468; Roth, presentation to 16. ÖJT 2006, pp. 112, 122.

[52] Lutter/Banerjea, ZGR 2003, 402, 415; Banerjea, ZIP 1999, 1153, 1161; Bitter, WM 2001, 2133; see also BGH NJW 1994, 447.

[53] Roth, presentation to 16. ÖJT 2006, pp. 112, 122 and ZGR 1993, 170, 180.

means of disclosure, would be even more effective. France requires the corresponding information for its SARL (Art. L 223–1 (4)), Italy for all corporations (Art. 2250 (2) CC).[54] Germany leaves it to the discretion of the company (sections 80 AktG and 35 a GmbHG, each in para.1 third sentence).

3. International criticism

Demand for fixed capital and, in particular, for minimum capitalisation levels, have been subject to increasing international, primarily Anglo-American inspired, criticism since the turn of the millennium.[55] This could have to do with the fact that since the CJEU decision in the Centros matter in 1999 competing European legal entity forms have received access to a European "market of legal entity forms" based on the freedom of establishment for companies as interpreted by the CJEU[56] and this has initiated a form of incentive and deregulation competition or race to the bottom. Interestingly enough, the decades-long German debate on the benefit of liable capital referred to above has practically been completely ignored.[57] The main thrust of this criticism is, however, based on another line of argument. The central point is the costs of the traditional system and these in turn are understood primarily to mean **an impediment to forming new companies** and thereby the creation of jobs. The core argument is that the desired protective purpose could just as well be realised by means of **autonomous self-protection** on the part of the parties.[58] This ignores the at least as interesting cost/benefit analysis of the formation of companies whose founders cannot or do not want to even commit to a relatively modest own share,[59] ignoring altogether the objection that the limited rationality of the actors threatens to fail in light of the high complexity of the task (see p. 31, above). German jurisprudence continues to believe in the principle despite certain reservations: the minimum capitalisation regime by itself, and even more so that of fixed capital, basically has a, if not throughout strongly, positive effect on efficiency.[60]

This criticism has been received differently in neighbouring countries. Whilst the Netherlands has generally signalled agreement,[61] reports from France and Italy

[54] In the event a single-member company is involved this must be indicated, Art. 2250 (4) CC.

[55] Armour, Modern L. Rev. 63, 355 (2000); identical EBOR 7, 5 (2006), reprinted in: Eidenmüller/Schön, The Law and Economics of Creditor Protection, p. 3; Enriques/Macey, Cornell L. Rev. 86, 1165 (2001); identical in Italy: Riv. Soc. 2002, 78; additional citations in: Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 295.

[56] See Roth, Vorgaben der Niederlassungsfreiheit für das Kapitalgesellschaftsrecht.

[57] Where Armour et al. refer to the danger of the immediate exhaustion of initial capital in: Kraakman et al., The Anatomy of Corporate Law, at p. 131 and attach the legitimacy effect to the voluntary capitalisation of more than one euro in deregulated entity forms, this is also without a distinction between fixed and minimum capital.

[58] Cf. Armour, EBOR 7, 5 (2006), p. 27: "legal capital rules are a form of primitive regulatory technology".

[59] The experience with the British limited company in Germany offers material for such a comparison, see p. 40, below.

[60] Eidenmüller/Grunewald/Noack, in: Lutter, Das Kapital der AG in Europa, p. 40; Merkt, in: Müller-Graff/Teichmann, Europäisches Gesellschaftsrecht auf neuen Wegen, p. 81; most recently Bayer, VGR-Jahrestagung 2012, in: Gesellschaftsrecht 2012, 2013, p. 25, 49. See also for Austria Krejci, Societas Privata Europea, 2008, p. 63 et seq., 166 et seq.

[61] Kluiver/Rammeloo, in: Lutter, Das Kapital der AG in Europa, p. 655 et seq., Rademakers/de Vries, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report The Netherlands marginal nos. 16, 57.

indicate that prevailing opinion wants to retain statutory capital[62] even though somewhat contradictorily France has abolished minimum capitalisation for the private limited company.

4. Most recent developments in national law

The criticism referred to above, and even more so the competitive situation triggered by the rulings of the CJEU, have not failed to have an effect on national legislators. **France** allowed a private limited company to be formed without minimum capital as early as 2003 (previously EUR 7,500)[63] and the MoMiG 2008 introduced the UG in **Germany** – the 1 euro entrepreneurial company (limited liability). Portugal enacted such legislation in 2011,[64] the Netherlands in 2012.[65] Spain reduced minimum capitalisation to EUR 3,000.[66] Among others, Italy has not bowed to this trend (private limited company minimum capitalisation EUR 10,000), Austria holds the line at EUR 35,000 anyway until 2013 and neither has experienced obvious negative consequences.[67] **Belgium** has followed an interesting middle way. It likewise permits the formation of a 1 euro private limited company subject to a specific designation which however must satisfy the normal minimum capital (EUR 18,500) requirement within five years,[68] whereas German lawmakers only set this as a goal in the case of the **Unternehmergesellschaft** (section 5 a (3), (5) GmbHG).

The new offer immediately received a warm reception in Germany with 47,000 new registrations between 1 November 2008 and 1 March 2011.[69] Of these, 10 % were content with one euro (only 5 % in the case of the French legal reform)[70] and in total 80 % up to EUR 1,000.[71] If this is supposed to be lauded as the success story of the new private limited company variation, the following question is entirely justified: Success for whom? In fact, the first concerns regarding the solidity of these formations are being documented empirically.[72] In any event, the system of fixed capital remains unaffected by these innovations to the system apart from the fact

[62] Urbain-Parleani ibid p. 577 et seq.; Miola, in: Lutter, Das Kapital der AG in Europa, pp. 612, 643, 650; similarly from Poland Kidyba/Soltysinski/Szumanski, in: Lutter, Das Kapital der AG in Europa, pp. 694, 714.

[63] Code de Commerce Art. L223-2 in the version from 1 August 2003, previously minimum capital of FF 50,000. See Meyer/Ludwig, GmbHR 2005, 346.

[64] Codigo das Sociedades Comerciais Art. 201 in the version of Legislative Decree No. 33/2011 of 7 March 2011; see Stieb, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Portugal marginal nos. 4, 35. See Lutter/Bayer/Schmidt, EuropUR, § 6 marginal no. 31 on reform efforts in Norway.

[65] Law of June 18, 2012, in force since Oct. 1, 2012. See Hirschfeld, RIW 2013, 134.

[66] See Hierro Anibarro, Simplificar el Derecho de Sociedades, 2010 on additional reform efforts which have deregulation as their goal.

[67] See p. 1. above, p. 40 below on competition from foreign "cheap" legal entity forms following the Centros decision and their quantitative significance. However, in Austria a reduction of the minimum capital to 10.000 Euro is scheduled for 1 July 2013 with the declared intention to make the forming of a limited liability company more attractive and to stimulate the formation of more limited liability companies in the future.

[68] Code des Sociétés Art. 214; according to Kocks/Hennes, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, marginal no. 29.

[69] Research project on the Unternehmergesellschaft (UG) at the University of Jena.

[70] According to Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 131 fn. 87.

[71] Figures and sources in: Roth/Altmeppen, GmbHG, Intro. marginal no. 9, § 5 a marginal no. 4.

[72] Niemeier, in: FS Roth, 2011, p. 533; in favour of further liberalizations – in spite of the high risk to fail for "necessity entrepreneurs" – see Braun et. al., ZHR 177 (2013), 131, 147.

that the determination of a one-EUR capital can just as well be dispensed with (as did the Dutch reform of 2012).[73] Initial capital must also be fixed in a binding manner and made public in the case of an UG. However, reduced acceptance among the public for the, as described above, less capitalised UG has not been documented to date.[74] It is also unknown how many founders feel forced to assume increased own risk in the form of a guarantee, etc., in order to compensate (which however benefits only some creditors).

More experience has been had with the appearance of the **British (private) limited company** which has been making itself evident since about 2003 primarily in Germany and the Netherlands but in Austria as well. The Limited has no minimum capitalisation requirements. Founders avail themselves of this benefit for businesses to be conducted in Germany, etc., and that is to the tune of approximately 40,000 formations in Germany through the end of 2006, whereby 1 to 2 Limited Companies were formed for each 10 new GmbHs during this period.[75] This did not fail to leave an impression on German lawmakers. However, the lessons which one could draw from the development of the Limited made less of an impression. These were characterised by far above-average early mortality and vulnerability to insolvency. Their creditworthiness was predominantly viewed as poor, apparently based on low capitalisation levels and borrowing power was accordingly limited, i. e. acceptance by the banks was limited. On the one hand, one could reach the conclusion that the market was entirely able to assess creditworthiness itself, i. e. mandatory statutory measures may be foregone, but the opposite conclusion may be drawn just as well, i. e. that it is in the best interests of all parties if minimum capitalisation levels are ensured by law. The impetus for the latter is the fact that the Limited caused considerable insolvency damage because creditors other than banks were apparently not able to protect themselves to the same degree.[76] The first unsettling findings are becoming available in the case of the Unternehmergesellschaft as well.[77]

III. Raising capital

1. The principle

The system of fixed capital can only fulfil its purpose if the effective raising of capital is also ensured, be it through contributions to company assets or be it in the form of enforceable, capitalisable claims on the part of the company against the persons obligated to make **contributions**.[78] For this purpose, the statutes initially provide that the entire capital amount must be assumed by the shareholders as an obligation to make a contribution or be subscribed as shares (e. g. Art. 2329 no. 1

[73] Hirschfeld, RIW 2013, 138.

[74] Cf. Holzner, Die UG im Wettbewerb der Gesellschaftsformen; this in contrast to the similarly numerous Limited formations for German enterprises during the past ten years. More on this topic immediately following.

[75] These and the following figures from Niemeier, ZIP 2007, 1794; identical in: FS Roth, p. 533.

[76] Niemeier, in: FS Roth, 2011, p. 543.

[77] Miras, NZG 2012, 486; quantifying Bayer/Hoffmann, NZG 2012, 887.

[78] Concurring Schön, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 157.

Ital. CC) and that the contribution/issue amount cannot fall below the respective nominal amount (prohibition of under-par issues, Art. 8 (1) Capital Directive).[79]

The validity of these contribution obligations, as well as the existence of the corporation as such, is assured by means of a special right to continuance upon their entry in the registry. This right largely overrides the general rules applicable to the non-binding nature of declarations of intent. In Community law, Art. 12 of the Disclosure Directive[80] limits the nullity of a public limited company or private limited company to specific exceptions[81] and in national law deficiencies in the legal declarations of any type are deemed to be irrelevant following entry in the registry to the extent the statutes do not list them as exceptional grounds for having the company declared invalid (sections 275 dAktG, 216 öAktG, Art. 2332 Ital. CC). And even in these cases, the contribution obligation continues to the extent needed to satisfy creditors (Art. 13 (5) Disclosure Directive: Art. 2332 (3) Ital. CC). It is expressly provided for in certain cases that subscribers of shares who are in error, or even cheated or deceived subscribers, are bound to assume contributions (cf. sections 185 (3) dAktG, 152 (3) öAktG for the assumption of shares in the case of a capital increase). This is the statutory expression of generally recognised legal principles in relation to faulty membership declarations according to which they will only be declared non-binding in cases of serious defects in the declaration such as legal incapacity, forged signature or representation without representational authority.[82] The purpose of these principles is nothing other than to **protect the existence of the company** in the interests of the creditors and (other) shareholders with the capitalisation provided for. Seen in this manner, these principles stand at the intersection between capital raising and capital preservation.[83]

With that, the view turns toward **satisfaction of the specific contribution obligation**. It goes without saying that the debtor may not be relieved of this obligation (section 19 (2) dGmbHG). However, effective capital inflows are exposed to still other risks. Typical examples: (1) The contribution is immediately returned to the shareholder even if in the form of a loan. (2) The contribution obligation is offset against a claim the shareholder has against the company, e. g. from a shareholder loan; of practical importance in the case of later capital increases. (3) A contribution in kind is agreed to or an asset is contributed in lieu of satisfying the monetary obligation which is of a lesser value. In all three cases, not only are the interests of the creditors at risk but rather other shareholders are disadvantaged as well if they have satisfied their contribution obligations in full. And specifically in the case of the public limited company, there is a long tradition of (4) the con where the founders pocket the contributions of the other or later shareholders by charging inflated formation expenses or other costs, contribute or sell assets above their value (often: patents, etc.) to the public limited company or otherwise appropriate corporate assets.

The legal system has three potential responses to this situation: It makes no provisions in general or makes no provisions regarding specific scenarios; it provides for ex post control of performance with appropriate sanctions, in most

[79] Lutter/Bayer/Schmidt, EuropUR, § 8 marginal no. 17.

[80] In the new version from 2009, 2009/101/EC, previously Art. 11.

[81] See Lutter, in: Nobel, Internationales Gesellschaftsrecht, 1998, pp. 129, 134.

[82] BGH ZIP 2007, 2416; 2008, 1018; 2010, 1540 and 2497; see also CJEU Case C-215/08, *Friz,* (2010) ECR I-02947 = ZIP 2010, 772.

[83] See most recently Roth, JBl 2012, 73, 76.

cases practically to be carried out by the insolvency administrator in later insolvency proceedings; it provides for an ex ante control or preventative measure, disclosure of the transaction and review and complaint, as needed, in the course of formation or in the case of a capital increase. In countries such as England, controlling capital raising or preservation does not appear to be assigned any value to the extent not compelled by the Capital Directive; however there as well fixed capital is likewise not a point of reference as such. In Continental European countries,[84] the consequences for capital raising are generally derived from the principle of fixed capital, however to differing degrees from country to country and from scenario to scenario, in some cases as an ex ante and in some cases as an ex post control and on the whole to varying degrees of intensity.

Every form of review starts with certain **substantive requirements** placed upon the contributions and which to some extent are self-explanatory, or may be derived from the conditions for satisfaction under general law of obligation principles, and which are to some extent specifically provided for in corporate law. For example, Art. 7 of the Capital Directive provides that subscribed capital may only consist of assets capable of economic assessment,[85] which perhaps need not have been expressly stated, and then provides in the second sentence that obligations to perform work or supply services are not permissible contributions.[86] The prerequisite for this is the requirement that the subject of the contribution, to the extent it does not consist of cash, must be described exactly in the formation document (Art. 3 (h) Capital Directive)[87] which refers to the fundamental distinction between contributions based on their nature for purposes of capital raising: Cash contributions, and others generally included under the term in-kind contributions – meaning every contribution which is not to be paid in money ("in cash").

2. Cash contributions and contributions in kind

a) Contributions in cash. In the case of cash contributions, the issues are the assurance of an **effective inflow** of funds into corporate assets and thereby the origin of the funds (not directly or indirectly from the company itself), the timing and method of payment, the recipient of the funds in the event the company does not yet exist while in the process of being founded and of the safe retention of the funds as part of corporate assets. Article 9 (1) of the Capital Directive requires that one-quarter of cash contributions be paid in during formation, similar to what is required under most national laws for the private limited company;[88] full payment

[84] Poland, Slovakia, the Czech Republic and Hungary have not only strongly oriented their stock corporation law based on the Capital Directive but also their private limited company laws to a great extent on the Continental European tradition, see the applicable country reports in: Ars Legis (ed.), Kapitalgesellschaften in Europa, and Süß/Wachter, Hdb. des internationalen GmbH-Rechts, 2011.

[85] Similarly Art. 2464 (2) Italian CC for contributions to the private limited company.

[86] Similarly, Germany, Austria, the Netherlands, Spain for the private limited company, Roth/Altmeppen, GmbHG, § 5 marginal no. 43, Kluiver/Rammeloo, in: Lutter, Das Kapital der AG in Europa, p. 663; otherwise in Italy, see Art. 2464 (6) CC (however with additional security) and France, Art. L223-7 (2) CCom.

[87] Similarly for the national laws for the private limited company: Sections 5 (4) dGmbHG, 6 (4) öGmbHG; France Art. L223-9 CCom; Italy Art. 2463 et seq. Codice civ.

[88] France prescribes 20 % for the SARL: Art. L223-7 (1) second sentence; additional information from Wachter, in: Schröder, Die GmbH im europäischen Vergleich, 2005, p. 50.

of cash contributions is only required in exceptional cases.[89] Belgium increased the minimum amount which must be paid in to two-thirds in the case of the single-member private limited company in 2004 (Art. 221, 223 Code des Sociétés);[90] in addition payment must be made into a bank account which is blocked until the company comes into existence.[91] The German and Austrian laws are even more detailed: Payment of one-quarter and one-half respectively (sections 7 (2) dGmbHG, 10 (1) öGmbHG, 28 a öAktG), payment in legal tender or to a company bank account or that of the managing directors and subject to their free disposition (sections 54 (3) dAktG, 10 (2) öGmbHG), no set-off against counterclaims (section 19 (2) dGmbHG). Additional specifications and refinements to this rule have been added through decisional law with the result – just to reference the most important points – that the funds to be contributed cannot be advanced by the company, the contribution cannot generally be made to a bank account with a negative balance[92] and thereafter cannot be paid back to the shareholder even if only indirectly (Art. L223-8 Abs. 1 CCom), in principle not even as a loan and thereby, for example, also not into a cash pool accessible by a controlled group.[93] The limitations added through judicial action serve the legitimate purpose of preventing avoidance of the statutory guidelines and therefore to make them air tight. However they are also what have drawn accurate criticism more so than the law's stringency. Proposals for deregulation must correctly be applied to them.[94] Lawmakers liberalised the return of funds by means of a loan for this reason as part of the 2008 MoMiG – and had to immediately witness its reform being watered down by the German Federal Court of Justice.[95]

b) Contributions in kind. The special treatment accorded contributions in kind relates to their cardinal problem, the so-called valuation problem. The contribution obligation may be simply circumvented by contributing assets the monetary value of which is set too high (= overvaluation) – to the detriment of the company's liable assets and to the disadvantage of the other shareholders who have made proper contributions. In light of the foregoing, the catch-all solution could be only to allow cash contributions; however no legal system has been able to decide generally in favour of this. Nevertheless, Germany makes offering certain benefits to the GmbH dependent upon forgoing contributions in kind, namely simplified formation using a model resolution (section 2 1a) GmbHG) and formation free of the minimum capitalisation requirement, i. e. in the form of

[89] Switzerland Art. 777 c OR; Spain Art. 78 LSC; Poland according to Wachter, in: Schröder, Die GmbH im europäischen Vergleich, 2005, p. 50.

[90] Kocks/Hennes, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Belgium marginal no. 30.

[91] According to Heitkamp, in: Ars Legis (ed.), Kapitalgesellschaften in Europa, country report Belgium p. 3.

[92] What is meant is a bank account which is in deficit at the time of deposit.

[93] In a cash pool, the liquid funds of the group companies are combined and subjected to common management (generally the parent company or a subsidiary); on the other hand, the individual companies may draw down funds from the pool thus foregoing expensive bank loans. The mutual payment streams are set up as a loan in most instances.

[94] Lutter, in: Lutter, Das Kapital der AG in Europa, p. 14: Der Überprüfung bedürfen "die vielen Schlacken, die sich um die Rechtsfigur des festen Kapitals angesammelt haben".

[95] BGH NJW 2009, 2375 (= BGHZ 180, 38) and 3091; see Roth, NJW 2009, 3397 and p. 47 below.

the Unternehmergesellschaft (§ 5 a Abs. 2 S. 2 GmbHG); Spain has done so similarly in the case of the SLNE.[96]

Otherwise, one is satisfied with subjecting the in-kind contributions to stricter requirements. Simply the circumstance that a certain in-kind contribution is supposed to be made must be set out contractually and accepted as such by the other parties to the contract and thereafter must be publically disclosed; otherwise the contribution is deemed to be a cash contribution (Art. 2464 (3) Ital. CC) and cannot be satisfied though an in-kind contribution. In this manner, its **valuation** cannot be left to the party making the contribution but rather must be reviewed and the requirement for this in turn is that the factors establishing the value must be disclosed. The former may be derived in turn from Art. 3 (h) of the Capital Directive; the Directive and the national laws applicable to stock corporations codify this review with the relatively most reliable, however most costly, solution of having an external appraiser prepare a valuation which is then published (Art. 10–10 b subject to certain modifications; sections 33 et seq. dAktG with exceptions in section 33 a; Art. 2343 Ital. CC with exceptions in Art. 2343). Laws on private limited companies fundamentally do without this expensive review of formation (exception: section 6 a (4) 4 öGmbHG for exceptional cases, in France L223-9 with a more refined solution) and presume that the shareholders will initially pay attention to correct valuation in their own interests. For this reason among others, in-kind contributions must be contributed in full during formation and must be subject to free disposition by the managing director (Capital Directive Art. 9 (2), dGmbHG section 7 (3)). In addition, in the case of the private limited company, especially if or because it is not subject to a review upon formation, many countries provide for **shortfall liability** on the part of the party making the in-kind contribution (Art. L223-9 (4) CCom, 73 et seq. LSC; sections 9 dGmbHG, 10 a öGmbHG). The shareholder must contribute the difference in cash if it is discovered within ten or five years respectively that the asset was worth less than its valuation at the time of contribution. The German Federal Court of Justice in turn placed this shortfall liability in the law governing stock corporations.[97] It is even more effective to have the contribution value of the asset secured from the outset by a guarantee or similar means which, for example, Italy has prescribed for private limited companies in certain cases (Art. 2464 (6) CC). Protective precautions related to in-kind contributions are less pronounced in other countries.[98]

The supervisory bodies with authority over the founding process must ensure that the requirements applicable to contributions are complied with and in doing so must pay particular attention to the circumstance of the contribution in kind and its valuation in order to protect the interests of the public from the outset and in order to preclude later complaints in the interests of the founders. In the event wilful breaches are discovered at a later point in time, the founders and possibly the managing director are liable for damages (Art. 30 LSC, sections 39 et seq. öAktG, 9 a dGmbHG).

With that, the mechanisms of **ex ante and ex post controls** have been described. The former takes place during formation or in the event of an increase in capital, primarily through the notary to the extent one is involved in the process (see p. 53

[96] Wachter, in: Schröder, Die GmbH im europäischen Vergleich, 2005, fn. 75.
[97] Most recently BGH ZIP 2012, 73.
[98] Lutter/Bayer/Schmidt, EuropUR, § 11 marginal no. 3.

below) and in the final instance by the registry court with the sanction that the capital measure which has been undertaken cannot be entered and is therefore void. The relevant circumstances must be disclosed during the process for such purposes. Mere ex post control is based solely on the substantive results, i. e. whether assets have been contributed at full value and if this is not the case, triggers liability to offset the difference. In general, Continental European laws interlink both mechanisms, thus requiring transparency and review during the formation process, and sanction later-discovered breaches with corresponding liability aimed at the payment of damages in case of fault, and at making up shortfalls independent of fault. However, if the goal is providing optimal protection to the company's financial interests and the effectiveness of procedural controls, sanctions based on strict liability can extend beyond merely making up a shortfall on the part of the party liable for making the contribution.

In this context, **Germany and Austria** have driven stringency to the extreme in two aspects. With regard to liability for shortfalls in contributions, both countries' laws provide for shortfall liability on the part of the fellow shareholders in the case of a private limited company (sections 24 and 70 respectively) which thus expands their share of risk beyond the limits of their own respective contributions to cover that of other shareholders and, as far as may be seen, is internationally unique in its breadth.[99] It affects not only the difference in value in the case of contributions in kind but rather any contribution shortfalls at all. In the case of contributions in kind this is especially difficult for the other shareholders to control.[100] On the other hand, it is especially important at this level for purposes of protecting the raising of capital, accordingly Art. L223-9 (4) CCom and Art. 73, 76 Spanish LSC provide for joint and several liability for shortfalls in contributions in kind except in cases of the review of a non-cash corporate formation.[101]

The problem in the case of protective precautions provided in laws governing contributions in kind is that founders can easily avoid them by not declaring the intended contribution in kind as such but rather agreeing pro forma to a cash contribution and then concluding an agreement with the company at a later point for the repayment of the cash or by indirectly contributing the assets by other means. Laws governing stock corporations, and for example the Capital Directive as well (Art. 11), have taken precautions in this regard under the rubric of **post-formation** in that larger acquisitions within two years of formation require a shareholder resolution and are likewise subject to the review applicable to contributions in kind. The provisions with which other legal systems more or less solve the problem[102] are lacking however in the case of the German GmbH. In addition the courts have discovered gaps in legal protection in general beyond disclosed acquisi-

[99] The joint and several liability described by von Karst, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, marginal no. 50 using the example of France applies only to a narrow group of cases.

[100] See Lutter/Bayer, GmbHG, § 24 marginal no. 6; Roth/Altmeppen, GmbHG, § 9 marginal no. 6.

[101] Art. 77 LSC still going beyond for the public limited company.

[102] öGmbHG section 35 (1) no. 7 represents a modest approach. However, Austria only assumed the German jurisprudence on constructive contributions in kind at a later point, see Roth/Fitz, Unternehmensrecht, marginal no. 592. For a discussion of other European countries, see Kalss/Schauer, report to 16. ÖJT 2006, p. 376 (here under the rubric of constructive distributions, namely distributions as the payment price for contributing the asset).

tions and have grouped them under the heading of **constructive contributions in kind**, for example where (primarily in the case of later increases in capital) an existing shareholder loan is repaid with the cash contribution or a distribution of profits is immediately used to make a cash contribution. (Explanation: in both cases there is a claim on the part of the shareholder against the company which could have been made and – in the view of the courts – should have been made the object of a contribution in kind in order to ensure that the claim is also fully adequate according to the company's solvency.)

As a result, the strict sanction was imposed for decades that the satisfactory effect of the contributed asset was simply declared void regardless of actual value solely due to the failure to disclose it as a contribution in kind. In the worst case this resulted in shareholders being required to make their contributions twice in the case of insolvency. This was explained by the preventative effect and preventative control intended through disclosure because otherwise there would be an incentive for the founders to ignore the specific requirements of the formation process and to simply wait for a later complaint which would if need be, result in the make-up of the short-fall. As convincing that might be in light of certain circumventions of the law, the legal consequences are however likewise imposed on inadvertent omissions and the relevant case law does not fail for examples of this. In doing so, German jurisprudence has taken an atypical path within Europe which is not only, as far as may be seen,[103] without parallel (disregarding accompanying Austrian jurisprudence),[104] but rather has also rightly prompted doubts as to its compatibility with the Capital Directive through its application to the laws governing stock corporations.[105]

However, with the 2008 MoMiG reform German lawmakers ultimately made the course correction which had previously been blocked by the highest court up to that point[106] and which makes do with an after-the-fact review of asset inflows and with a reversal of the burden of proof with regard to value, i. e. the shareholder must prove the value of his contribution and must make up any short-fall (sections 19 (4) GmbHG (new version), 27 (3) AktG (new version)). Admittedly the new rule walks a tightrope between prevention and mere control of values because it prohibits concealing contributions in kind as had previously been the case, makes this part of the review upon formation and ties this to the liability for damages mentioned previously. It also threatens the managing director who frustrates this control by providing, or tolerating the provision of, false information with penalties. Nevertheless, the actual value to which the company accedes is credited against the contribution upon successful entry in the registry.

c) Flow back. At the same time, the reform accepts the adequacy of the claim for value even in cases where contributions flow back out in the form of **loans** or into a

[103] Similarly Kalss/Schauer, report to 16. ÖJT 2006, p. 344; for France, see Karst, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report France marginal no. 47.

[104] OGH ecolex 2001/79; 2003/279.

[105] Meilicke, DB 1989, 1067; LG Hannover ZIP 1991, 369; see CJEU Case C-83/91, Meilicke, Schlussanträge des GA, ZIP 1992, 1036; Judgment (1992) ECR I-04871 = ZIP 1992, 1076; see Ebenroth/Neiß, BB 1992, 2085.

[106] Overview of the development of case law and the only later crumbling of acknowledgment by the academic community from Roth, in: FS Hüffer, 2009, p. 853.

cash pool and even legalises this type of transaction from the outset (sections 19 (5) GmbHG (new version), 23 (4) AktG (new version)). This merely caused the Federal Court of Justice to declare the later scenario as the new theatre of war for its old sanction theory. For in this case as well, the new rule requires disclosure of the intended process of formation or capital increase, as applicable, and the jurisprudence again blithely attaches its old sanction which has since been recognised as excessive. If disclosure is not made on a timely basis, not even the adequate value of the claim acquired would have satisfactory effect.[107]

3. Analysis

The purpose of the fixed capital system, whether seen as a secure liability fund or whether seen as a sign of the seriousness of the business formation, may only then be realised if precautions are also taken to ensure that the promised capitalisation exists not only on paper. If one tolerates that a contribution is immediately paid back out – apparently not all that rare an occurrence – or that worthless in-kind contributions are credited against it, then one does not need to attach any expectations to the quantification of initial capitalisation. Protection for the shareholders against the situation in which some shareholders do not satisfy their obligation to make a contribution should also not be left solely to their own attentiveness. From this point of view, a norm-based security for raising capital is thus needed. On the other hand, resourceful founders will always find loopholes and if legislators and courts want to keep apace, the legal situation will quickly become complicated, confusing and above all a trap for unwary founders and even legal advisers who do not have detailed knowledge of the subtleties of developments in the law or who are not able to foresee them.

German law over the past decades is exemplary of all of this. The differentiated standardisation of capital raising is essential as an accompanying measure to a fixed capital requirement. Precautionary measures and controls must be in place in order to ensure compliance from the formation process onward. However, if the company is nevertheless entered in the registry despite a violation because it goes unrecognised or undiscovered, finding the correct middle way that maintains the equilibrium between legal protection and legal certainty is not easy. The substantive purpose of the rule need be kept in mind, namely that the company receives and retains the full value of its contributions. The insights related to the constructive contribution in kind may be generalised for this purpose: The subject of the control is valuation; a crisis scenario shows that an undervaluation needs to be corrected if it occurs within a certain period of time following the formation of the company. The effectiveness of the review conducted in such cases, tied to a make-up of any short-fall, may be ensured by means of an appropriate reversal of the burden of proof; however once **full value** is demonstrated in this manner, the company's interests in ensuring the full value of the capital it raises are sufficiently served.[108]

On the other hand, an **ex-ante review**, i. e. during the formation process, is in the interest of all of the participants and of the public because firstly it prevents the later occurrence of the crisis and the resulting losses, and secondly it permits a simpler and surer valuation during this phase. Finally, the participants are better served if a

[107] See fn. 95 above.
[108] Concurring Bayer, in: Gesellschaftsrecht 2012 p. 40, 47.

violation is discovered at this stage rather than having such a violation be subject to painful sanctions at a later date. For all of these reasons, efficient controls during the formation process are superior to the mere imposition of sanctions, for example as is the case in the English system.[109] A stop must be put to attempts at evasion for this reason. If German law thus places special obligations on the managing director and punishes a knowingly false registration, the penalty which threatens the shareholders as a result of the reversal of the burden of proof must not be underestimated either; for in most cases it is not easy to prove the earlier value of an asset after the passage of several years.[110]

4. Pre-formation corporate liability

The company must be guaranteed its prescribed or agreed capitalisation as at that point in time at which it comes into existence. In the case of corporations with independent legal personality: when they attain legal capacity (upon entry in the registry:[111] Sections 11 dGmbHG, 2 öGmbHG, 41 dAktG, 34 öAktG). However, risks to its assets may already be created during the pre-formation phase, namely on the one hand from transactions giving rise to liabilities and, on the other, through dispositions of the previously contributed assets (the previous contribution being to a certain extent prescribed, see above) or other losses in value. In order to protect the company, statutes provide for personal liability on the part of the persons acting (Disclosure Directive Art. 8[112] and the statutory sections cited above)[113] whereby this usually means the managers. Even if they do not occupy such a position, shareholders may be included as indirectly acting persons.[114] In addition, German case law has developed short-fall and adverse balance liability[115] which is supposed to cover all operating losses of the company arising out of the pre-formation commencement of business activities. It is correctly based on all impairments in assets through registration and is unlimited in amount.[116]

5. The capital increase

A capital increase in exchange for new contributions means an increase in the company's fixed capital, in this instance based on the discretion of the shareholders and by definition going beyond the statutory minimum capitalisation. This is accomplished by adding new capital to company assets. By contrast a capital increase

[109] See Ch. 1 I on directors' disqualification. Dissenting Bayer, previous fn., for the private limited company.

[110] Accordingly, the German literature occasionally recommends a precautionary preservation of evidence, for example in the form of an "inventory opinion" (see Ulmer/Casper, GmbHG, Erg.-Bd. MoMiG, 2010, § 19 marginal no. 85). At the same time however, this also represents the best evidence of intentional evasion.

[111] Already prior to entry in the registry under Belgian law, Code des sociétés Art. 66, 450; European Corporate Law, 2nd ed. 2009, p. 141.

[112] Art. 7 of the original version.

[113] Likewise in Spain where the problem could be alleviated through the new expedited formation process however, see Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain marginal no. 77. It is generally true that expediting the formation process alleviates the problem.

[114] Kersting, Die Vorgesellschaft im europäischen Gesellschaftsrecht, p. 364.

[115] BGHZ 80, 129; 105, 300; ZIP 2005, 2257.

[116] See Roth/Altmeppen, GmbHG, § 11 marginal no. 12.

from company funds merely converts an existing balance sheet item (reserves) into share or registered capital, i. e. tied-up capital, and in doing so subjects the corresponding assets to a stricter commitment. However, company assets as such do not increase. Such a transaction is to be viewed as an aspect of capital preservation.

An injection of capital by means of a capital increase in exchange for contributions should be understood as the mirror image of raising initial capital. For this reason, the same rules apply notwithstanding some differences on the margins. The Capital Directive presents this very clearly: Art. 26 corresponds to Art. 9, Art. 27 to Art. 10. Even the control mechanisms are the same. For example Art. 25 Capital Directive requires disclosure like Art. 3 in the case of formation and the legal systems which employ a notary likewise involve the notary as is the case for formations (sections 53 (2), 55 (1) dGmbHG, 49 (1), 52 (4) öGmbHG, Art. 290, 296 Spanish LSC). However, certain **deviations** are provided which are natural due to the circumstance that the company is already in existence. For this reason contributions may immediately be employed in the company's operational processes and the other issues related to pre-formation companies do not apply. Accordingly one need not hurry with the effective contribution of assets (5 years under Art. 27 Capital Directive; not the case under German or Austrian GmbH law). By contrast, France demands the immediate full payment of cash contributions: Art. L223-7 (1) CCom.

However, this raises new issues: On the one hand, **advance payments** for capital increases subsequently agreed upon may pose a problem – they are generally not recognised if they have already been consumed – and on the other crediting or "converting" earlier shareholder loans against or into a capital contribution, as applicable, generally plays a larger role here. The value of the outstanding loan may be doubtful; the prescribed method is that of an in-kind contribution with a review of valuation. The economic quirk consists of the fact that no new assets are contributed but rather debt is converted to equity.

Ultimately the interests of the shareholders are at risk in the case of a capital increase if they do not participate on a proportionate basis and on the same terms. Then in such cases their ownership percentage declines along with their co-determination rights. In the event new shares are issued below value, the value of their old shares is diluted.

Example: If share capital is divided into 1,000 shares and the net asset value amounts to EUR 100,000 and an additional 1,000 shares are issued with a nominal value of 60 as part of a capital contribution, the share of a shareholder with 100 old shares declines from 10 % to 5 % and accordingly the value of his shares from EUR 10,000 to EUR 8,000 in the event he does not participate in the capital contribution.

For this reason, every old shareholder is granted a **subscription right** in the new shares by law in proportion to his previous ownership percentage which may only be excluded under qualified circumstances. This right is anchored in Art. 29 of the Capital Directive and similarly in national corporate laws (e. g. section 52 (3) 3 öGmbHG, Art. 2473 Italian CC, Art. 304 et seq. Spanish LSC; Art. 652 b (2) and 781 (5) no. 2 Swiss OR) and where this is not the case, is recognised just as unanimously (e. g. in German GmbH law) even if derived from the duty of loyalty and the principle of non-discrimination.[117] This shareholder protection mechanism is otherwise not a

[117] Roth/Altmeppen, GmbHG, § 55 marginal no. 23. Disputed in France according to Karst, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, marginal no. 55 et seq.

unique feature of Continental European corporate law but rather has likewise been introduced into the Anglo-American legal tradition as a pre-emptive right. In this case however, only as part of the articles of association in some instances; whereby the duty of loyalty is referred to here as well as an alternative.[118]

The subscription right may generally be sold (Art. L 225–132 (3) CCom), and if there is a market for it, the shareholder may avoid dilution of his shares if he cannot or will not participate in the capital increase. However, in the latter case he cannot prevent the capital increase as such and thereby the reduction of his ownership percentage if he is outvoted when the resolution is adopted. The statutory protection only goes so far as to require a resolution of the shareholders in any event (Capital Directive Art. 25) and the national laws prescribe qualified majorities in such cases (generally three-quarters in Germany and Austria). Another problem is where a very high issue price is set for the new shares; that is a premium above value, which may also benefit the old shares[119] but can make it more difficult for a shareholder to participate in a capital increase on a proportionate basis.

In all other respects, the subscription right is subject to disposition within certain limits and shareholder protection then becomes protection of the right to have a say in corporate affairs (see Ch. 4). The issue premium then becomes more important in a converse sense: Dilution of the old shares may be avoided if the premium corresponds to the actual value of the shares.[120]

6. Securing capital contributions in special cases

a) Shareholder loans. Where small numbers of shareholders are involved, i. e. namely in the case of the private limited company, a popular alternative to capitalisation is the grant of shareholder loans, i. e. debt rather than equity. The shareholder may grant his company a loan just as any other third party may and in this manner become a creditor in the same manner as he may enter into any other contractual relationships with the company. This form of debt financing could and can appear to be advantageous in a variety of ways however, primarily because it enables the company to have de facto viability with disproportionately low equity. The down side of this is that this form of loan financing may in principle be repaid, especially during a looming crisis of which the insiders are already aware, using the last liquid funds and therefore to the detriment of third-party creditors. The legal system has put a stop to this – again with the courts playing a pioneering role – in a variety of manners. However as a hindrance to capital outflows this belongs to the topic of capital preservation.

b) Shelf company. A special form of entity formation is the so-called shelf company in which a company, usually a private limited company, is initially formed "in reserve" without its own business activities and is then later used by the same or other founders as the legal entity for an enterprise. A company which had been active earlier and then ceased operations may be used in the same manner. The

[118] Rock/Davis/Kanda/Kraakman, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 195.

[119] And which permits the value of a subscription right sink to nil.

[120] Accordingly made a prerequisite in Art. 308 (2)(c) LSC; correctly stated as well by Urbain-Parleani, in: Lutter, Das Kapital der AG in Europa, p. 605; contrary view Hüffer, AktG, § 186 marginal no. 39 b.

problem here, as the latter variation illustrates, is the capitalisation of the newly awoken company; then the original initial capital is potentially no longer on hand. For such cases, the German Federal Court of Justice single-handedly developed a principle that the new use of the old company is deemed to be the equivalent of the formation of a new company. Accordingly, capitalisation must be fully paid in as of this point in time, the shareholders are liable based on the principles applicable to formation, and the determinant of this liability is entry in a registry or, if this is not done or there is nothing to be entered, disclosure to a register court. The aspect of disclosure as preventative shines here again, yet problematic again due to the rigorous sanction and additionally due to its pure judicially-created basis. For this reason however, the courts have signalled certain efforts at mitigation and also have been giving more critical consideration to the literature and to the precedential cases referred to previously.[121]

c) Formation benefits. The scenario in which the founders promise themselves or other persons **consideration for the formation**, or other special benefits to the detriment of corporate assets, stands at the intersection between capital raising and preservation. These types of arrangements must at least be set out in the statutes and disclosed with them (Capital Directive Art. 3 (j), (k)), however additionally require a review upon formation (section 33 dAktG), or distinctions need to be made based on the type and amount of the associated costs under the rubric of capital preservation.[122]

IV. Other aspects of corporate formation

1. The act of incorporation

a) Contents. The formation of a corporation is of necessity executed in several steps. The reason for this is that entry into the registry occurs at the end of the process, following which, the company comes into existence according to the legal systems considered as part of this study.[123] However, the core element of formation, which precedes the registration process, is a **legal agreement** on the part of the founders or a legal act on the part of a founder acting alone. This is described in the Capital Directive as the statutes or instrument of incorporation (Art. 2). The contents are determinative for the rights and obligations of the founders and later shareholders as well as for the existence and activities of the company to the extent mandatory law is not applicable or no deviations or further specifications from optional provisions of law are desired.

Legal systems could allow the parties to regulate their legal relationship more or less themselves as is the case with any other contracts. However, they have followed a different path in the case of corporations. The respective form of legal entity may only be validly selected if statutorily-prescribed **minimum provisions** are contained in the shareholders' agreement, instrument of incorporation or

[121] Overview in: Roth/Altmeppen, GmbHG, § 3 marginal no. 12 et seq. see also, e. g. Bachmann, NZG 2011, 441.

[122] Roth/Altmeppen, GmbHG, § 5 marginal no. 74.

[123] With the exception of Belgium, fn. 111. For the other legal systems, see, e. g. France Art. L210-6 CCom, Germany section 11, Austria section 2 GmbHG.

statutes; remaining discretion related to structure is frequently limited (Capital Directive Art. 2, 3), however fundamentally to a lesser degree in the case of the private limited company than the public limited company.[124] The necessary consequence is that the formation instrument requires a **form**. Some legal systems also provide model agreements for cases of standardised, simple company formations. France offers founders a **statutory model agreement**,[125] Germany permits a simplified formation process if a statutory model protocol is used containing severely limited room for discretion (section 2 (1a) GmbHG). The same applies for the expedited formation of the Spanish SLNE.[126] Austria plans to reduce the costs of formation for the one-person-company by reducing the responsibilities of the notary under certain circumstances.

The mandatory **substantive requirements** vary greatly in national laws governing private limited companies and in some instances set out merely a minimum: Type and name of the company, registered office and business object[127], composition of its capital (initial capital, subscribed capital), potentially its division or shares, as applicable, or information regarding the duration of the company or regarding its disclosures, for example section 3 dGmbHG, Art. L210-2 French CCom, Art. 776 Swiss OR, Art. 2463 Italian CC, Art. 22 et seq. Spanish LSC. The information required in the case of the public limited company is much more specific according to the Capital Directive, primarily regarding the shares to be issued and the contributions to be made with respect thereto, as well as regarding formation expenses and benefits to the founder(s). In addition, personal information on the founder is provided here; if listed by name they are required to appear in the articles of association as signing parties. This must be distinguished from information which only becomes required parts of the contract if discretionary provisions of law are to be deviated from or replaced entirely because such deviations are subject to the condition of inclusion in the articles of association. This includes for example more detailed rules regarding the company's executive bodies and their powers, the establishment of subscribed capital (Capital Directive Art. 2 (c); section 55 a dGmbHG), etc.

b) Form. The prescribed provisions require tangible form and thus must at least be set out **in writing** if for no other reason than that compliance with the regulations could not be guaranteed if this were not the case. For this reason, this is worthy of being highlighted because a company's contract of formation generally requires no specific form under Continental European legal systems, but rather may also be concluded orally in certain cases. Satisfaction of the statutory requirements must also be documented through the submission of the relevant documents to the registry court or authority for purposes of **registration**. France and the Scandinavian countries content themselves with a private agreement even in the case of

[124] For Italy, see Miola, in: Lutter, Das Kapital der AG in Europa, p. 614, for the Netherlands, see Kluiver/Rammeloo, in: Lutter, Das Kapital der AG in Europa, p. 657.

[125] Art. D223-2 and Annexe 2–1 for the single-member formation.

[126] Orden Ministerial des Justizministeriums No. 1445/2003 dated 4 June 2003; for a discussion see Wachter, in: Schröder, Die GmbH im europäischen Vergleich, 2005, pp. 27, 34.

[127] See Schön, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 14 on the significance to the shareholders and creditors of establishing a business purpose and object.

corporations (acte sous seing privé).[128] By contrast, most of the other legal systems require an **authentic instrument**.

2. Analysis

Qualified formal requirements normally serve a simple purpose: To make the parties aware of the significance of their declaration in advance and to encourage them to give more careful consideration to the transaction as well as ensuring legal certainty and the preservation of documentation. Regarding the instrument of incorporation, this goal integrates itself seamlessly into the protective function of corporate law. With regard to the relationship among founding shareholders and to the organisational basis of their company, it is ensured that the rules deemed necessary are specifically defined and legitimised through private action. Publication in the registry makes the rules which have been selected transparent and enables subsequent shareholders or parties interested in making an acquisition as well as the public to have access to information. From a substantive standpoint, the most important structural elements are highlighted as mandatory minimum requirements which the parties are required to establish independently, i. e. may not be left to ready-made model agreements.

The even more highly qualified **notarial form** increases protection in both directions by involving external, knowledgeable and neutral support and control which, through its involvement in drafting the agreement, ensures that agreements are made which serve all interests and thereby that statutory requirements are complied with. At the same time, as a result of this involvement, the notary is able to discover and correct violations during the formation process itself before adverse consequences for the participants or the public occur at all. That is the benefit of ex ante control in the context of preventative justice. More on this topic in Ch. 5.

By contrast, the pressure to reform emanating from the Anglo-American model and the jurisprudence of the CJEJ has had a **deregulatory effect** in some Continental European legal systems not only in relation to statutory capital but rather on the entire formation process. Key words such as administrative simplification and cost-savings govern the discussion[129], and as part of this process it is correct to critically weigh the costs and benefits of the individual formation requirements. However, the regulatory purposes contained in corporate law have their own intrinsic value which cannot always be quantified. Practice often seems to have a better feeling for this, which for example experience has shown on the Iberian Peninsula in the case of the Portuguese EIRL merchant[130] and the Spanish SLNE both of which have been met with low levels of acceptance. For example, the Spanish simplified option from 2003 was initially only selected for 0.5 % of private limited company formations and since then the share has slowly increased to 1 %.[131] The use of statutory model agreements is viewed rather sceptically in German practice due to the associated limitations and the remaining notarial

[128] Notarial form only if contributions of a certain type are made, e. g. real estate.

[129] One result was the introduction of the Société par actions simplifiée in France, Art. L227-1 CCom, the Sociedad nueva empresa in Spain, Art. 434 LSC; contrary view from the literature, see Hierro Anibarro, Simplificar el Derecho de Sociedades.

[130] See above fn. 12.

[131] Hierro Anibarro, Sociedad Nueva Empresa, p. 12; Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GbmH-Rechts, country report Spain marginal no. 41 et seq.

advisory function is emphasized all the more positively.[132] In France, the special corporate form, the Société par actions simplifiée, is only advisable with limitations because it would require an especially carefully and detailed instrument of incorporation due to the great deal of freedom of design.[133]

V. Capital maintenance

1. Contributed equity capital

The requirement of capital maintenance starts with the mirror image of capital raising: The contributions which a shareholder has initially paid in may not thereafter be repaid. Projected to the sum of all contributions to a company, this means contributed equity capital in the amount of the entire share or subscribed capital is tied-up by law, i. e. should remain in the company permanently[134] and may not be distributed. The amount of his individual contribution is then no longer determinative for the individual shareholder, but rather any withdrawal which would be charged against tied-up capital is prohibited. By contrast, it is generally not relevant – at least not in the case of the private limited company – to what extent the contributions have actually been paid in; to the extent the contribution obligations may be seen as having full value, they are likewise included in determining available assets in the same manner as if the amount payable had already been paid in to the company as was (still) included in its assets.

Section 30 (1) first sentence dGmbHG provides a clear statutory expression of this form of capital preservation: "The assets required to preserve the company's share capital may not be distributed to the shareholders". Accordingly, what is relevant is the extent to which available assets are on hand in excess of the limit of **share or nominal capital** and that means: Net assets after deducting all debt. The company's bookkeeping (commercial books of account) must be consulted to make this calculation; a balance sheet approach is determinative.[135] For this reason, the text of Art. 15 of the Capital Directive refers to the annual accounts of the previous financial year. The net assets set out there may not fall below the amount of subscribed capital either before or after the distribution in question.

However, the amount tied-up according to the Capital Directive is expanded to include **reserves** "which may not be distributed under the law or the statutes". In German and Austrian laws related to public limited companies,[136] this means first that the commitment of paid-in contributions extends to premiums and similar supplemental payments which have been established above the nominal value of the shares (lowest issue price) which must be booked to a capital reserve not subject to

[132] Bayer, in: Lutter/Hommelhoff, GmbHG, § 2 marginal no.54; Miras NZG 2012, 486, 487.

[133] Feuerbach/Victor-Granzer, in: Ars Legis (ed.), Kapitalgesellschaften in Europa, country report France p. 73.

[134] Up to the point of any liquidation and subject to a reduction in capital, if permissible.

[135] Roth/Altmeppen, GmbHG, § 30 marginal no.10; Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 349; prevailing opinion.

[136] Similarly in Austria for the large private limited company. Section 229 (4) UGB. Only to a limited extent in Italy: Art. 2431 CC. See also sect. 5 a (3) d GmbHG for the 1 Euro limited company, the Unternehmergesellschaft, a provision aimed at gradually accumulating a more meaningful company capital out of retained earnings.

distribution (sections 150 (3), (4) dAktG, 272 (2) nos. 1–3 HGB). Second, mandatory statutory reserves are referred to which (primarily in laws related to public limited companies) must be segregated out from net income for the year during good years for purposes of shoring up the equity base,[137] for example with a percentage of net income for the year and of subscribed capital (section 150 dAktG) and which then must be logically not subject to distribution. The statutes may provide for the creation of additional reserves, however such reserves are later subject to the disposition of the shareholders as part of an amendment to the statutes. This is also the case where a previously-created reserve is reversed in the authors' opinion.[138] On the other hand, the statutes may provide for surplus reserves which are not exempt from distribution.[139] Laws governing public limited companies in the Latin legal tradition also follow the system of tying up assets in the amount of subscribed capital and of reserves which are exempt from distribution, e. g. France pursuant to Art. L232-11 CCom, Spain pursuant to Art. 273 (2) LSC, with both limits applicable to the same degree to the private limited company.[140] The same applied formerly in the Netherlands, however the recent private limited company reform not only did away with the minimum capital threshold but even permits the later distribution of capital which had been voluntarily determined at the outset.[141]

Under German, and in part Austrian law, a different assessment with regard to presentation on the balance sheet is required for the purpose of the prohibition on distributions on two points: In the case of **outstanding** (and not yet called) portions of a **contribution** and in the case of treasury **shares held by the company**. Neither may be capitalised based on new accounting laws, but rather must be directly and openly deducted from subscribed capital (section 272 (1) third sentence, (2) dHGB).[142] However, in the case of the German GmbH, the reference amount for computing distributable assets continues to be the fixed share capital and treasury shares are not be capitalised as an asset because they have no value independent of the company's condition, instead the acquisition of treasury shares (for consideration) is already the equivalent of a repayment of capital to the shareholders (more on this on p. 62, below).[143] It therefore reduces distributable assets.[144] By contrast, contribution obligations owed by the shareholders represent real assets if and to the

[137] Hüffer, AktG, § 150 marginal no. 1; Claussen, in: Kölner Komm, AktG, § 150 marginal no. 7.

[138] Contra, Claussen, in: Kölner Komm, AktG, § 150 marginal no. 11.

[139] Claussen, in: Kölner Komm, § 272 HGB marginal no. 50.

[140] Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 375; Fleischer, in: Lutter, Das Kapital der AG in Europa, pp. 114, 123. For Italy, see Miola, in: Lutter, Das Kapital der AG in Europa, p. 625. Similarly Belgium according to Kocks/Hennes, in: Süß/Wachter, Hdb. des internationalen GbmH-Rechts, country report Belgium marginal no. 45.

[141] Rademakters/de Vries. in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report The Netherlands marginal no. 104; Kluiver/Rammeloo, in: Lutter, Das Kapital der AG in Europa, p. 665. Supporting this view see Haas, report to 66. DJT 2006 E 133.

[142] Subject to limitations, öUGB in section 229 (1).

[143] Baumbach/Hopt, HGB § 272 marginal no. 4; Roth/Altmeppen, GmbHG § 33 marginal no. 24, end.

[144] Different if only disposable profits, and thus the dissolution of reserves is relevant to distributions (see text, below): In such cases the acquisition of a company's own equities (shares) effects a de facto reduction in capital to the extent deducted from subscribed capital and not charged against reversible reserves. See Rodewald/Pohl, GmbHR 2009, 32; critical view, Verse, in: Gesellschaftsrecht in der Diskussion, 2009, pp. 67, 85.

extent they may be viewed as having full value and, for purposes of calculating assets in excess of share capital, the extent to which the contributions have actually been made is irrelevant.[145] Based on the prior accounting rules, this difference was made clear in that both items were required to be capitalised, however treasury shares were to be offset by a non-distributable reserve. From a practical standpoint, the new accounting laws will not change this.

2. Mere distribution of profits

More comprehensive capital protection is provided by law in the case of the public limited company (and similarly for the Austrian and Swiss private limited company) where the permissibility of distributions is based on the other side of the balance sheet, i. e. distributable profits. "Only distributable profits determined based on the annual balance sheet may be distributed to the shareholders" (section 54 öAktG, with the same intent section 57 (3) dAktG, section 82 (1) öGmbHG, Art. 798 OR, Art. 15 (1)(c) Capital Directive). In turn, distributable profits are shown in the income statement based on the annual surplus. Whereas the commitment of assets oriented toward nominal or share capital zeroes in on the core item of the balance sheet which is thus declared as sacrosanct, limitations on distributions based on profits (realised profits)[146] are pulled from the economic success of the financial year and, it at least appears so on first glance, leave all other balance sheet items untouched. This also results in the general characterisation that this second system of asset commitment subjects the public limited company to stricter capital preservation requirements than the former, share capital based system, imposes on the German GmbH.[147]

For this reason, **Art. 15 of the Capital Directive** causes some misunderstandings where, on the one hand, (a) acts as a negative prohibition on distributions which would reduce subscribed capital including "reserves which may not be distributed under the law or the statutes" and, on the other, (c) contains a positive declaration limiting distributions to the amount defined as distributable profits in accounting law.[148] The relationship of these two limitations to another is worthy of a closer look not in the least because it illustrates the difference between both forms of capital commitment as such.

Some attribute a fundamental meaning to this difference, namely that (a) is oriented on a static view of balance sheet items whereas (c) tracks the dynamic process of appropriating profits.[149] However, in a given financial statement, the variable balance sheet items which are relevant under (a) (reserves) are nothing more than the result of the appropriation of profits for the respective and previous financial years. And vice versa: When (c) specifies the calculation process, which roughly conforms to the standard process of transferring net income for the year to

[145] Kropff, ZIP 2009, 1137; Baumbach/Hueck/Fastrich, GmbHG, § 30 marginal no. 15; Roth/Altmeppen, GmbHG, § 30 marginal no. 15; Wicke, GmbHG, § 30 marginal no. 5, Handkomm/Greitemann, GmbHG, § 30 marginal no. 70.

[146] Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 350.

[147] A special rule applies in the case of a German AG or GmbH in a controlled group which replaces the strict prohibition on distributions with other measures: Sections 57 (1) second sentence AktG, 30 (1) second sentence GmbHG.

[148] Cf. Kalss, in: Koppensteiner, Österreichisches und europäisches Wirtschaftsprivatrecht, Teil 1: Gesellschaftsrecht, 1994, pp. 119, 235 with 237.

[149] Wild, Prospekthaftung einer AG unter deutschem und europäischem Kapitalschutz, p. 186.

distributable profits (cf. sections 158 dAktG, 231 öUGB) it is offering the mirror image for purposes of the negative limitation of (a). On the one hand, (c) refers to the creation of reserves which then reduce distributable assets; on the other hand it refers to sums drawn from reserves available for distribution which again increase distributable profits. In both cases, the discretion of the relevant decision-maker is subject to certain limitations, whereby there is a small difference compared to (a) in respect of the bases for calculation to the extent that the statutes may curtail the distribution of disposable profits to create obligatory surplus reserves; however in doing so they may not necessarily expand the committed assets exempt from distribution referred to in (a).[150]

Indeed, the decisive factor manifests itself in the process of creating reserves mentioned immediately above on the one hand and withdrawals from reserves (their reversal) on the other: Little (c) governs the power of the corporation's decision-making bodies to make distributions when appropriating profits and (a) the extent to which assets are tied-up.[151] And this in turn leads to the following thought: If one ignores for a moment the just-mentioned peculiarity with respect to creating reserves, the difference between both systems of capital commitment is reduced to the process of **reversing reserves**. The commitment of capital applicable to contributed assets includes its expansion through reserves exempt from distribution. The limitation on distributions to the amount of distributable profits permits them to be increased at any time through withdrawals from reserves which may be reversed by means of the process provided for this purpose. Seen this way, profits are that portion of equity which has been generated in excess of contributions and is not tied-up in reserves which may not be reversed.[152] Or, as stated in the Swiss OR: "Dividends may only be distributed from distributable profits or reserves created for such purpose" (Art. 675 (2), 798). The decisive difference is (only) compliance with the process provided for the reversal of reserves, i. e. that of approval of the annual financial statements, and even that does not make much of a difference in the case of forthright distributions since such or similar resolutions have to be passed on distributions anyway.

The resulting expanded commitment of assets may no longer be explained solely by creditor protection goals because the creditors simply enjoy no irrevocable prerogative in this regard,[153] but rather with the goal of safeguarding the **formal process** for reversing reserves and thereby compliance with decision-making authority for purposes of approving the annual financial statements. In the case of the private limited company, this primarily refers to a shareholder resolution (section 35 (1) no. 1 öGmbHG) and in the case of a public limited company, perhaps not the general meeting, but in any event to a qualified regulation of competences, a certain point in time and substantive relationship, on the whole to a prominent significance and formalisation of this decision. However, the scope of the commitment of capital from an economic standpoint is measured in both instances based on which reserves may

[150] See p. 55, above. Disputed in certain points, see Wild, Prospekthaftung einer AG unter deutschem und europäischem Kapitalschutz, p. 187 with citations.

[151] Similar, Veil, in: Lutter, Das Kapital der AG in Europa, 2006, pp. 91, 95.

[152] Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 350.

[153] However, they also benefit from the fact that a distribution rule oriented on the formal annual financial statements promises greater legal clarity, especially in relation to current assets, see Reich-Rohrwig, Grundsatzfragen der Kapitalerhaltung, p. 101.

be reversed, which are exempt from distribution, and that depends on the respectively applicable statutory guidelines.

Accordingly, the above-mentioned reform of accounting laws reveals the **acquisition of own shares** in a different light. Whereas based on prior accounting law they were capitalised and offset by a non-distributable reserve, based on current accounting law they are directly deducted from subscribed capital using their nominal value. Then the new balance sheet shows higher retained earnings to the extent of this figure than were shown previously.[154] This new conception of the acquisition of shares may be explained as form of capital reduction by which the amount of subscribed capital is likewise reduced. However, the crux of the matter is that the reduction in capital is tied to mandatory protective measures (see 7, p. 66 below), not in the least that the minimum capital floor may not be breached – limitations which do not apply to the presentation of the acquisition of own shares on the balance sheet. The process applicable to normal capital reductions need only be complied with where shares are to be cancelled following their acquisition (Art. 37 (2) Capital Directive; section 237 (2) dAktG). Where this is not required in exceptional cases (section 237 (3) dAktG) the law likewise again clearly demands, just as does the Capital Directive, the creation of a non-distributable[155] capital reserve (Capital Directive ibid.; section 237 (5) dAktG). For this reason, the literature calls for the creation of a separate account for determining non-distributable capital following the acquisition of own shares in which it will continue to be increased by the nominal amount of the own shares.[156] This may be somewhat unorthodox in a new law but in any event maintains capital commitment to the extent believed to be necessary.

3. Constructive distributions

The avoidance of prohibitions on distributions by means of fictitious transactions and the like is just as simple and obvious as in the case with constructive contributions in kind, and just as has been the case with regard to the latter, German jurisprudence has produced an expansive collection of cases which also include these attempts at evasion. They cover all measures which economically effect a reduction in corporate assets to the benefit of a shareholder and which have the corporate relationship as their base.[157] The simplest examples include excessive management pay for a shareholder or other **excessive or fictional remuneration** or payment to third parties which indirectly benefit the shareholder.[158] For purposes of examining the relationship between performance and consideration, sections 30 (1) dGmbHG (new version), 57 (1) dAktG (new version) examine whether the company's payment is "covered by an entitlement to full consideration". If the payment of money is in

[154] For additional detail, see Verse, in: Gesellschaftsrecht 2009, pp. 67, 83. Only to the extent shares are acquired above par, the difference reduces freely available reserves, section 272 (1a) second sentence dHGB.

[155] Hüffer, AktG, § 327 marginal no. 38 et seq.

[156] Verse, in: Gesellschaftsrecht 2009, pp. 67, 83 with citations. The same should apply to the public limited company for purposes of taking outstanding and not called contributions into account, whereby they then must be capitalised based on full value (see above).

[157] Roth/Altmeppen, GmbHG, § 30 marginal no. 2; Hüffer, AktG, § 57 marginal no. 7; Wilhelmi, Der Grundsatz der Kapitalerhaltung im System des GmbH-Rechts, p. 131 et seq.

[158] Additional cases in: Roth/Altmeppen, GmbHG, § 29 marginal no. 60 et seq. See BGH ZIP 2011, 1306 on the issue of assumption of risks for the benefit of the shareholder in the form of a constructive payment.

exchange for non-cash performance, this must initially be valued at market value; thereafter the value of the claim must be assessed based on the debtor's solvency in the case of consideration which is not be provided concurrently. It is a matter of the equivalence or appropriateness of the performance or obligation, as applicable, of both parties based on objective standards for which the so-called arm's length standard had been employed previously, whereas the new rule places emphasis on an accounting approach.[159]

The principle of also protecting tied-up capital from constructive repayments is intended first to ensure **creditor protection** which is supposed to be provided by the prohibition on distributions as such. However, the second protective purpose, directed at the interests of the **other shareholders**, is emphasized here more strongly because constructive distributions may potentially be hidden from them and are intended to prefer the shareholder who benefits in violation of the principle of equal treatment. For this reason, additional legal barriers must be heeded here even beyond the limits of capital commitment: The principle of equality of treatment and the allocation of decision-making authority within the company with regard to such payments.[160] In this regard, the latter aspect is included in capital commitment anyway where distributions may only be made from disposable profits (see 2, above) because the proper, formal reversal of a reserve can of course not be considered in the case of a constructive distribution. Accordingly the commitment of capital applies necessarily to all reserves and thus such commitment is practically always violated in the case of a constructive distribution.[161]

The grant of **loans to shareholders** represents an issue of its own when viewed from the standpoint of a deemed repayment, in particular of unsecured loans which would ordinarily not be granted to unrelated third parties. A special scenario within this category relates to the addition of liquid funds to a **cash pool** within a controlled group in which the liquidity of several or all affiliated companies is combined on a running basis and is made available to the individual companies as needed. If a company is included in such a system from the time of its formation forward and accordingly cash contributions to it are already paid into the cash pool (see p. 47, above), the protective principles of capital raising and capital preservation are implicated to an equal degree. Accordingly, German law has developed in parallel with regard to constructive contributions in kind and constructive repayments or distributions. In its efforts to consequently implement the intended legal protections, case law has again ultimately overreached with the legal consequences in that it gave no consideration to the fact that the company acquired a recoverable asset in the form of the right to repayment in the case of distributions from tied-up capital as a loan to a shareholder or to the cash pool of a corporate group but instead declared the withdrawal of funds illegitimate as such. In the end, the legislator had to intervene in a corrective manner and expressly made the value of the right to repayment the standard of measurement (sections 57 (1) second sentence dAktG, 30 (1) second sentence 2 dGmbHG since the 2008 reform).

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[159] Cf. BGH ZIP 2011, 1306 and Nodoushani, ZIP 2012, 97.

[160] Roth/Altmeppen, GmbHG, § 29 marignal no. 61; Baumbach/Hueck/Fastrich, GmbHG, § 29 marginal no. 75; BGH ZIP 2008, 1818.

[161] Roth, presentation to 16. ÖJT 2006, p. 116. On the Austrian GmbH, see Reich-Rohrwig, Grundsatzfragen der Kapitalerhaltung, p. 119; Koppensteiner/Rüffler, GmbHG, § 82 marginal no. 15.

From the perspective of a **comparative legal analysis** of other Continental European legal systems, the parallelism in the treatment of constructive contributions in kind and constructive distributions just highlighted, continues to the extent that the stringent inclusion of deemed transactions has also been able to assert itself there in the case of distributions only by way of exception and frequently under the influence of developments in German law. The legal situation is similar to large degree in Austria.[162] Constructive dividends are likewise included in limits on distributions in Sweden.[163] Switzerland permits no payments to shareholders "which are obviously disproportionate to the consideration or the company's financial situation" (Art. 678 (2) OR) the first part of which may serve as the definition of a constructive distribution and the second part approximates a capital commitment on the part of the company (however, see also 6, p. 65, below).[164] Finally, indirect payments via third parties are expressly included within the phrase "related parties".

By contrast, the idea of subjecting constructive payments of benefits to the prohibition on distributions under the aspect of constructive distributions is foreign in the countries following the Latin legal tradition.[165] They follow an alternative regulatory approach. The perceived danger here is that transactions will be concluded with members of the management bodies and/or shareholders which are detrimental to the company. The solution is consequently found in **control, publicity and participation** and is backed up with civil and criminal liability on the part of the persons acting. In France, these types of transactions require the consent of the administrative or supervisory board and potentially the subsequent approval of the general meeting; rules in Italy and Belgium tend in the same direction.[166] That is a parallel to the post-formation regulations referred to previously which are intended to counter evasion of protections on contributions; here as there transparency within the company and the devolution of decisional competence to the shareholders or a shareholder committee stand in the foreground. If that is however the end of the matter,[167] focus is then placed on their interests alone and those of the creditors are only protected reflexively and to the extent that it must be in the interests of the shareholders as a whole to prevent the erosion of corporate assets for the benefit of some individuals.

In light of these differing national views, it is no wonder that there is no unanimous opinion when interpreting the **Capital Directive** as to whether constrictive distributions are included in the limitation on distributions. This applies to the

[162] See Reich-Rohrwig, Grundsatzfragen der Kapitalerhaltung, p. 118 et seq.; Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 367, there with emphasis on the still existing differences.

[163] For additional details, see Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 381 taking into account the stock corporation law reform of 2006.

[164] The shareholder is only obligated to make a refund in the case of bad faith. This corresponds to German or Austrian law in the case of disclosed distributions which should be supposed to be the case under the disproportionate relationship presumed in Art. 678 (2) OR.

[165] Nienhaus, Kapitalschutz in der Aktiengesellschaft, p. 122; Wild, Prospekthaftung einer AG unter deutschem und europäischem Kapitalschutz, p. 191.

[166] According to Kalss/Schauer, Gutachten zum 16. ÖJT 2006, p. 375 et seq.; Fleischer, in: Lutter, Das Kapital der AG in Europa, pp. 114, 123. On criminal sanctions in Italy (Art. 2626 Codice civ.), see Miola, in: Lutter, Das Kapital der AG in Europa, p. 625.

[167] Post-formation law does not stop at transparency and devolution, but rather also includes the other protective mechanisms of laws related to in-kind formations up to including external review of formations. Section 52 (4) dAktG, Art. 2343 to (2) Italian CC, section 45 (3) öAktG (however not section 35 (1) no. 7 öGmbHG).

German literature even if there the affirmative response is in the majority[168] and for the good reasons that the Capital Directive would need to be interpreted out of the spirit of the German legal tradition and that its protective objective requires such a broad interpretation. The text of the directive yields little on this issue because Art. 15 is very specifically formulated yet Art. 19 again refers expressly to Art. 15 in the case of the acquisition of own shares and thereby suggests a broader understanding. By contrast, those Member States which do not include constructive distributions obviously do not view themselves as limited by the Capital Directive in relation to their laws on public limited companies.[169] This is also supported by the fact that there were legitimate doubts as to whether the Capital Directive even permits the strict German legal view let alone follows it (see p. 46, above).

4. Shareholder loans

The question already arose in connection with the capitalisation of the company (see I and II 1, above) as to whether the formation as such de facto requires a commercially reasonable influx of equity as working capital and in the converse case of whether the substantial undercapitalisation of the company fails in light of the requirements of the market and/or potential business partners. However, it is still possible for the shareholders to pay in necessary capital to their company not in the form of subscribed capital but pro forma as debt, namely in the form of shareholder loans. In that case, they could believe that they have the advantage, among others, that these funds are not covered by the statutory commitment on capital and especially that they could be paid back from what liquidity is left in the face of an impending crisis (see III 6, p. 50, above). In this case, the shareholders would favour themselves ahead of third party creditors by virtue of their influence on the company.

However, to the extent that insolvency proceedings must later be initiated within certain periods of time, the **law of insolvency** already has a mechanism to put a stop to this in the form of proceedings to have it set aside as a preference. However, even treating these rights of recovery the same as the claims of third party creditors in the insolvency proceedings may appear unfair. For this reason, some legal systems have developed a special treatment for shareholder loans, the intent of which is to largely deprive the shareholder of the benefits of his legal position as a creditor and to treat his loan substantively as equity. The central idea for this is that such a loan replaces economically reasonable and possibly required contributions of equity and the law should take this circumstance into account because the shareholder, other than is the case for a third party creditor, owes a financial responsibility to his company. Although he may not be obligated to make additional contributions where additional capital is required, if he does so, then it shall be done in the economically correct form.

The question needs to be posed based on this conceptual approach whether reclassification as equity is economically sound and this then places the criterion of undercapitalisation back in the foreground – now described as **nominal undercapitalisation**. It depends on whether the loan replaces equity from an evaluative

[168] Wild, Prospekthaftung einer AG unter deutschem und europäischem Kapitalschutz, p. 189 et seq. with citations.

[169] For France, see Fleischer, in: Lutter, Das Kapital der AG in Europa, p. 124.

approach because "prudent businessmen would have contributed equity" to the company instead of a loan as provided in section 32a dGmbHG until it was reformed by the MoMiG in 2008 – a situation which the statute itself defined as a "crisis of the company". The legal consequence is that the claims of the shareholders are subordinated to those of third-party creditors in the event of insolvency rendering a preferential payment or security subject to challenge. Italy introduced a similar rule it its 2004 reform (Art. 2467 CC) which describes the characteristic feature in more general terms as a "disproportionate relationship between debt levels and equity".[170] Austria attempts to describe the criteria for the crisis in more precise terms in a separate law on shareholder loans, the EKEG (see p. 65, below).

By contrast, for the sake of legal clarity Germany took the rigorous step in its 2008 reform of treating shareholders loans generally as equity during and immediately preceding insolvency proceedings regardless of whether they would need to be classified as replacing equity in a given case (sections 39, 135 InsO among others).[171] Spain has taken a similar approach.[172]

5. Acquisition of own shares

As the converse of the original act of issuing shares in exchange for the contribution, the acquisition of a company's own shares is practically the model of the return of contributions, apart from the purchase price, which is based on the present or fair value and is independent of the original contribution amount, i. e. is normally higher than such amount.[173] Still, the purchase of a company's own shares is allowed within certain limits. France and Italy demonstrate that this is not necessarily so, and in the case of the private limited company, prohibit the acquisition of a company's own equity interests without exception (Art. L223-34 (4) CCom, Art. 2474 CC).

By contrast, the other legal systems permit such an acquisition – namely in the case of listed shares – most recently based on three reasons: If the company has surplus liquidity it may be distributed to the shareholders based on their individual wishes – in contrast to the across-the-board approach of a dividend – of course taking into account the requirement of equal treatment. If the company generates an above average yield compared to the capital employed, the equity base may be reduced by means of higher borrowing levels with comparatively cheap loans thus increasing the return on equity, i. e. the so-called leverage effect. And ultimately, the redemption of a company's own shares was assessed positively by Austrian lawmakers as a "measure to stabilise prices".[174] Nevertheless, the principle remains valid that such a purchase price may only be paid from non-committed assets (Capital Directive Art. 19 (1)(c); dGmbHG section 33 (2) first sentence) and the acquired shares may not be considered as assets in calculating tied-up capital (see end of 2, above). Otherwise, special rules are applicable in such cases which are to

[170] Similarly in Switzerland, see Schindler/Töndury, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Switzerland marginal no. 61.

[171] In overview form, Roth/Weller, Handels- und Gesellschaftsrecht, marginal no. 458, comprehensive treatment in: Roth/Altmeppen, GmbHG, preceding sections 32 a, b (prior version).

[172] Embid Irujo, in: Lutter, Das Kapital der AG in Europa, p. 691.

[173] See Lutter/Bayer/Schmidt, EuropUR, § 8 marginal no. 24 on the topic of financing a share purchase by a third party on the part of the public limited company.

[174] Begründung zur erweiterten Zulassung des Aktienrückerwerbs 1999, 1902 Beil. XX GP, p. 4.

be accorded priority over the general limits on distributions (sections 57 (1) second sentence dAktG, 52 second sentence öAktG).

Specifically, these regulations provide that such an acquisition is permitted subject to simplified requirements for a series of special purposes. One example is the acquisition of shares for purposes of distributing them to the company's employees as employee shares (Capital Directive Art. 19 (3)). That aside, the company is granted a degree of freedom of disposition which is limited in two regards: The volume may not exceed 10 % of subscribed capital and the decision-making process is limited by means of a requirement of a transparent authorisation on the part of the general meeting (Capital Directive Art. 19 1 (a) and (b)). What is being referred to here is an unrestricted repurchase transaction, to be distinguished from a company's eventual redemption rights and the shareholders' rights to tender their shares to the company. See Ch. 4 III with regard to the latter.

A special issue at the intersection of stock repurchase and constructive repayment results from the collision of the requirements of capital preservation and **investor protection** based on capital markets law where a public limited company violates statutory disclosure obligations with regard to its shares[175] and shareholders who experience price losses following acquisition sue the company for damages based on such losses. In most cases this means practically that they want to tender the shares in exchange for a refund of the purchase price. Whereas the principle that such claims were aimed at an impermissible return of equity applied previously, jurisprudence in Germany and Austria has accorded priority to such claims for damages at least in cases of intentional deception of the investing public.[176]

6. Analysis

a) Capital protection. In the case of the collision issue referred to immediately above, the courts, supported by the majority opinion contained in the literature, goes beyond the principle of capital preservation too recklessly; because at the core what is involved is the enforceability of joining the company as a shareholder which cannot be disturbed by a lack of consent due to deception (see III 1., P. 41, above) even if it generates media attention as a form of investment fraud. In any event, placing the solution at the European level in association with the applicable directives and submitting the matter to the CJEU is inevitable for this reason.

In the case of a stock repurchase in general, the main problem in light of the safeguards referred to above is less one of capital preservation than much more the potential for **price manipulation** for which there is more than enough illustrative material since the economic crises of the inter-war period.[177] Recommending this as

[175] Based on multiple European Directives: Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading, 2004/109/EC of 15 December 2004, 2003/6/EC of 28 January 2003, overview in Möllers, BB 2005, 1637, 1641.

[176] BGH ZIP 2005, 1270; 2007, 326 and 681; OGH GesRZ 2011, 251. Critical view from Kindler, in: FS Hüffer, 2010, p. 417; contrary view already Lutter, in: KölnerKomm, AktG, § 71 marginal no. 69, end. A submission to the CJEU was not considered, see Roth, JBl 2012, 73, most recently (2012) this has occurred on the part of an Austrian lower-level court: HG Wien GesRZ 2012, 196 with comments by Eckert; see Fleischer/Schneider/Thaten, NZG 2012, 801.

[177] Maltschew, Der Rückerwerb eigener Aktien in der Weltwirtschaftskrise 1929–1931; Terberger/Wettberg, Der Aktienrückkauf und die Bankenkrise 1931.

price stabilisation is an economic policy euphemism.[178] On the other hand, the justification that price manipulations have since been sufficiently regulated with the instrument of capital markets law and are no longer an issue in the case of stock repurchases, appears to be daring from a practical standpoint.

However, the question of the threshold value of capital preservation as such is of much more fundamental importance and the applicable system appears to have multiple opportunities for improvement in this regard. This is first of all applicable to the balance sheet-oriented, and therefore rather static and retrospective fixation on equity. A forward-looking alternative would look to the **liquidity** of the company in relation to foreseeable future functions and stresses. Secondly, the applicable threshold is very high if one only subjects annual disposable profits to disposition and is potentially too low if one subtracts distributable reserves so that only subscribed capital and the relatively minor reserve items remain tied-up. Third, the legal consequences are severely limited if one only considers distributions or repayments, as applicable, instead of expanding capital preservation to cover other forms of **asset erosion**. This is so because of a generally-known phenomenon already referred to above that in the case of such an impending crisis for the company not only does the temptation of the shareholders increase to funnel out the last remaining liquid funds to themselves but the appetite for risk increases as well, i. e. the willingness to take high or even irrationally high entrepreneurial risks because one no longer personally has much to lose, i. e. from a practical standpoint to speculate at the creditors' expense because the fundamental parity of risk between the owners and shareholders has been lost.[179] Of course, legal regulations are subject to limits in this situation because entrepreneurial discretion (business judgment) should not be made subject to judicial review and in principle there is no remedy to prevent losses from occurring which in turn indirectly depend on entrepreneurial risk.

If one sees the prevention of insolvency as the actual protective purpose, this opens up a broad perspective which refers us to **three threshold values** with various legal consequences already found in current law: Subscribed capital, potentially expanded to include certain reserves, defines the amount of net assets exempt from distribution; so-called negative equity begins below this limit. If net assets decline to nil, this represents the start of over-indebtedness, i. e. debt can no longer be covered and a reason to commence insolvency proceedings has occurred. Many legal systems take a middle path with the loss of one-half of subscribed capital (e. g. Capital Directive Art. 17; dGmbHG section 49 (3); Swiss OR Art. 725 (1)) triggering various responses starting with the calling of a general meeting of the shareholders, at which the critical situation is at least intended to be made generally known, through to legal obligations to restructure, implement capital reductions or dissolve the company respectively (France Art. L223-42, 225–248 CCom; Spain Art. 363 (e) LSC; making further distinctions Italy Art. 2446 et seq., 2482 bis 2484 CC).[180] If these protective measures prove to be insufficient, then the reaction threshold must be tied to more suitable

[178] On this topic, see Roth, in: FS Koppensteiner, 2001, pp. 141, 146, presentation to 16. ÖJT 2006, p. 114.

[179] See II 2, above.

[180] Overview in: Kalss/Adensamer/Oelkers, in: Lutter, Das Kapital der AG in Europa, p. 134. Regarding the loss of one-third of capital in Italy, see Miola, in: Lutter, Das Kapital der AG in Europa, pp. 612, 624, in Spain Embid Irujo, in: Lutter, Das Kapital der AG in Europa, p. 690.

crisis parameters, allowing for earlier intervention and giving the company more comprehensive protection for its existence if not successful restructuring.[181] It then falls within the responsibility of the management to establish a risk management system which ensures that crises are recognised on a timely basis.[182]

b) Crisis parameters. Two criteria are primarily under discussion as determinants of whether the company finds itself at the outset of a crisis and continued business activities appear to be at risk.[183] They are **credit standing** = the ability to borrow at prevailing market conditions and **solvency** = the forecast ability to meet financial obligations beyond a foreseeable period. German lawmakers have already declared a loss of creditworthiness as the hallmark of a crisis (based on the prevailing interpretation of section 32a GmbHG (prior version)).[184] The solvency or liquidity test is an approach taken at the international level based on the Anglo-American example.[185] For purposes of assessing short or medium-term ability to meet financial obligations, the latter is ultimately nothing other than the converse of impending insolvency[186] which already plays a role in the commencement of insolvency proceedings or measures to avert such proceedings under applicable law. The core issue under this approach is what facts or probabilities should function as the basis of this assessment. On the other hand, the question of credit standing remains a theoretical issue if the company has not in fact turned to the capital markets or may not be shown to have done so.

For this reason, **Austrian** lawmakers subjected this to precise indicators, the equity ratio and the deemed debt repayment period, in the URG under the rubric of the need for reorganisation (flanked by the EKEG in relation to shareholder loans).[187] These are based on examples from European banking laws and may likewise be arrived at from a balance sheet approach in the broader sense, i. e. indirectly from the company's accounts. This rule combines the advantages, but also the respective corresponding disadvantages of clear computation formulas, with additional room for exercising discretion and complicated legal consequences oriented toward insolvency. As a result it is somewhat stigmatised such that its practical effectiveness trended toward nil to date. The French Procédure de sauvegarde (Art. L620-1 CCom) is committed to similar goals tied to the general principle that the entrepreneur "justifie de difficultés qu'il n'est pas en mesure de surmonter" and which likewise, as is reported, has only enjoyed modest success.[188]

[181] Legal comparison, overview in Haas, report to 66. DJT 2006; Adensamer/Oelkers/Zechner, Unternehmenssanierung, p. 98 et seq.

[182] BGH ZIP 1995, 560; NZG 2012, 940.

[183] According to Bauerreis, ZGR 2004, 294, 298 for French law (see next page).

[184] Roth/Altmeppen, GmbHG, § 32 a (prior version) marginal no. 22.

[185] EU Commission Action Plan from 2003, see Reich-Rohrwig, Grundsatzfragen der Kapitalerhaltung, p. 424; Veil, in: Lutter, Das Kapital der AG in Europa, p. 91; für Italien Miola, in: Lutter, Das Kapital der AG in Europa, p. 635 et seq., for the Netherlands Kluiver/Rammeloo, in: Lutter, Das Kapital der AG in Europa, p. 659; Hirschfeld, RIW 2013, 139. See additionally, Rickford and Schön, EBOR 7 (2006), reprinted in: Eidenmüller/Schön, The Law & Economics of Creditor Protection, pp. 135, 181.

[186] Similarly, Haas, report to 66. DJT 2006 E 124.

[187] Overview of this issue, Roth/Fitz, Unternehmensrecht, marginal no. 595. The key idea for the EKEG is the company crisis.

[188] Urbain-Parleani, in: Lutter, Das Kapital der AG in Europa, p. 592. However, see also CJEU Case C-116/11, Bank Handlowy, ZIP 2012, 2403; Submissions of the Advocate-General, ZIP 2012, 1133.

Potential solutions which are tied more closely to the contractual theory (Ch. 1 1 I), here again place their trust in voluntary private agreements with the creditors.[189]

With that, proposed solutions have been described which go beyond the circumstances or legal consequences side of mere capital preservation by attempting to define a threshold value for undercapitalisation or threats to continued existence in advance of an insolvency[190] on the one hand and, on the other, link them to differentiated rules governing conduct and sanctions on the other. These sanctions comprise personal liability on the part of management and/or the shareholders, i. e. the piercing of the limitations on liability to which they are otherwise entitled. This creates the link to piercing the corporate veil to be discussed under VI. below.

7. Capital reduction

The reduction of subscribed capital is the converse of raising capital whereby the amount of the reduction may be used to repay assets to the shareholders or to offset losses on the balance sheet which have already occurred (adverse balance). In any event, this results in a reduction in the amount of subscribed or share capital which is why the limits on statutory minimum capital must be complied with (Capital Directive Art. 34 with an exception for a concurrent increase in capital: restructuring variation), that is a reduction in capital may only then be considered in cases where the shareholders have voluntarily provided for higher capital levels in advance and the scope of tied-up capital is reduced. In other words, the scope of protection for the interests of the creditors and shareholders provided by the previously applicable capital commitment is reduced and thus cannot be accomplished without their consent or accompanying protective measures.

Such protective measures are primarily two-fold: The decision to reduce capital including its intended purpose and implementation must be made by the shareholders in the form of an **amendment to the statutes** including the associated control mechanisms and must be approved by that qualified majority prescribed for amendments to the statutes (Capital Directive Art. 30; section 54 (1) öGmbHG). Additionally, the **claims of creditors** must be satisfied before distributions to shareholders are made or provisions must be made for claims on the part of creditors which are not yet due as applicable. Sufficient and timely information must be provided to the creditors to this end (Capital Directive Art. 32; dGmbHG section 58).

VI. Piercing the corporate veil (reach-through liability)

1. Limitations on liability and reach-through

The benefit of limited liability is not granted on an unrestricted basis but is instead tied to certain requirements, at least in theory, corresponding to interests of shareholders and creditors in relation to the existence and creditworthiness of the enterprise, which prevent the complete externalisation of risks, of speculation on the part of the shareholders, or from influential shareholders at the costs of others.

[189] Spindler, JZ 2006, 839; Schön, in: Bachmann et al., Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 147.

[190] "In the vicinity of insolvency", Davies und Spindler, EBOR 7 (2006), 301 und 339.

If this fundamental consensus is violated, the legal system may pierce the corporate veil for the benefit of the creditors and reach through to the personal assets of responsible shareholders. Such reach-through liability is not particular to Continental European law, but rather is also a fixed component of Anglo-American law under the term "piercing the corporate veil"; however it has been given a special character in particular under the direction of the German Federal Court while other countries follow their own paths with similar goals (e. g. France in the form of the action en comblement du passif or pour insuffisance d'actifs).[191] What is at issue is primarily liability based on **conduct or fault** which is not only related to, but also very significantly has to do with, capital protection which also extends to management of the company and influence on it and accordingly spares the shareholder who has no influence under certain circumstances or targets company management as such.

Reach-through liability is not warranted merely as a result of an initial undercapitalisation of the company. As previously mentioned, initiatives taken in this direction have been without success to date. The shareholders are not obligated to make additional contributions even if the company later "runs out of money". Instead, acts have been relevant to the courts which undermine the protection of capital in a targeted manner to the detriment of the creditors and which could be viewed as an **abuse of the limitation on liability** in a broader sense. The most obvious example is the co-mingling of assets. If the company's assets which may be used to satisfy the claims of creditors are not clearly segregated from the shareholder's personal assets, the separation principle underlying limited liability is surrendered.[192] The latter case is of practical importance to single-member entities if the sole owner co-mingles assets of different spheres. In general the risk of personal liability is likely higher for him than is the case where multiple parties are involved. Italy has statutorily enabled liability reach-through to the sole shareholder if contributions have not been properly made or his sole ownership has not been disclosed pursuant to applicable rules and regulations (Art. 2325 (2), 2462 (2) CC).

The business risks of a larger enterprise may be divided up among several legal entities using the trick of **liability segmentation**, for example through the formation of individual companies for a fleet of taxis, mobile cranes, ships or for the realisation of individual construction projects which then are related to one another in the context of a corporate group. In the event a project fails or one of the vehicles causes a large amount of damage, only the respective subsidiary becomes insolvent and the creditors may only be satisfied from its (insufficient) assets.[193] In principle, this is still tolerated as the exploitation of legal structuring opportunities.[194] The BGH has only permitted reach-through to other companies

[191] Art. L651-2, previously Art. L652-1 CCom. On this issue and Spanish law, Merkt/Spindler, in: Lutter, Das Kapital der AG in Europa, pp. 207, 222 et seq., additionally on France, see Urbain-Parleani, in: Lutter, Das Kapital der AG in Europa, pp. 592, 598; regarding Spain Haas, Der Durchgriff im deutschen und spanischen Gesellschaftsrecht, 2003.

[192] BGHZ 123, 366; 173, 246; BGH NJW 2006, 1344; NZG 2008, 187.

[193] Roth/Fitz, Unternehmensrecht, marginal no. 585.

[194] According to Belgian law, the sole shareholder who operates multiple single-member entities is personally liable for the debts: Heitkamp, in: Ars Legis (ed.), Das Recht der Kapitalgesellschaften in Europa, country report Belgium p. 13.

within the corporate group in cases where one company is sacrificed in a certain sense for the good of the others through measures undertaken by group management.[195]

2. Risk to the company as a going concern, insolvency trigger

The BGH decisions referred to immediately above already place the erosion of the company's capital base to the fore. The BGH has since abandoned the corporate group approach and in its place has even more strongly emphasized the invasion of corporate assets as an abuse of the corporate form and ultimately as an impermissible injury to the company and/or its creditors.[196] In this regard the court is concerned with expanding the statutory prohibitions on distributions into areas which they literally do not cover because either the invasion may no longer be classified as a distribution or constructive distribution from an accounting standpoint or because the intent is to cover an outflow of assets beyond the limits of the prohibition on distributions. The latter is a problem peculiar to the German GmbH because the prohibition on distributions limited only to subscribed capital still leaves open the possibility of constructive outflows to the detriment of reserves (see V 3, p. 58, above).[197] Even the otherwise admissible formal distribution of profits inclusive of reversed reserves may be concerned.[198] Examples of the former include the **depletion of the company** by transferring employees, know-how, business relationships, the customer base or operationally-required resources to the shareholder or other subsidiaries.[199] These are acts with which the owners attempt to secure assets for themselves, and to the detriment of the creditors, in the face of an impending crisis just as they are tempted to withdraw liquid funds. Furthermore, characteristic of these scenarios is that no invasive act may be viewed individually, assessed on its own and redressed as such through compensation.

Instead, in a more general sense what is involved is **endangering the existence** of the company through a lack of consideration for its viability (and thereby also the interests of its creditors) and if these acts bring about insolvency thus destroying the company's existence, the entire damage experienced by the company must be compensated for to the extent necessary to satisfy the creditors. The courts construe this as an act of intentionally, unethically harming the company.[200] If entrepreneurial risk on the part of a shareholder is limited to the company's assets, he is obligated to the company (and thereby indirectly to its creditors) to not deprive it of the resources needed for its continued existence. Such assets required for continued existence are described as earmarked for the satisfaction of creditors and accordingly may not be freely disposed of by the shareholders. They may not sabotage the company's ability to service its obligations. From a practical standpoint, the result is that the responsible shareholder(s)

[195] BGHZ 95, 330; 115, 187; BGH NJW 1993, 1200.

[196] BGHZ 173, 246; 176, 204; see Altmeppen, ZIP 2008, 1201.

[197] However, the same question arises in general as to the regulatory model of Art. 15 (1)(a) of the Capital Directive as soon as one wants to include constructive distributions.

[198] Lutter/Hommelhoff/Bayer, GmbHG, § 29 marginal no. 22 in connection with § 13 marginal no. 34.

[199] Roth/Weller, Handels- und Gesellschaftsrecht, marginal no. 561.

[200] BGHZ 173, 246 following NJW 2002, 3024 and ZIP 2001, 1874; here with a still different justification of the claim. Summarising BGH NZG 2012, 667.

or the management as well are thereafter personally liable for the company's debts to the extent they have impermissibly withdrawn assets and may even expose themselves to criminal liability for breach of trust.[201]

3. Analysis

The solution proposed by the courts of establishing a threshold for the beginning of the crisis – if perhaps unclear but useful – on the other side of which the shareholders or also the management are subject to particular obligations in handling the company's assets, is suitable in principle to not only prevent harmful outflows of assets but also other management acts endangering the continued existence of the enterprise. From a practical standpoint, this would mean that responsible shareholders (in the case of the private limited company: majority or managing shareholders) and/or company management (in the case of the public limited company the supervisory board as well in its capacity as a control mechanism) would pay more careful consideration to the viability of the company during a crisis, that they would regularly have to act with a lower degree of risk tolerance (instead of giving in to the contrary temptation, see II 2, p. 37, above) and in extreme cases would be confronted with the alternative of undertaking restructuring measures or initiating the dissolution of the company on a timely basis. However, to date the BGH has failed to develop this potential solution further.[202]

From a legal protection standpoint these decisions are to be classified in a broader sense as **capital maintenance** measures. This may already be seen in the fact that their applicability is limited to impermissible asset outflows. The act of endangering continued existence may be viewed as eroding the capital structure to a point beyond which a certain risk threshold is exceeded.[203] The requirement of protecting continued existence is equivalent to capital preservation; fixing asset protection to the company's ability to satisfy its creditors is pursuing precisely this goal. This shows that the focus of the most recent rulings from the BGH in the field of GmbH law has been placed on capital preservation.

This is turn is symptomatic for a general shift in emphasis in corporate law **from capital raising to capital preservation**.[204] This trend appears to be correct in principle, because the imperative of capital raising is, as described above, the creation of a certain condition in the form of a type of snapshot. This may then deteriorate very quickly from this point moving forward so that later in the company's life business partners or potential purchasers of shares in the company have no other choice but to procure current information in the event they want to obtain a picture of the company's financial situation and evaluate this themselves. Last but not least, for this reason the so-called seriousness signal remains practically the most important effect of the requirements applicable to capitalisation. However the seriousness of the shareholders and/or their management may suffer from the negative development in economic circumstances and, as already discussed above, can ultimately result in

[201] On the latter, see BGH NZG 2009, 1152; 2012, 836, 839.

[202] BGHZ 176, 204 = ZIP 2008, 1232; NZG 2005, 114 = LM 2005, 57 [Roth]; contra Roth, NZG 2003, 1081. See also Schön, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 131 et seq.; see also the contributions of Davies and Spindler in EBOR 7 (2006), reprinted in Eidenmüller/Schön, The Law and Economics of Creditor Protection, pp. 303, 341.

[203] Roth, NZG 2003, 1081.

[204] Roth, presentation to 16. ÖJT 2006, p. 112.

overly-high willingness to take risks and to speculate at the expense of the creditors if legal systems do not put a stop to this.

If therefore the company's economic solvency at a given point in time is determinative for the persons requiring protection when entering into transactions with the company, whereby its original capitalisation is only meaningful to a limited degree, the further **development of the capital structure** is of great importance to them for two reasons and is subject to a great degree of uncertainty: First, they do not want to or cannot undertake constant observation (monitoring) of the financial situation[205] and second their abilities to react within the context of an existing legal relationship are limited. They cannot undo the conclusion of a transaction or the making of an investment. It is essential for them that the company's solvency, once established whether through the original capitalisation or through subsequent financial success, remains in place or at least – given that a decline in the performance curve can never be ruled out – is not exacerbated by actions on the part of the controlling shareholders. Apart from that, even from the start, credit standing may not so easily be assessed by business partners as the freedom to contract theory would have it or overwhelms their attention or judgment in the course of day-to-day business.

Putting this knowledge into practice in light of the paramount task of legal protection is however a process which has not yet been concluded. There appears to be room **to develop legal instruments further** in two respects: On the one hand, what is involved is more closely framing the definition of the circumstances, the occurrence of which trigger heightened legal consequences in addition to – not in replacement of – applicable capital protections,[206] i. e. terms such as crisis, endangering continued existence, solvency test and need for reorganisation. On the other, the legal consequences could be further refined, whereby the outflow of assets will be in the foreground as an anathema to capital preservation, however other risks to the capital base such as potentially the failure to undertake rescue measures on the part of those in positions of responsibility could also be classified as invasions which endanger continued existence under the heading of heightened duties. Correspondingly, the focus of sanctions may shift from an undifferentiated reach-through to the shareholders to a duty to compensate for damages on the part of those in positions of responsibility (company management, shareholders exercising effective control).

[205] See Schön, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 151 et seq. regarding information and disclosure obligations for the benefit of creditors and/or the public in a crisis.

[206] In accordance with all those (not all) Anglo-American advocates who aggregate the solvency test with the balance sheet test. Since what is intended is that the current reaction threshold be moved forward: Roth, presentation to 16. ÖJT 2006 p. 118 et seq.

Chapter 3. The Structure of the Corporation

I. Organisational structure and plurality of interests

Legislation in the area of corporate law must take both the variety of interests represented within the corporate body itself and those represented in its legal environment into consideration.[1] The applicable allocation of competences set out in the TFEU likewise refers to both internal and external relationships of the association. Pursuant to Art. 50(2)(g), European lawmakers are supposed to harmonise the safeguards of the Member States related to the protection of "members and others". With regard to internal relationships within the company, the law must therefore first regulate the **competing interests among shareholders**. For this purpose, a distinction is drawn between shareholders who exercise influence on the enterprise and shareholders who merely own minor interests. In this respect, what is involved is the classic issue of **protecting minority shareholders** against abuses on the part of the shareholding majority; protective instruments here include individual management rights of the shareholders. This includes, for example, the right to call and participate in shareholder meetings – including the right to be heard, rights to information, voting rights and rights to challenge resolutions. These rights are of particular importance if the company is a dependent member of a group and the controlling shareholder attempts to use his influence to pursue group corporate policy without consideration of the company and the outside shareholders. Other issues include – in the case of a listed public limited company – capital market related conflicts of interest between shareholders who hold stock as an investment, speculators and institutional investors.

In addition to these conflicting interests between members of different shareholder groups which will be addressed in the following Chapter,[2] the national lawmakers further regulate the interests of **employees as a class** in a variety of manners. Conflicting interests within the group of employees will not be considered here, i. e. between hourly workers, salaried employees and managers. Regulating these relationships is the task of employment law. The interests of the employees in high wages and employee benefits as well as secure jobs and agreeable working conditions must be taken into account within the relationship of the employees as a group to the company. These employee interests may potentially conflict with the shareholders' interest in profits even if it is a truism today that satisfied employees are generally distinguished by higher productivity which in turn directly benefits the company.[3] Whether and in what form corporate law takes the **collective interests of**

[1] Cf. (especially for laws related to public limited liability company) Raiser/Veil, Recht der Kapitalgesellschaften, § 13, p. 104 et seq.; Kübler/Assmann, Gesellschaftsrecht, 6th ed. 2006, § 14 III p. 176 et seq.

[2] See below, p. 113 et seq.

[3] On employee satisfaction as a production factor, see Koys, Personnel Psychology, 54, 103–114 (2001); Otte, Arbeitszufriedenheit. Werte im Wandel; Stock-Homburg, Der Zusammenhang zwischen Mitarbeiter- und Kundenzufriedenheit. Direkte, indirekte und moderierende Effekte; Wright/Cropanzano/Bonett, Journal of Occupational Health Psychology, 12, 2, 93–104 (2007).

the employees into account varies at the international level. Some countries, e. g. Germany, provide employees generous managerial codetermination rights within the management bodies,[4] where by contrast others have opted for weaker forms of codetermination or have opted to forego managerial codetermination entirely. This aspect will not be addressed further here because the focus of this book is on the small corporation which only rarely attains the number of employees required for the applicability of managerial codetermination. Similarly, in its 2011 report, the **Reflection Group** on the Future of EU Company Law did not see any need to take action in the area of managerial codetermination; according to the report, its effect on the economic success of a business could not be positively or negatively verified.[5] This is in addition to the fact that consensus on the issue of codetermination will be nearly impossible to achieve in Europe. The temporary failure of the EPC project based on just this reason dramatically demonstrates this point.[6] Accordingly, the European Commission's Action Plan 2012 instead relies on increasing equity participation on the part of the employees.[7]

In addition to the shareholders and the employees, a third corporate constituency must be considered: the **members of the management bodies** who in economic reality are entirely able to pursue their own interests. Both the company management and, where applicable, the members of the supervisory body, often pursue corporate policy which goes against the direct interests of the shareholders as a whole and those of the employees. Strengthening and expanding the enterprise are often at the centre of these corporate policies even if this is at the expense of dividends or employee satisfaction. In the view of management, profits should be more likely reinvested as distributed to the shareholders or passed along to the employees in the form of increased compensation. The motives for these forms of restrictive distribution and wage policies are both tangible (pursuit of increased compensation) and intangible (pursuit of power and prestige). The profile of this form of autocratic corporate manager is the subject of academic research in the field of economics as well as satirical depictions.[8]

Finally, unrelated **third parties** must be included as the fourth reference group. In addition to the protection of shareholders, their protection is of particular importance in EU law (Art. 50(2)(g) TFEU). This primarily includes a company's **creditors** whose protection comprises one of the central concerns of corporate law.[9] This relates to suppliers, customers and lenders. The primary instruments of creditor protection include capital raising and preservation as well as a series of instances which could give rise to liability on the part of shareholders and members of the management bodies. This fourth corporate constituency of 'stakeholders' also includes all additional persons who have a legal relationship

[4] Cf. Raiser/Veil, Recht der Kapitalgesellschaften, § 13 III, p. 108 et seq.

[5] Cf. the report dated 5 April 2011 (p. 53 f.) available at://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf; see also Hopt, Europäisches Gesellschaftsrecht: quo vadis?, EuZW 2012, 481 et seq.; Bayer/J. Schmidt, BB-Gesetzgebungs- und Rechtsprechungsreport zum Europäischen Unternehmensrecht 2010/2011, BB 2012, 3, 13 et seq.

[6] On the topic of the Hungarian proposal dated 20 June 2011 (Council Doc. 11786/11) Bayer/J. Schmidt BB 2012, 3.

[7] COM(2012) 740/2 dated 12.12.2012 (see Ch. 1 fn. 35), p. 11 (at 3.5); see also Bremer, NZG 2012, 817.

[8] Ogger, Nieten im Nadelstreifen; Noll/Bachmann, Der kleine Machiavelli.

[9] Confirmed also by the ECJ, case C-378/10, *Vale Epitesi kft* (2012), NZG 2012, 871 pt. 39.

with the company. The law implements the **protection of the public** required in this regard through comprehensive disclosure obligations, above all in accordance with the First, Fourth and Eleventh EU company law directives and the associated national implementing regulations.

The particular interests of the shareholders, employees, members of the management bodies and third parties must be viewed separate and apart from the **interests of the company**. In certain circumstances, the courts and legal doctrine view this as an independent factor, for example as a guideline for the exercise of entrepreneurial discretion on the part of the management bodies (section 93 (1) second sentence dAktG, so-called "Business Judgment Rule"[10]).

Within this highly-complex web of interests, the goal of statutory regulation of organisational structures is to create a balance between the influence of the different corporate constituencies and the necessary independence of the company management. This independence of influence on the part of the shareholders is also ensured in the small corporations wherever the powers and obligations of the management bodies are established in the interest of third parties. For this reason the authority to represent the company of the management body is unlimited and cannot be restricted (section 37 (2) dGmbHG; section 78 dAktG; section 20 (2) öGmbHG; Art. 223–18 (5), (6) CCom; Art. 2475 bis CC[11]). Furthermore, there are accounting and insolvency petition requirements independent of contrary provisions in the articles of association or other influences on the part of the shareholders (sections 40 to 42 a dGmbHG; section 15 a InsO; sections 22, 23 öGmbHG; Art. L232-1 and L640-4 CCom; Art. 224 L. fall.). The same applies in the case of the obligations of members of the management body in connection with capital preservation (cf. only sections 30 (1), 43 (3) GmbHG) and disclosure in the commercial register (see e. g. section 78 GmbHG; section 26 (1) öGmbHG).

In the course of a **comparative legal analysis**,[12] it becomes clear that the German **distinction between the large and the small corporation**[13] is followed[14] by Continental European legal systems. The public limited company and the private limited company are likewise known in Austria[15] and Switzerland.[16] The same applies in the

[10] On the topic of entrepreneurial discretion on the part of management bodies in other legal systems, see: *a) Austria:* OGH GesRZ 2006, 86; Kalss, in: MüKoAktG, § 93 AktG (D) marginal no. 302 et seq. (on section 84 öAktG); *b) Switzerland*: Kunz, in: FS Druey, 2002, p. 445, 455 et seq.; *c) Italy:* Kindler, ZEuP 2012, 72, 92 et seq.

[11] The basis is Art. 10 Disclosure Directive; deviating Art. 814 (4) in conjunction with Art. 718 a OR, see text accompanying fn. 51, below.

[12] Raiser/Veil, Recht der Kapitalgesellschaften, p. 20 et seq.

[13] The private limited company (GmbH) was first introduced in Germany by statute dated 20 April 1892; see Lutter, in: FS GmbHG, 1993, p. 49 et seq. on this law and its reception in many countries around the world; Schubert, in: FS GmbHG, 1993, p. 1 et seq.; Zöllner, JZ 1992, 381 et seq.; comprehensive treatment in Koberg, Die Entstehung der GmbH in Deutschland und Frankreich.

[14] That is also the finding of the "Reflection Group" (fn. 5 above, there p. 8 et seq., subsection 1.1.2) which however views this fundamental distinction as "irrelevant" because in reality there are also "small corporations" with a large group of shareholders and vice versa.

[15] Cf. Kalss/Nowotny/Schauer, Österreichisches Gesellschaftsrecht; Beer, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, Country e. g. Österreich, p. 1263 et seq.

[16] Boeckli, Schweizer Aktienrecht.

case of France[17] and Italy.[18] The countries of Eastern Europe have also adopted a distinction between large and small corporations in the course of introducing a market economy.[19]

By contrast, within the English-American legal tradition, the uniform form of corporation predominates as the company (England) or the corporation (USA) which is designed as a public company. Of course, these systems also have special rules for other company forms which exist as well with closed groups of shareholders, namely in the sub-forms private company limited by shares (Ltd) and the close corporation respectively.[20]

Two fundamental approaches emerge with respect to **organisational structure**, the geographical spread of which largely corresponds to the boundary between the Continental European and the English-American legal traditions. The two approaches reveal different weight given to the interest of the shareholders as a group. One may fundamentally divide organisational structures between the "two tier" supervisory board system and the "one tier" board system. These systems are also described respectively as "dualistic" and "monistic". Seen historically, the **supervisory board** was originally a peculiarity of the public limited company under German law. The body originated during the nineteenth century as a voluntary institution – which speaks in favour of its usefulness[21] – and was made mandatory in 1870 as replacement for state supervision which had since been seen as ineffectual.[22] The primary responsibility of the mandatory supervisory board in a public limited company is that of a shareholders' committee tasked with monitoring company management (section 111 (1) dAktG). This is backed by the assessment that, in any event in the case of the public company, the **general meeting of the shareholders** could not be considered as an efficient monitoring body due to its lack of expertise and/or clumsiness.[23] Italian law originally adopted the two-tier system for the società per azioni with a weak supervisory body (collegio sindacale/monitoring council) which is also obligatory for the società a responsabilità limitata above a certain level of registered capital (EUR 120,000)[24] since 2004. Instead, since 2004 Italian corporations may select the two-tier "Ger-

[17] Regarding the Société Anonyme (SA) and the Société à Responsabilité Limitée (SARL) s. Bonnard, Droit des sociétés; Constantin, Droit des sociétés; Cozian/Viandier/Deboissy, Droit der sociétés; Guyon, Traité des contrats. Les sociétés. Aménagements statutaires et conventions entre associés; Sonnenberger/Dammann, Französisches Handels- und Wirtschaftsrecht; Sonnenberger/Classen (ed.), Einführung in das französische Recht.

[18] Regarding the Societá per Azioni (S.p.A.) the Societá a responsabilitá limitata (S.r.l.) see Di Sabato, Diritto delle Societá, 2nd ed. 2005; Kindler, ZEuP 2012, 72 et seq.

[19] Raiser/Veil, Recht der Kapitalgesellschaften, § 7 marginal no. 1, p. 21.

[20] Specially regarding the systematic of English law – and still valid today – Hallstein, RabelsZ 1938/39, 341, 350 f.

[21] According to the accurate assessment in Raiser/Veil, Recht der Kapitalgesellschaften, § 13 marginal no. 8, p. 106.

[22] A contemporary view Renaud, Das Recht der Aktiengesellschaften, p. 625 et seq., see also Lutter, in: Bayer/Habersack (eds.), Aktienrecht im Wandel, Band II, Kapitel 8; for a general overview on the history of the public limited liability company in Germany see Schubert/Hommelhoff (eds.), Hundert Jahre modernes Aktienrecht.

[23] Raiser/Veil, Recht der Kapitalgesellschaften, § 13 marginal no. 8., p. 106; contemporary view L. Lehmann, Das Recht der Aktiengesellschaften, Band 2, 1884, p. 335 et seq.

[24] Ghezzi/Malbreti, ECFR 2008, 1 et seq.; Kindler, ZEuP 2012, 72 et seq.

man" organisational structure with a strong supervisory body (consiglio di sorveglianza/supervisory board, Art. 2409-octies through Art. 2409-quinquiesdecies CC).[25] In practice, this choice is hardly ever made.[26]

By contrast, **French corporate law** has historically followed the **one-tier system**. The ability to select the supervisory board model, available since 1966, is hardly used in practice.[27] A strict, one-tier organisational structure – without options for the shareholders to elect otherwise – is furthermore characteristic of the **English-American legal tradition**. In these systems, company management is the responsibility of a collegial body (board of directors, in particular sec. 170–181 Companies Act 2006) which is appointed by the general meeting of the shareholders. Upon closer examination, it may admittedly be seen that clear distinctions are made within this body between the management and monitoring functions of its members. For example, company management is the responsibility of the full-time members of the body (managing directors or executive directors) whereas the monitoring functions are largely exercised by part-time members of the body (ordinary directors or non-executive directors).[28]

The picture of the organisational structure of the small corporation (private limited company) is less varied in the comparative legal analysis. In this regard, the countries from within the Continental European legal tradition examined as part of this study (Germany,[29] France,[30] Italy,[31] Austria,[32] and Switzerland[33]) also follow the one-tier system. The only exceptions in this regard relate to the elections available to the shareholders[34] and the obligatory supervisory board in the private limited company based on German codetermination law[35] or additionally upon attainment of a certain level of registered capital[36] or number of employees.[37]

[25] See Kindler, ZEuP, 2012, 72, 75 et seq.

[26] However, further refinements for use in practice are still being worked on feverishly, cf. only the useful guidelines of Consiglio Notarile di Milano (ed.), Massime notarili in materia societaria, 4th ed., 2010. In 2008 there were only 476 public limited companies in all of Italy which had decided against the traditional system (thereof 321 monistic, 155 dualistic); cf. the figures in Paolo Benazzo, Giur. comm. 2009, I, 702, 704 and available at www.associazionepreite.it (via the button "materiali").

[27] Raiser/Veil, Recht der Kapitalgesellschaften, § 7 marginal no. 7., p. 22.

[28] Ebert/Levedag, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country ex. England, p. 777, marginal no. 521.

[29] Sections 35 et seq. dGmbHG.

[30] Art. L223-18 CCom; see Karst, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country ex. France p. 899 et seq., marginal no. 120 et seq.

[31] Art. 2474 CC.

[32] Sections 18 et seq. öGmbHG.

[33] Art. 809 et seq. OR.

[34] Both German and Austrian law provide for an optional supervisory board: section 52 dGbmHG, section 29 (6) öGmbHG.

[35] See the rules contained in the MitbestG [German Codetermination Act], DrittbG [German One-Third Participation Act]; see also Ulmer/Habersack/Henssler (eds.), MitbestG.

[36] Cf. for Italy Art. 2477 (2) in conjunction with Art. 2327 CC: EUR 120,000.

[37] Cf. section 29 öGmbH; see also Beer, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country ex. Austria, p. 1305 et seq., marginal no. 188 et seq.

II. Organisational structure and limitation of risks

As previously discussed in Chapter 2 of this book, a company's *capital structure* – statutory minimum capitalisation requirements, securing raising of capital, capital preservation mechanisms – is aimed at protecting the company's creditors. By contrast, the company's *organisational structure* – primarily the division of powers between the shareholders and the management bodies – is likewise designed with another important protective purpose in mind which is also derived from Art. 50 (2)(g) TFEU: **safeguarding the interests of the shareholders**.

The interests of the shareholders are threatened by errors in management and illegal conduct on the part of the management bodies. In both cases, a reduction in company profits or even annual financial statements showing a loss must be anticipated, for example due to declines in revenue, obligations to pay damages or penalties. Funds available for the appropriation of profits decline or vanish entirely. Accordingly, an organisational structure focused on the interests of the shareholders must allocate significant competences to the shareholders themselves or at least provide the shareholders with sufficient monitoring and sanctioning options in relation to company management. Only in this manner may entrepreneurial risk for the shareholders be kept within a manageable framework.

There is a vast variety of duties with which the members of the management body are obliged to comply in so far as certain matters are within the competence of company management, i. e. shareholders are no longer involved in the first instance in management decisions. In addition to the general duty to act in the interest of the company (e. g. under section 93 (1) second sentence dAktG), it includes a series of specific obligations some of which serve the interests of the shareholders but in many cases the protection of creditors and other third parties (accounting, capital protection, entry in the commercial registry, obligations to petition for insolvency). To this extent, the company's organisational structure – as is the case with the capital structure – is not aimed at protecting the shareholders but rather third parties.

The obligation to pay compensation for damages to the company is the primary civil law sanction imposed where members of a management body breach their duties (section 43 (2) dGmbHG; section 25 (2) öGmbHG; Art. 827 in conjunction with Art. 754 OR; Art. L223-22 (1) CCom; Art. 2476 (1) CC). Other sanctions include removal (section 38 dGmbHG; section 16 (1) öGmbHG), termination of the employment agreement (section 626 BGB[38]) and the cancellation of pension benefits.[39] Whether such sanctions will be imposed is generally within the discretion of the shareholders (section 46 no. 5 dGmbHG).[40]

[38] Cf. regarding Austria Kalss, in: MüKoAktG, § 93 AktG (D) marginal no. 239, 249 et seq. 262. Only a few legal systems provide for an employment contract between the company and the management body member in addition to the status as a management body member which, in part, raises difficulties in explanation with regard to rights to compensation: Sangiovanni, GmbHR 2012, 841 et seq. (on Italy).

[39] BGH AG 1997, 265, 266 = NJW-RR 1997, 348; Hüffer, AktG, § 84 marginal no. 17.

[40] However contra in Art. L223-22 (4) CCom according to which clauses in company statutes are void which make the initiation of proceedings asserting liability dependent on a shareholder resolution.

III. The members of the management body as "mandataries" of the shareholders

In the case of the small corporation, the key to understanding the relationship of the shareholders to the management body and its members still lies in the civil law contract of mandate (mandatum).[41] The background to this is the idea prevailing in numerous systems of corporate law in the nineteenth century, namely that the members of the management body were the agents ("mandataries") of the shareholders. Many traces of this "**mandate theory**" may still be found in modern positive law, for example to the extent the law of mandate is applied accordingly to the company's managing directors.[42] It is based on the conventional view of the company as a contractual obligation with its origins in Roman law.[43] The **shareholders' general meeting** is the **highest decision-making body** in the company. The shareholders are the "masters of the company". In relation to the general meeting of the shareholders, the company's management body – consisting of the managing directors – has a subordinate meaning in the small corporation. The general meeting of the shareholders appoints the management body and transfers authority to it. In the classic form of the mandate theory, the members of the management body receive binding instructions from the shareholders as their representatives, whereby these instructions are not given directly by the shareholders but rather via their body, the general meeting of the shareholders. Consequently, this right of instruction is supplemented by the general competence of the general meeting of the shareholders: Based on such competence, this body may even assume management of the company itself in lieu of the management body in regard to any issue.[44]

In English law, the relationship between "principal" and "agent" corresponds approximately to the relationship between shareholders and management body under the mandate theory.[45] The principal-agent theory from the social and economic sciences borrows this terminology.[46] According to this theory, inherent in every division of management powers and ownership is the danger that the decisions and actions of the management body will run contrary to the interests of

[41] Sections 662 et seq. BGB; sections 1002 et seq. ABGB; art. 1984 et seq cc (fr); art. 1703 et seq. CC (it.); art. 394 et seq. OR; DCFR D. IV. – 1:101 et seq.

[42] The case in German law: Sections 712 (2), 713 BGB; sections 105 (3), 161 (2) HGB; in Italian law: Art. 2260 (1), 2293, 2315 CC (partnerships); regarding the role of the contract of 'mandato' in Italian corporate law, see Maffei Alberti, Commentario breve al diritto delle società, Art. 2389 CC Anm. I 1; Cass., 9 agosto 2005, n. 16764, Società 2006, 973 with comments from Sangiovanni; see also GmbHR 2012, 841, 843 et seq.; as to French Law see Vidal, Droit des sociétés, 7th ed., 2010, p. 204 et seq., 517 et seq.; Bachmann et al., Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 77 et seq.

[43] Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 15; regarding Roman law, see Zimmermann, The Law of Obligations – Roman Foundations of the Civilian Tradition, 1990, p. 468–469; Kaser/Knütel, Römisches Privatrecht, § 43; fundamentally Arangio-Ruiz, La società in diritto romano; Meissel, Societas. Struktur und Typenvielfalt des römischen Gesellschaftsvertrages.

[44] Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 15 et seq.

[45] Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 20; for a modern view, see Armour/Hansmann/Kraakman, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 35 et seq.

[46] For a fundament treatment, see Jensen/Meckling, 3 Journal of Financial Economics (1976), 305; Blair/Stout, 31 Journal of Corporation Law (2006), 719.

the shareholders. One person (the agent) who is authorised to act in the interests of another (the principal) is inclined to exploit his scope of action for his own benefit (and thereby to the detriment of the principal) where sufficient monitoring is not ensured.[47] This presupposes – as is typical in the case of a corporation – a situation in which the principal (the shareholders) transfers responsibilities to an agent (the members of the management body) along with the associated decision-making competence. The principal does so to unburden him or herself and/or in the face of a lack of expertise in the area of business management. In doing so, the agent generally has more or less an edge in knowledge compared to the principal regarding information related to the responsibilities which have been transferred.[48] Significant qualities of the agent (hidden characteristics), his acts and expertise (hidden actions and hidden information) as well as his intents (hidden intentions) remain hidden from the principal. Overcoming these deficits triggers so-called "agency costs".

Modern economic science seeks to create precautionary measures in the context of principal-agent theory which equalise the information deficits referred to above in an incentivised and cost-efficient manner. Of course it cannot be dismissed out-of-hand that in a corporation there is typically such a principal-agent relationship with the members of the management body on one side and the shareholders on the other.[49] This is because in this situation, the shareholders transfer significant decision-making authority within the company to the management body. The members of the management body act in the context of a relationship where they must safeguard the interests of another because their task consists precisely of managing the capital invested in the company well and – if possible – to increase it. It is in the nature of the arrangement that the members of the management body do not have the required substantive or personal aptitude in all cases in order to realise the best possible economic success. Of course there is also the risk that the members of the management body will place their individual interests above those of the shareholders. The accurate description of the issue by means of principal-agent theory is of course only of limited use for its legal solution. The instruments suited to this purpose have long been applied in the civil law contractual relationship as will be shown presently. Modern corporate law has adopted this in modified form without the need to consult academic theory in order to make further distinctions.

However, **today** the classic **"mandate theory"** is **no longer seen to apply** to the extent the company's **relationship with third parties is involved**. Thus, in the interest of protecting the public, regarding the scope of the authority to represent the company, the First (Disclosure) Directive drew a line of demarcation from internal relations (Art. 10).[50] In German law, this is clear from section 37 (2) dGmbHG, according to which the representational authority of a member of the management body extends to all judicial and non-judicial legal transactions. The authority to represent the company of the management body defined in this

[47] Drygala/Staake/Szalai, Kapitalgesellschaftsrecht, § 21 marginal no. 5; see also previously Baums, ZIP 1995, 11; Fleischer, ZGR 2001, 1, 6 f.; Seibert, ZRP 2011, 166.

[48] Fundamental – for contract law – Fleischer, Informationsasymmetrie im Vertragsrecht.

[49] Cf. also Farma/Jensen, 26 Journal of Law and Economics (1983), p. 301 et seq.; Eidenmüller, JZ 2001, 1041, 1046 et seq.; Hopt, in: FS Wiedemann, 2002, pp. 1013, 1014 et seq.; Wiedemann, ZGR 2006, 204, 244 et seq.

[50] Habersack/Verse, Europ. Gesellschaftsrecht, § 5 marginal no. 30 et seq.

manner is unlimited and cannot be restricted in dealings with third parties. Identical rules may be found in France (Art. L223-18 (6) CCom), Italy (Art. 2475-bis CC), Austria (section 20 (2) öGmbHG) and – subject to limitations – Switzerland. Under Swiss law, the scope of representational authority is fundamentally measured based on the purpose of the company[51] – similar to the English-American ultra vires doctrine. Accordingly, the managing director's representational authority extends to all legal acts which could be justified by the business objects of the company (Art. 814 (4) in conjunction with Art. 718 a OR). In the interest of protecting the public, this statutory framework is understood broadly and includes all transactions which *could* be valid based on the corporate purpose and which are not expressly excluded by it. In addition, a limitation on the representational authority defined in this manner does not bind third parties acting in good faith.

The 'mandate nature' of the management body's function is made most explicit in the classic ultra vires doctrine of the English-American legal tradition. According to this doctrine, the company's legal capacity is limited by its objects as defined by the shareholders. As a result, the members of the management body may in no event obligate the company in a manner which goes beyond the will of the shareholders as declared in the articles. England finally bid farewell to this model with the Companies Act 2006 (section 39 (1)).[52]

In the case of **internal relationships** – i. e. the topics under discussion here involving the division of competences and hierarchy – important basic principles, in particular personnel competence of the general meeting of the shareholders (IV. 3, below, p. 83 et seq.), may still be traced back to the civil law 'mandatum'. This applies to the obligation on the part of the members of the management body to follow instructions in the case of the small corporation (e. g. section 37 (1) dGmbHG; section 20 (1) öGmbHG; Art. 31 (4) EPC statute; law of agency, e. g. section 664 (1) first sentence BGB) even if some of these items need to be separately provided for in the articles in some legal systems (Art. 815 (1) OR; in Italian law Art. 2475 (1) CC[53]). The duty of the members of the management body to safeguard the interests (of the company) likewise has its origins in the law of agency (section 43 (1) dGmbHG; section 25 (1) öGmbHG; Art. 812 (1) OR). The agent's duty of information and duty to render account (section 666 BGB) is codified in corporate law as an obligation owed to the single shareholder (section 51 a dGmbHG; Art. 2476 (2) CC). Similarly the ability to revoke the relationship at any time finds its analogue in agency law (section 671 (1) BGB, section 38 (1) dGmbHG; section 16 (1) öGmbHG; Art. 815 (1) OR; Art. L223-25 (1) CCom; Art. 2383 (3) CC by analogy[54]).

[51] On the following topic, see Schindler/Töndury, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, national report on Switzerland, p. 1528, marginal no. 147.

[52] Davies/Worthington, Gower and Davies' Principles of Modern Company Law, 9th ed., 2012, ch. 7–4 (p. 166 et seq.); Ebert/Levedag, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, national report on England, p. 707 et seq., marginal no. 521 et seq.; see also Witt, ZGR 2009, 872, 890; Mayson/French/Ryan, Company Law, p. 102 et seq.; Davies/Rickford, ECFR 2008, 48, 56; Möser, RIW 2010, 850, 851 et seq., 856.

[53] Regarding Italy, see Maffei Alberti, Commentario breve al diritto delle società, Art. 2475 CC comment. I 7.

[54] Maffei Alberti, Commentario breve al diritto delle società, Art. 2475 CC comment. IV 1.

IV. Delimitation of competences and hierarchy of the company organs

The delimitation of the shareholders' competences from those of the management body depends on the significance of the respective matter. The following applies as a rule of thumb: Matters which relate to the fundamentals of the company or the internal relationship between the shareholders are to be decided by the shareholders themselves. The same applies to the relationship between the company and the members of its management body. A comparative legal analysis shows that the matters assigned to the shareholders are mostly specifically enumerated where by contrast the management body is tasked with managing the business of the company without a more detailed description. In this case, the guiding principles can again be found in the civil law principles governing the mandate (mandate theory). This is to be illustrated below based on some competences of the general meeting of the shareholders within the small corporation. Thereafter, these will be compared to the particularities of the organisational structure in the large corporation.

1. Principle of general competence

In the small corporation, the shareholders are the "masters of the company", which is in line with the mandate theory. Accordingly, the general meeting of the shareholders is the supreme management body in the company.[55] It possesses general competence, i. e. it can fundamentally make any decision within the business by means of a resolution. Certain limits are provided in the form of protections for minority shareholders and management duties related to third party interests. Whether the general meeting of the shareholders has no competence to such an extent or whether one assumes the substantive illegality of certain resolutions, e. g. an instruction to the members of the management body to violate a law, is ultimately irrelevant. In any event, mandatory law acts as a boundary in the relationship to the management body which the shareholders may not cross whether by contractually expanding their statutory competence or by claiming the general competence of the general meeting of the shareholders. The contours of this boundary vary: Whereas German law codifies comparatively broad contractual freedom on the part of the shareholders even in relation to the transfer of competence to other bodies (section 45 dGmbHG), Swiss law contains a long catalogue of *non-transferable* powers of the general meeting of the shareholders found in Art. 804 (2) OR.

2. Fundamentals of the company

To start with, the most fundamental competence of the shareholders is the power to **amend the company's articles**. The articles represent the basic framework of the association out of which the material legal relationships between the company and the shareholders flow. The design of the association's basic framework is naturally the task of the shareholders because they are the ultimate bearers of freedom of contract within the association.[56] Accordingly, the competence of the general meeting of the

[55] The dogmatic issue of whether the "shareholders" are not the actual corporate decision-making body and the "general meeting of the shareholders" is merely a form of decision-making should be left open at the moment; on this issue, see Teichmann, in: Gehrlein/Ekkenga/Simon, dGmbHG, § 45 marginal no. 3 with additional citations.

[56] Zöllner, in: Baumbach/Hueck, GmbHG, § 53 marginal no. 3.

shareholders for purposes of amending the articles is generally recognised (section 53 dGmbHG; section 49 (1) öGmbHG; Art. 804 (2) no. 1 OR; Art. L223-30 (3) CCom; Art. 2479 (2) no. 4 CC; Art. 28 (1) SPE statute[57]). Nevertheless, even in this area there are isolated constraints on shareholder competence in the public interest, where for example French law permits the management body to make a modification to the articles to the extent this is necessitated by mandatory provisions of law (Art. L223-18 CCom). In addition, it appears to be a logical step when some legal systems also presuppose competence on the part of the general meeting of the shareholders to make binding **interpretations of the articles**. This may for example involve compliance with certain procedural rules related to certain measures which are set out in the articles or the clarification of the substantive requirements for certain measures.[58] Similarly, the **decision to dissolve the company** is of fundamental character. As actus contrarius to formation, this decision may likewise only lie within the competence of the shareholders (section 60 (1) dGmbHG; section 84 (1) no. 2 öGmbHG; Art. 804 (2) no. 16 OR; Art. L223-42 CCom; Art. 2484 no. 6 CC; Art. 28 (1) SPE Statute[59]). The members of the management body have no interest of their own in the continuation of the company.

The fundamentals of a company are likewise at stake where **protection against unwanted participation by third parties (Überfremdungsschutz)** is involved. In most cases, the instrument for this is provisions in the articles which subject the transfer of shares to company consent or to the consent of certain bodies within the company ("restriction on transfer clauses").[60] In German law, where the articles tie the transfer of shares to the consent "of the company" pursuant to section 15 (5) dGmbHG, the power to make a decision regarding the grant of such consent lies within the competence of the general meeting of the shareholders. The members of the management body may only give notice of such consent to third parties; internally they are bound by the instructions of the general meeting of the shareholders.[61] Other legal systems indirectly refer to the competence of the general meeting of the shareholders for the grant of this form of consent (Art. 804 (2) no. 8 OR; Art. L223-14 (1) CCom). In Austria, this competence appears to lie with the management body.[62] From a legal certainty standpoint, the Italian rule is preferable according to which consent on the part of "the company" is not provided for but rather the clause must precisely designate the relevant company body (Art. 2469 (2) CC).

Some legal systems include not only the legal framework of a company among its fundamental elements but also the **material base of the business conducted by the company**. They guarantee substantive protection to those shareholder rights which are threatened in multiple respects in the event of an obligation on the part of the company to pledge or transfer all corporate assets by means of singular succes-

[57] In the version of the compromise proposed by Hungary (Council doc. 10611/11 = 11786/11) for the SPE Project, see *supra*, Chapter 1, III 3, p. 23 et seq.

[58] BGH NZG 2003, 127.

[59] In the version of the compromise proposed by Hungary (Council doc. 10611/11 = 11786/11) for the SPE Project, see supra, Chapter 1, III 3, p. 23 et seq.

[60] Section 15 (5) dGmbHG; section 76 (2) third sentence öGmbHG; Art. 2469 (2) CC; section 16 (2) SPE Statute.

[61] Roth/Altmeppen, GmbHG, § 15 marginal no. 100.

[62] Beer, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, national report on Austria, p. 1294, marginal no. 137.

sion.[63] It may also be reasonable in such cases for the lawmaker to set limits on the management authority in the company's organisational structure itself. That is because in such cases there is absolutely a risk that, on its own initiative, the management body will deprive the company of the material basis of its entrepreneurial activities on terms which in fact harm the shareholders' business interests.

Recent developments in **France** go very far in that direction. Under Art. 1849 of the French civil code, in the relationships with third parties, a manager binds the partnership (for non-commercial purposes) through transactions which are within the objects of the partnership; clauses of the articles limiting the powers of the managers may not be invoked against third parties. Until 2012, French judges have recognized the validity of an enhancement provided in the form of a mortgage or other guarantee referred to the company's immovable property; even where such was to guarantee for the debt of a third party, e. g. the parent company of the company providing the guarantee. In a much discussed judgment of 12 September 2012, the Civil Chamber of the French Cour de Cassation held that such a guarantee was invalid "if against the interest of the company"; when threatening its very existence (because it included nearly the whole of the company's assets), and that the managers of the company therefore had no authority to bind the company.[64] Interestingly, the unanimous shareholders' resolution in favour of the guarantee was irrelevant in this case. The "**interest of the company**" was defined from the **creditors' perspective**!

Also exemplary of this issue is a **sale of corporate assets** to the majority shareholder followed by the dissolution of the company. In this scenario, the minority runs the risk of not only losing their share as a legal position, but also the economic value of their equity interest. In German and Austrian law, restrictions on management competence like those set out in section 179 a dAktG or section 237 öAktG, aim to provide a certain degree of protection against these risks to the shareholders' property; although it is doubtful whether this protection is truly sufficient from the point of view of constitutional property guarantees[65] in the particular scenario of a dissolution by means of asset transfer. According to section 179 a dAktG, a contract pursuant to which a public limited company obligates itself to transfer its entire corporate assets also requires a resolution of the general meeting under certain circumstances if it is not associated with a change in the objects of the company. This consent requirement has a dual legislative purpose. On the one hand, it safeguards freedom of disposal on the part of the shareholders: They are protected against having management surrender or subject to outside influence the assets of the company which comprise the basis for its business activities as set out in its articles.[66] Under German law, the consent of the general meeting is even intended to be a prerequisite to the effectiveness not only of the transfer itself but also of the mere obligation of the company to transfer the asset(s).[67] Absent a valid consent resolution from the general meeting, the transfer agreement is not effective as against third

[63] On the following topic, see Stein, in: MüKoAktG, § 179 a marginal no. 5 et seq.

[64] Cass Civ 12.9.2012, Rev Soc 2013, 16 note Viandier = Droit Sociétés 2013, 14 note Mortier. See also the brief outline by Mondini, Rivista delle società, 2013, p. 293 et seq.

[65] Regarding constitutional protection of share ownership, see most recently BVerfG NZG 2012, 826 subsection C I 1 a – Delisting.

[66] BGHZ 82, 188, 195 f. = NJW 1982, 933 – Hoesch/Hoogovens; BGHZ 83, 122, 128 = NJW 1982, 1703 – Holzmüller.

[67] BGHZ 169, 221, 228 = NJW 2007, 300 – Massa/Metro.

parties. The consent requirement thus limits both the management as well as representational authority of the board by operation of law. It remains to be seen whether the position taken by German law is compatible with Art. 10 Disclosure Directive.[68] In addition, the consent requirement protects the shareholders against inappropriate contractual terms which do not provide for appropriate consideration in exchange for the transfer of corporate assets thereby harming the shareholders' property interests.[69]

The legislative purposes of the consent requirement set out above are not specific to the large corporation. It thus comes as no surprise that, for example, German law has recognised the analogous application of section 179 a AktG to the private limited company. The discussion of this issue illustrates the general character of this competence norm. The issue of corresponding application is frequently discussed in the literature on laws related to private limited companies under the heading "de facto amendment to the articles" or "de facto change in the objects of the company" and this is exactly what is involved in substance in the case of a transfer of corporate assets.[70] Regarding the legal consequences, there is consensus that a resolution amending the articles requires a qualified majority (in German law, section 53 (2) GmbHG) and likewise that the conclusion of the agreement is not within the competence of the management body without the consent of the shareholders. A certain capital majority is not required, however the likely dominate view would require notarial authentication[71] analogous to section 53 (2) GmbHG. In specific cases, contracts within the scope of section 179 a AktG could be the equivalent of a change in the business object, namely where the formerly operating company is de facto transformed into a liquidating company. In such cases, there are many arguments in favour of requiring the **consent of all shareholders** (section 33 BGB).

3. Personnel competence

a) Appointment and removal of members of the management body. In the small corporation, the core of the general meeting of the shareholders' personnel competence is the power to appoint and remove managing directors. This power is widely recognised in the law (section 46 no. 5 dGmbHG; section 15 (1) öGmbHG; Art. 804 (2) no. 2 OR; Art. L223-25 in conjunction with Art. L223-29 CCom; Art. 2479 (2) no. 2 CC; Art. 28 (1) SPE statute[72]). The reason for having this personnel competence located in the general meeting of the shareholders is based on the central requirement that there must be an **unconditional relationship of trust** between the members of the management body and the shareholders. Of course, this does not rule out limitations on the personnel competence of the general meeting of the shareholders through specific provisions in the articles. For example, the articles

[68] Directive 2009/101/EC dated 16 September 2009, OJ dated 1 October 2009, L 258/11; see additionally Lutter/Bayer/Schmidt, EuropUR, § 19 marginal no. 68 et seq., p. 442 et seq.

[69] See Stein, in: MüKoAktG, § 179 a marginal no. 7, with citations.

[70] See additionally, Leitzen, NZG 2012, 491, 493, also regarding the following topic.

[71] Stellmann/Stoeckle, WM 2011, 1983, 1987; Priester/Veil, in: Scholz, GmbHG, § 53 marginal no. 176; Eickelberg/Mühlen, NJW 2011, 2476, 2480 et seq.; Marquardt, in: Priester/Mayer (ed.), Münchener Hdb. d. GesellschaftsR, Bd. 3, 3rd ed., 2009, § 22 marginal no. 90.

[72] In the version of the compromise proposed by Hungary (Council doc. 10611/11 = 11786/11) for the SPE Project, see *supra*, Chapter 1, III 3, p. 23 et seq.

may grant nominating rights to shareholders or third parties or may also provide for rights to appoint a member or mandatory representation rights on the part of specific shareholders. Even the transfer of competence to another body, such as an optional supervisory board is possible in many cases and is legitimate because these types of provisions in the articles are supported by the will of the shareholders. The general meeting of the shareholders frequently has the power to audit and monitor company management in addition to the power to make fundamental decisions within its personnel competence area (appointment, removal) (section 46 no. 6 dGmbHG; section 35 (1) no. 5 öGmbHG). This rule, which may be deviated from in most cases, is also an expression of the hierarchical relationship between the general meeting of the shareholders and company management.

b) Discharge. The same applies with respect to the power to discharge the members of the management body (section 46 no. 5 dGmbHG; Art. 804 (2) no. 7 OR). The discharge is a corporate law-based declaration which has a certain preclusive effect due to the endorsement contained therein. Based on its discharge declaration, the company is precluded from asserting any claims against the members of the management body which were discernible to the body providing the discharge – the general meeting of the shareholders – based on the rendering of account along with all documentation provided applying the standard of care required in business matters. What is involved is the approval for past actions by company management and an expression of confidence for the future.[73] The fact that competence to issue the discharge lies with the general meeting of the shareholders is also logical because the general meeting of the shareholders likewise has the authority to assert claims for damages against the members of the management body in connection with the formation as well as the management of the company (section 46 no. 8 dGmbHG; section 35 (1) no. 6 öGmbHG). The French rule on this issue is noteworthy (Art. L223-22 (4) CCom) according to which the assertion of such claims by the company may not be subject to a decision on the part of the shareholders. This rule visibly takes the creditor protection component of the assertion of claims for damages into account. This is because the successful assertion of such claims restores impaired corporate assets, thereby improving prospect of payment on the part of the company's creditors. From a procedural standpoint, it is important in many instances that the general meeting of the shareholders represents the company in litigation against members of company management in order to avoid personal conflicts of interest on the part of other management team members (section 46 no. 8 dGmbHG; section 35 (1) no. 6 öGmbHG).

c) Limitations on personnel competence through employment law? Recently, significant **limitations on the personnel competence** of the general meeting of the shareholders have resulted from **European employment law** the final consequences of which cannot yet be foreseen (and which were probably not at all intended by European lawmakers). In this regard, the leading case is a ruling from the German Federal Court of Justice (BGH) on the applicability of the Allgemeines Gleichbehandlungsgesetz [German General Non-Discrimination Act] (AGG) to the

[73] BGHZ 94, 324 = NJW 1986, 129; Roth/Altmeppen, GmbHG, § 46 marginal no. 30.

appointment of management body members.[74] Under German law, the conclusion of a service agreement with the managing director is a transaction separate and distinct from the act of appointment.[75] When filling a vacant managing director position, the supervisory board of a German private limited company (GmbH) decided not to extend the fixed-term contract of the 61 year-old managing director but rather to give priority to a 41 year-old applicant for the same position. The company publicly explained the decision based on the difference in age between the applicants. The BGH found that to be an impermissible, age-based discrimination against the 61 year-old pursuant to section 7 (1) AGG. Among others, the AGG implements the EU Directive establishing a general framework for equal treatment in employment and occupation (CD 2000/78/EC) Art. 1 of which prohibits age-related discrimination in accessing employment and self-employment. Pursuant to section 6 (1) AGG, "employees" within the meaning of the law are, among others, persons in a dependent employment relationship; certain provisions of the AGG apply correspondingly to members of the management body (section 6 (3) AGG) to the extent – as is relevant here – the conditions for access to employment as well as professional advancement are implicated. The BGH determined that the AGG is applicable to the staffing of the managing director position at a GmbH pursuant to section 6 (3) AGG not only with respect to the employment agreement but also with respect to membership in the management body – and it is the latter which represents the **intrusion into the personnel competence of the general meeting of the shareholders**.[76] In the view of the BGH, discrimination-free "access to employment" guaranteed by section 6 (3) AGG is only complete if it also applies to the appointment of a managing director in the corporate setting because without such appointment the employment agreement could not be performed. Beyond that, it is doubtful in general whether managing directors who hold no shares in the company they represent (third-party managers) constitute employees within the meaning of section 6 (1) AGG. The BGH did not address this issue. If that is the case, the AGG would not only be applicable to third-party managers with regard to access to employment and professional advancement but rather with regard to every measure undertaken by the company. Interestingly, the BGH also referred to the CJEU decision in the Danosa matter.[77] In that case, the CJEU affirmed the application of the EU Directive on Maternity Leave[78] to the female manager of a GmbH. Accordingly, one must assume that German courts at least will in future classify third party managers of a GmbH as employees within the meaning of section 6 (1) AGG in the course of construing the Act in conformance with

[74] BGH dated 23 April 2012, II ZR 163/10, NJW 2012, 2346 – Kliniken der Stadt Köln GmbH; see also Maiß, GWR 2012, 294; Miras, GWR 2012, 335011 = GWR 2012, 311; reprinted also in GmbHR 2012, 845 with comments from Brötzmann.

[75] Kindler, Grundkurs Handels- und Gesellschaftsrecht, § 14 no. 46 et seq.; K.J. Müller, The GmbH. A Guide to the German Limited Liability Company, 2009, p. 37.

[76] BGH NJW 2012, 2346 subsection 19.

[77] Case C-232/09, *Dita Danosa/LKB Lizings SIA* (2010) ECR I-11405 = GWR 2010, 586 with comments from Bauer.

[78] Council Directive 92/85/EEC of 19 October 1992 on the introduction of measures to encourage improvements in the safety and health at work of pregnant workers and workers who have recently given birth or are breastfeeding dated 19 October 1992, OJ No. 348 p. 1, Celex-No. 3 1992 L 0085; last amended by Art. 3 no. 11 Amendment 2007/30/EC dated 27 June 2007 (OJ No. L 165 p. 21).

European law.[79] Additionally, the BGH made clear that access to employment pursuant to section 6 (3) AGG not only includes first-time access but rather all cases in which an employment agreement with a fixed term ends and the manager who had been acting to date/the retired manager reapplies for the position. In the view of the court, the same protection against discrimination enjoyed by every other applicant applies to the still-acting or prior manager as well.[80] The court then closed any gaps in protection for members of the management body through the additional statement that the **removal of a member of the management body** (e. g. pursuant to section 38 GmbHG) on grounds that are prohibited under section 1 AGG is **forbidden**[81] and in doing so the court entered the realm of corporate law.

However, in the event of prohibited discrimination related to a hiring decision, the person discriminated against has only a secondary claim to compensation for damages (section 15 (1) AGG) and to reasonable compensation in money (section 15 (2) AGG). Restitution in kind, meaning the creation of an employment relationship – and thereby appointment to the management body – is however expressly excluded based on the German implementing regulations for the Equal Treatment Directive (section 15 (6) AGG). Nevertheless, these claims may also painfully affect the company and even their impending assertion may **influence the decision of the general meeting of the shareholders**.

d) Shareholder liability for ineligible managers. Finally, the protection of third parties is implicated in the exercise of personnel competence by virtue of regulations which impose personal liability on the part of the shareholders when they entrust company management to someone who cannot be a manager. These forms of barriers to appointment are found in all corporate law codifications (e. g. section 6 (2) dGmbHG; section 15 (1) second sentence öGmbHG; Art. 809 (2) and 814 (3) OR; Art. L223-18 CCom;[82] Art. 2382 CC[83]). They may involve status as a natural or legal

[79] Based on prior German case law, the managers of a GmbH were not employees, regardless of whether or in what amount they held shares in the GmbH (BAG NZA 2009, 669). The decisive factor for this conclusion was that the management exercised the management function as statutory representative of the GmbH and could not simultaneously represent the employer and its dependent employee. In its jurisprudence based on the Anti-Discrimination Directives (2000/43/EC and 2000/78/EC), the CJEU by contrast relied upon a functionally-based definition of employee the constituent element of which include dependence on instructions, the degree of control and the ability to be dismissed by other company organs (CJEU ibid. – Danosa). The result is now that a third-party company manager must be classified as an employee within the meaning of section 6 (1) AGG due to his dependence on instructions, comprehensive duty to render account and ability to be dismissed at any time. Accordingly, in the case of the third-party manager, the prohibition on discrimination does not apply to hiring and promotion but rather on issues of compensation and other measures under section 2 (1) AGG.

Members of the board of management of a *public limited company* who are employees and who do not own any or any significant share in the company are not to be classified as employees within the meaning of section 6 (1) AGG due to their independence guaranteed in section 76 (1) AktG and the limited grounds for removal pursuant to section 84 (3) AktG; for a different approach, see Fischer, NJW 2011, 2329, 2331.

[80] BGH NJW 2012, 2346 subsection 21.

[81] BGH NJW 2012, 2346 subsection 23.

[82] See Karst, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, national report on France, p. 899 et seq., marginal no. 121.

[83] This provision concerning public companies (spa) applies in a corresponding manner to the private company (srl): Dolmetta/Preti/Bianchini, S.r.l. – Commentario dedicato a Giuseppe B. Portale, 2011, Art. 2475 CC comment A 15 et seq. (p. 529 et seq.).

person, or legal capacity, status as a citizen or non-citizen as well as domicile, the lack of certain exclusionary criteria such as lack of capacity, prohibitions on the exercise of a profession or business or criminal convictions. Pursuant to section 6 (5) dGmbHG, shareholders who entrust management to a person who is not eligible to serve as manager either intentionally or through gross negligence are liable to the company. This liability includes damages resulting from the fact that this person has violated his or her obligations to the company. The idea behind this provision is that there is necessarily a responsibility on the part of the shareholders to ensure that "their" company can be properly managed.[84] Liability merely requires that the shareholders have "entrusted" management of the business to an ineligible person. Accordingly, liability is not imposed solely for faulty acts of appointment. Instead, the shareholder acts in contravention of his duties if an ineligible person in fact – that is regardless of an act of appointment whether void or later meaningless – manages the business and the shareholder does not intervene (de facto director).[85] This also includes the case where a person who is not eligible by law in fact acts on behalf of the company without an act of appointment. Even though this is framed in terms of internal liability to the private limited company, the **slant toward protecting third parties' interests** is obvious. This liability is mostly first asserted during insolvency so that the amount of the liability is available to the entirety of the creditors. There are also good reasons for an independent right to institute proceedings on the part of company creditors if they cannot obtain any satisfaction from the company.[86]

e) Analysis. On the whole, the rules regarding personnel competence demonstrate a high degree of conformity in the sense that the general meeting of the shareholders plays an exceptionally prominent role. This is even made mandatory in some cases (for Swiss law see Art. 804 (2) OR). In some instances, one encounters surprising rules such as that provided under French law according to which no requirement of a corresponding shareholder resolution may be established in the articles for the assertion of claims for compensation (Art. L223-22 (4) CCom). External dangers in the form of contractual obligations on the part of the company threaten the shareholders' freedom of decision. In certain circumstances, the classification of members of the management body as employees can – in the case of unlawful termination/removal – even justify a claim to establish an employment relationship as a member of the management body.[87] At the same time, it became clear that personnel competence must also be exercised under consideration of third party interests in certain respects. This is illustrated by shareholder liability for ineligible managers (section 6 (5) dGmbHG).

4. Financial structure

One significant core financial competence of the general meeting of the shareholders in the small corporation first of all relates to approving the annual financial statements (section 46 no. 1 dGmbHG; section 35 (1) no. 1 öGmbHG; Art. 804 (2) no. 5 OR; Art. L223-26 CCom; Art. 2364 no. 1, 2479 (2) no. 1 CC). This consists of

[84] Goette, in: MüKoGmbHG, § 6 marginal no. 49 et seq.; Roth/Altmeppen, GmbHG, § 6 marginal no. 27 et seq.
[85] Roth/Altmeppen, GmbHG, § 6 marginal no. 27.
[86] Lutter/Hommelhoff/Kleindiek, GmbHG, § 6 marginal no. 59.
[87] Section 6 (3) AGG; see BGH GmbHR 2012, 845.

the balance sheet as well as the profit and loss account and the notes (Art. 2 (1) Accounts Directive). At the same time, in the small corporation, the management body is always responsible for preparing the draft balance sheet – which always precedes approval of the annual financial statements (cf. section 264 (1) second sentence dHGB; section 222 (1) öUBG).[88] The circumstance that the shareholders likewise have primacy over the management body in this regard is particularly clear in the power of the general meeting of the shareholders to make changes to the draft balance sheet prepared by the management body. In doing so, the shareholders are bound solely by principles of accounting law and the mandatory provisions of the company's articles. The decision regarding the **appropriation of profits** must be legally separated from approval of the annual financial statements even if both decisions are regularly tied together in practice. Appropriating profits also lies within the competence of the general meeting of the shareholders in the legal systems reviewed as part of this study (section 46 no. 1 dGmbHG; section 174 (1) first sentence dAktG; section 35 (1) no. 1 öGmbHG; Art. 804 (2) no. 5 OR; Art. L232-22 CCom; Art. 2479 (2) no. 1 CC). This decision involves the use of the net income for the year, i. e. the genuine entrepreneurial decision of whether to distribute the profits earned or to invest them in the business. In the case of the small corporation, this decision is left to the shareholders.

5. Particular features of the organisational structure of large corporations

a) Variety of organisational structures. The organisational structure of large corporations is more complex to the extent that supervision over company management is assigned to specific bodies or persons. This is performed either by specific members of the management body itself (monistic system) or by a separately established supervisory body (dualistic system).[89] German corporate law, according to which the public limited company is required to have three bodies, is exemplary of the dualistic system: Management board, supervisory board and general meeting. To some extent, the legal systems analyzed in this study offer the shareholders the choice of different organisational models as is also provided in the SE Regulation (Art. 38 (b)). In this regard, **Italian law** as provided in the major corporate law reform of 2004 is representative of such a combination model:

The "Riforma Vietti"[90], based on law no. 366 of 3 October 2001,[91] was supposed to promote the origination, growth and competitiveness of Italian companies and to create new options for accessing the capital markets. One regulatory focal point of the legislative decree of 17 January 2003[92] promulgated under this law, which is of

[88] In the case of the large corporation, the competence to approve the annual financial statements may be held by the supervisory body which must also safeguard the interests of the shareholders in this regard: sections 172, 173 dAktG; section 125 (2) öAktG; in the "dualistic" Italian società per azioni: Art. 2409-terdecies lit. b CC.

[89] Discussed previously under I. above, p. 74 et seq.

[90] Named after Michele Vietti, the then chair of the Commissione ministeriale per la riforma del diritto societario; on the following topic, see Kindler, ZEuP 2012, 72 et seq.

[91] See Fusi/Mazzone, La riforma del diritto societario. Commento sistematico alla legge delega 3 ottobre 2001, n. 366, 2001; Buse, RIW 2002, 676 et seq.; a comprehensive documentation of the reform (with material, comments from industry and science) may be found in Rivista delle società (Riv. soc.) 2002, 1345 et seq.

[92] D. lgs. 17 gennaio 2003, n. 6.– Riforma organica della disciplina delle società di capitali e società cooperative, in attuazione della legge 3 ottobre 2001, n. 366; see Angelici, La riforma delle

interest for purposes of our study, was the introduction of several options in establishing the organisational structure.

aa) "Traditional" system.[93] Since the reform, the shareholders of Italian public limited companies (società per azioni) have a choice between three different organisational forms.[94] In the conventional "traditional" system – still the standard according to the Italian civil code – the general meeting (assemblea dei soci)[95] appoints the company management (amministratori), decides their compensation and, if needed, removal, passes extraordinary resolutions (capital increases and reductions, conversions (changes in entity form), mergers, splittings, dissolution, etc.) and approves the annual financial statements (Art. 2380 to 2409-septies CC). The traditional system is characterised by a **strong general meeting** (Art. 2364 CC) and a **weak position for management**, in particular the **supervisory body**.[96] For example, the articles may provide that certain measures to be taken by company management are subject to the consent of the general meeting (Art. 2364 (1) no. 5 CC – competenza gestionale dell'assemblea).[97]

In the event that two or more managers have been appointed, they comprise an administrative board which functions as a collegial body (consiglio d'amministrazione – c.d.a.); otherwise a single manager (amministratore unico)[98] is solely responsible for managing the company. The managers may – in the interest of the company's ability to act – transfer their responsibilities in part to an executive committee (comitato esecutivo) which consists of one or more members of the company management (Art. 2381 (2) CC). This transfer requires the relevant authorisation in the company's articles or a simple resolution from the general meeting. The ability to petition to avoid decisions of the consiglio di amminis-

società di capitali; Galgano, Il nuovo diritto societario; Santosuosso, La riforma del diritto societario; Abbadessa/Portale (eds.), Le nuove società di capitali, 3 Bde.; Abriani et al., Diritto delle società, 3. ed., 2006; in the German literature Bader, Aktuelle Entwicklungen im italienischen Kapitalgesellschaftsrecht, Jahrbuch für Italienisches Recht (JbItalR) 19 (2006), 37 et seq.; see also, e. g. Hartl, NZG 2003, 667 et seq.; Steinhauer, EuZW 2004, 364 et seq.; Tombari, in: FS Erik Jayme, Bd. 2, 2004, p. 1589 et seq.; in English see Ferrarini/Giudici/Stella Richter, RabelsZ 69 (2005), 658 et seq.; Hilpold/Brunner, ZVglRW 2006, 105, 519 et seq.; overview with extensive citations in Kindler, Einführung in das italienische Recht, § 18 marginal no. 12 et seq.; Magrini, Italienisches Gesellschaftsrecht; for a comparison of the old and new articles in the Codice civile see Il Foro italiano (Foro it.) 2003, Riforma del diritto societario, Decreto legislativo 17 gennaio 2003, n. 6 (Testo a fronte a cura della redazione), Inserto pubblicitario.

[93] Also referred to as the "sistema latino", cf. Santosuosso, La riforma del diritto societario, p. 149 et seq.

[94] With an introduction to the topic, see Atlante, I tre modelli di gestione della s.p.a.: la prospettiva del notaio, Rivista del notariato (Riv. not.) 2003, 531 et seq.; Buonocore, Le nuove forme di amministrazione nelle società di capitali non quotate, Giurisprudenza commerciale (Giur. comm.) 2003, I, 389 et seq.; Rordorf, Le società per azioni dopo la riforma: il sistema dei controlli, Foro it. 2003, V, 184, 186 et seq.; comparative legal analysis of the various options at hand in Hirte, in: FS Thomas Raiser, 2005, p. 839 et seq.

[95] See Art. 2364 CC regarding their competences.

[96] In-depth analysis and comparison of the legal situation prior to the Riforma Vietti in Abbadessa/Mirone, Le competenze dell'assemblea nelle s.p.a., Riv. soc. 2010, 269 et seq.

[97] For additional analysis, see Abbadessa/Mirone, Le competenze dell'assemblea nelle s.p.a., Riv. soc. 2010, 318 et seq.; Santosuosso, La riforma del diritto societario, p. 101 et seq.; see additionally Portale, Lezioni di diritto privato comparato, 2nd. ed., 2007, p. 191 et seq.

[98] Art. 2386 (5) CC.

trazione, namely on the part of the shareholders, was introduced as a new feature (Art. 2388 (4) CC).[99]

A so-called monitoring council (collegio sindacale) monitors compliance with the laws and company's articles by the management (Art. 2397 et seq. CC). The responsibilities of the *collegio sindacale* were redefined as part of the reform. Since then, the monitoring council is generally required to monitor compliance with the law and company's articles as well as the "principles of proper business management" (Art. 2403 CC). In this respect, it is an ancillary organ of the general meeting and thus indirectly of the minority shareholders.[100] A different rule applies in the case of the annual audit. Under Art. 2409-bis CC, this is the responsibility of an auditor or an auditing company. The articles of companies not subject to mandatory consolidation[101] may determine that the collegio sindacale is responsible for the annual audit in which case only registered auditors may belong to this body.[102]

bb) "Dualistic" system. Instead of the monistic system, shareholders may elect what the law terms the "dualistic system" based on the example of German law (Art. 2409-octies to 2409-quiquiesdecies CC).[103] It is characterised by a weak general meeting (Art. 2364-bis CC) and a **strong position of the management**, in particular the supervisory board.[104] In this case, the company's management consists of a management board with at least two members (consiglio di gestione)[105] and a supervisory board (consiglio di sorveglianza). As is the case in the German law of public limited companies (section 84 dAktG), the general meeting has no direct influence on the appointment and removal of members of the management board. It merely appoints the members of the supervisory board which in turn appoints and dismisses the members of the management board (Art. 2409-terdecies lit. a CC).[106] In addition, the supervisory board, rather than the general meeting, is responsible for approving the annual financial statements (Art. 2409-terdecies lit. b CC). Furthermore, the supervisory board must monitor compliance with laws, the company's articles and the "principles of proper business management" as does the monitoring council in the traditional system. In addition, it is fundamentally responsible for determining the compensation of management board members and approving the annual financial statements.

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[99] Correctly asserting a critical view Hirte (in: FS Thomas Raiser, 2005, p. 839 et seq.) because shareholders frequently do not learn of resolutions passed by the consiglio d'amministrazione (cf. the weak information rights of the shareholder in a public limited company as defined in art. 2422 Abs. 1 CC).

[100] Galgano, Il nuovo diritto societario, p. 296; Hirte, in: FS Thomas Raiser, 2005, p. 851.

[101] Regarding the duty to consolidate, see Art. 25 et seq. D. lgs. 9 aprile 1991, n. 127; see additionally Kindler, Italienisches Handels- und Wirtschaftsrecht, § 2 marginal no. 74 et seq.; ders., ZGR 1995, 225 et seq.

[102] Regarding companies which are included within the term of legal entities of public interest ("Ente di interesse pubblico"), see Kindler, ZEuP 2012, 72, 75.

[103] Cf. also Art. 39 et seq. SE Regulation.

[104] Abbadessa/Mirone, Le competenze dell'assemblea nelle s.p.a., Riv. soc. 2010, 339: "Il modello di amministrazione di tipo dualistico … comporta una significativa riduzione delle competenze spettanti all'assemblea ordinaria dei soci, che vengono trasferite all'organo di controllo, e cioè al consiglio di sorveglianza."; similar Santosuosso, La riforma del diritto societario, p. 160.

[105] The management body may also form a committee in the dualistic system: Art. 2409-novies in conjunction with Art. 2381 CC.

[106] See 2364-bis CC regarding the competences of the general meeting.

cc) "Monistic" system. There is only one management body in the "monistic system" based on the Anglo-American model (Art. 2409-sexiesdecies CC to Art. 2409-noviesdecies CC)[107] which is the third option. As is the case with the traditional organisational structure,[108] it is described as the administrative board (consiglio di amministrazione – c.d.a.). At least one-third of the administrative board must – and this makes the influence of U.S. law clear – consist of independent members (amministratori indipendenti).[109] The lack of certain corporate interrelations is not the only criteria for such purposes. In addition there may be no familial relations between the amministratori.[110] As in the traditional system, the central competences reside in the general meeting (personnel competence, approval of the financial statements; Art. 2364 CC).

The administrative board contains a ‹control committee' (comitato per il controllo sulla gestione) which monitors the suitability of the company's organisational structure and the appropriateness and suitability of the company's management and accounting systems. At least one member of the control committee must be a registered auditor (revisore contabile). The control committee cannot assume any company management responsibilities and its members may not be members of the executive committee (comitato esecutivo, Art. 2409-noviesdecies in conjunction with Art. 2381 (2) CC) while serving on the control committee. The administrative board establishes the number of members on the control committee and appoints them.

b) The dualistic system. Other legal systems have selected s**olutions permitting options** only to some extent. This is the case in **France**, for example, where the SA nevertheless has fundamentally a hierarchical structure and the individual organs are assigned mandatory responsibilities and powers by law.[111] However, French law permits organisational freedom to the extent that the shareholders may choose between two organisational schemes for an SA. The classical, monistic model has an administrative board (conseil d'administration) and an executive officer (Art. L225-17 et seq. CCom). The modern, dualistic model has a board of directors (directoire) and a supervisory board (conseil de surveillance) (Art. L225-57 et seq. CCom). The latter model follows the supervisory board model under German law, however has hardly enjoyed acceptance in practice.[112]

To this extent, corporate practice resembles that of **Italy** where companies have largely retained the traditional system even though in Italy – as described – several organisational structure options have been available to select from as well since 2004. This may be due to the fact that the shareholders see no need to forgo existing opportunities to exercise influence, i. e. to exchange the broad competences under

[107] In the SE Regulation: Art. 43 et seq.

[108] See aa) above.

[109] Hirte, in: FS Thomas Raiser, 2005, p. 855; see also Ferrarini/Giudici/Stella Richter, RabelsZ 69 (2005), 658, 677 (2005); Angelici, La riforma delle società di capitali, p. 119.

[110] Art. 2409-septiesdecies CC refers to the corresponding grounds for ineligibility for members of the control body in the traditional system (Art. 2399 CC). The background is no. 131. of the recommendation of the EU Commission dated 15 February 2005 on the duties of the non-managing directors/supervisory board members/listed companies as well as the committees of the administrative/supervisory board dated 15 February 2005, OJ 2005 L 51/51.

[111] Fundamental here the "arrêt Motte", JCP 1947, II, 3518; see Großerichter, in: Sonnenberger/Classen (eds.), Einführung in das französische Recht, No. 157.

[112] See fn. above.

the traditional system (Art. 2364 CC) for the limited catalogue of responsibilities under the dualistic system (Art. 2364-bis CC). However, the traditional Italian model (see b aa, above, p. 89 et seq.) also may be characterised as **dualistic in a broader sense** because a body set up in addition to the management body is responsible for monitoring activities, namely the monitoring council.

The situation in **Switzerland** is similar. There, the public limited company is required to have three bodies: The general meeting (Art. 698 et seq. OR), the administrative board (Art. 707 et seq. OR) and the audit committee (Art. 727 et seq. OR). Under this system, primary decision-making authority such as adopting and amending the articles and approving the appropriation of profits is the task of the general meeting. The administrative board has a certain hybrid character because it has both business management and supervisory duties (Art. 716 (2) OR). In addition, the audit committee performs important monitoring duties with regard to the accounting and annual accounts as well as the request for the use of the disposable profits (Art. 728 et seq. OR).

By contrast, **Austrian law** follows the classical dualistic system modelled after German corporate law. This is based on the introduction of the German AktG 1937 in the year 1938.[113]

From a comparative law standpoint, the central contrast to the dualistic model of organisational structure in the case of the small corporation is that in the large corporation the **representational body of the shareholders ("general meeting") does not have superior standing compared to the management body**. The primary decision-making powers lie with the management body (board of directors) even if certain fundamental decisions are also allocated to the shareholders here.[114] Accordingly, in the case of the large corporation, each body fundamentally acts on an independent basis in performing its duties and exercising its competences. There is no hierarchy between the bodies. Under the dualistic organisational structure, in the case of the large corporation primary business management responsibility is in the hands of the management body which – other than is the case for the management of the small corporation – is not subject to instructions issued by the shareholders' meeting (§ 76 (1) dAktG; § 70 (1) öAktG; Art. 716 a no. 1 OR; Art. L225-35 CCom; Art. 2380-bis para. 1 CC; in addition Art. 39 (1) SE Regulation). The management body thus administers and shapes the business operated by the company whereby – following the mandate theory, III, above, p. 77 et seq. – the interests of the shareholders must be appropriately taken into account. As is the case with the small corporation, the management body is entitled to exercise a broad degree of business judgment (cf. section 93 (1) second sentence dAktG).[115]

The **supervisory board** monitors and advises the board of directors (section 111 dAktG; section 95 öAktG; Art. L225-68 CCom) and exercises personnel competence to the extent that it is responsible for the selection, appointment and removal of members of the board of directors (section 84 dAktG; section 75 öAktG; Art. L225-59 (1) CC; Art. 2409-terdecies (1)(a) CC). In a real dualistic

[113] Kalss/Burger/Eckert, Die Entwicklung des österreichischen Aktienrechts, p. 328 et seq.

[114] See on this issue, the competence norms in section 119 (1) dAktG; section 103 (1) öAktG; Art. 698 OR; Art. 2364 CC.

[115] Regarding business judgment in Italian corporate law, see Kindler, ZEuP 2012, 72, 92 et seq.; on the same topic in Austrian corporate law, cf. Nowotny, in: Doralt/Nowotny/Kalss, öAktG, § 84 marginal no. 8; Kalss, in: MüKoAktG, § 93 (D) marginal no. 302.

system (Germany, Austria, dualistic SE), the shareholders decide who sits on the supervisory body to the extent that rules on the involvement of employees in the company do not require an employee representative on the supervisory board, or that single shareholders have rights to appoint members (section 101 dAktG; sections 87, 88 öAktG; Art. 40 (2) SE Regulation). Neither the shareholders (cf. section 119 (2) dAktG) nor the supervisory body (section 111 (4) first sentence dAktG; section 95 (5) öAktG) have decision-making powers in matters of business management. The institutional separation of company management and monitoring company management represents a characteristic difference compared to the internationally prevalent monistic model which is distinguished by a unitary management body (board of directors) (cf., e. g. Art. 43 SE Regulation).[116] In the case of the dualistic system, the shareholders likewise have no freedom to change the organisational structure scheme. Thus, the shareholders do not have the ability to eliminate the supervisory board via company articles or to replace it with a board of directors based on examples from abroad. In German and Austrian law, this is based on the principle of "**Satzungsstrenge**" (meaning that company articles may only depart from a provision of law to the extent this is expressly provided for in the relevant law) (section 23 (5) dAktG; sections 16, 17 öAktG).[117] In the legal systems with dualistic organisational structures, the only option for avoiding this model is to have the shareholders opt for a small corporation from the outset or – as is possible in Italy or under the SE Regulation – opt for the monistic model.

c) Company management ("corporate governance"). The term "corporate governance" covers the entirety of regulations addressing the organisational and substantive design of the management and monitoring of enterprises.[118] The EU Commission has likewise taken up this topic – most recently for example in its "Green Paper The EU Corporate Governance Framework" from April 5, 2011.[119] According to the Green Paper, Corporate governance is defined as the system by which companies are directed and controlled, and as a set of relationships between a company's management, its board, its shareholders and its other stakeholders.[120] The issues regarding corporate governance are also of interest to our discussion of the organisational structure to the extent they relate to the **professionalization and strengthening the supervisory board** as a monitoring body. Over the course of the past several years, there has been a shift in focus at least in the German discussions and developments insofar as the focus of the supervisory board's duties is no longer seen as only retrospectively monitoring the acts of the board of directors. German lawmakers have strengthened and expanded the powers and obligations of the supervisory board related to its control function through a series of statutory amendments. The supervisory board is now an "entrepreneurial

[116] For additional information, see Hellgardt/Hoger, ZGR 2011, 38 et seq.

[117] Although the öAktG does not contain a provision limiting indepdence regarding company statutes corresponding to section 23 (5) dAktG, corporate law is fundamentally seen as mandatory in Austria; Kastner/Doralt/Nowotny, Grundriss des österreichischen Gesellschaftsrechts, p. 176; Jabornegg, in: Jabornegg/Strasser, AktG, § 17 marginal no. 5; Nowotny, in: FS Peter Doralt, 2004, p. 411 et seq.

[118] Drygala/Staake/Szalai, Kapitalgesellschaftsrecht, § 21 marginal no. 8.

[119] COM(2011) 164/3; see *supra*, Chapter 1, III.3, p. 21 et seq.

[120] See the Green Paper ibid. p. 2.

partner" and no longer a mere monitoring body.[121] Rules of behaviour for members of the organs which have been adopted as a form of self-regulation in most countries ("corporate governance codices") accompany statutory provisions governing company management.[122]

d) Legal status and function of the general meeting in the large corporation. The term general meeting is understood to refer both to an organ of the large corporation as well as the actual (physical) meeting of the shareholders at which the intent of the body is formed. As already explained under c), the dualistic organisational structure contains **no primacy of the general meeting over the management body**. However, the general meeting has a certain degree of priority in that only it – and not the board of directors or the supervisory board – may determine the **corporate purpose** and the **object of the company** and may likewise modify these fundamental aspects of the company. The management and supervisory bodies are bound by the guidelines provided by the shareholders to that extent. The specific responsibilities of the general meeting as an organ of the company have largely been defined in the same manner in the legal systems investigated in this study (cf. the corresponding provisions of section 119 dAktG; Art. 698 OR; Art. 2364 and 2364-bis CC) respectively).[123] Based on these provisions, the general meeting decides on a series of **fundamental matters** such as amendments to the company's articles including capital measures, the transfer of the entire assets of or dissolution of the company. With regard to personnel competence, the general meeting is responsible for appointing the members of the supervisory board, discharging members of the board of directors and supervisory board as well as dismissing supervisory board members. Within the **financial structure**, the general meeting is, among others, responsible for decisions regarding the appropriation of disposable profits and the appointment of the auditor.

Of primary importance is that issues of day-to-day company management do not fall within the scope of the general meeting's responsibilities. The legislative intent of placing company management competence solely at the level of the management is to increase the professionalism of decision-making.[124] However, there are also contrary trends even here: During the past several years – at least in Germany – a series of unwritten competences on the part of the general meeting have come into being in addition to the differentiated system of general meeting competences which ultimately have their justification in the constitutional guarantees of property rights (in German law Art. 14 GG). Based on this, "share ownership" (Aktieneigentum) includes a minimum level of decision-making authority within the company.[125] This results in an obligation on the part of the board of directors in exceptional cases to induce the general meeting to make a decision in the event of serious encroachments on rights and interests of the shareholders.[126] If a measure

[121] Fundamentally, Lutter, ZHR 159, 287 (1995); see additionally, Drygala/Staake/Szalai, Kapitalgesellschaftsrecht, § 21 marginal no. 10 et seq.

[122] Cf. the extensive international documentation under www.ecgi.org.

[123] Regarding the catalogue of competences in the Austrian AktG, cf. Kalss, in: MüKoAktG, § 119 marginal no. 172.

[124] Drygala/Staake/Szalai, Kapitalgesellschaftsrecht, § 21 marginal no. 197.

[125] Most recently, e. g. BVerfG NZG 2012, 826, subsection CI1 a – Delisting.

[126] Fundamental BGHZ 83, 122 – Holzmüller.

encroaches so deeply on the membership rights of the shareholders and property interests inherent in their share ownership that the board of directors cannot reasonably assume that it can make such a decision on its own, this will always represent such an exceptional case. An important application of this doctrine is for example the economic hive-down (transfer) of a material business division of the company to a subsidiary.

6. Analysis

An overall assessment of rules on the division of powers as between the shareholders and the management body reveals a clear hierarchy in the case of the small corporation: The shareholders are the "masters of the company". This hierarchy is based on the classic mandate theory. The law counters the lack of protection for creditors and the public originally associated with this theory, with a series of manager duties with which not even the general meeting of the shareholders can interfere. On the whole, this represents a balanced system for allocating powers. Of course, there is a need for further discussion of whether the sacrifices in personnel competence on the part of the shareholders associated with the expansion of protection against discrimination found in EU law are actually desired. The "Reflection Group on the Future of EU Company Law"[127] also did not consider these types of conflicts between corporate law and employment law.

The primary competence of the management body which has been codified in the interest of the professionalism of decision-making in the case of **large, dualistically-organised corporations** (section 76 (1) dAktG; section 84 öAktG; Art. L225-58 CCom; Art. 2380-bis Abs. 1 CC; Art. 39 (1) SE Regulation) likewise appears to be sound: It counterbalances the lack of expertise found at the general meeting commonly seen in the case of a large body of shareholders. However, those legal systems which solely provide for the dualistic model for large corporations (Germany, Austria) should consider the introduction of an optional, monistic organisational structure based on the Italian or French examples. Since only the large corporation is capable of being stock exchange listed, under Italian or French law the shareholders may combine access to the capital markets with a form of corporate organisational structure in which they, and not the management body, have primacy. At present, German or Austrian large corporations can only achieve this result indirectly through participation in a monistic SE. The EU Company Law Action Plan 2003[128] represents a model to the extent it – following a corresponding recommendation of the High Level Group[129] – describes the introduction of a choice between the monistic and dualistic systems of company management as desirable at least in the case of all listed corporations[130]; this is the case in Italy and France, and for the SE under Art. 38 (b) SE Regulation. After only approximately 38 % of market participants spoke out in favour of such a choice during the consultation on the priorities for the Action Plan 2012, with a similar percentage opposing it, the proposal has been tabled for the time

[127] See above, p. 72, fn. 5.

[128] KOM(2003), 284; reprinted also in NZG 2003, Sonderbeilage zu Heft 13; regarding the Action Plan, see Ch. 1 above, sub III.2, p. 20 et seq.

[129] Final Report of the High Level Group of Company Law Experts chaired by Jaap Winter, presented on 4 November 2002, which focused on corporate governance in the EU and the modernisation of European Company Law, p. 63.

[130] Action Plan (fn. 128), 3.1.3 (p. 18 et et seq.) and Annex 1 (p. 29).

being.[131] This idea should be retained because neither of the systems is structurally superior (which the Action Plan 2012 also acknowledges),[132] it always depends on the specific interests of the respective company, and because of the positive experience with such an election in many national legal systems[133] as well as in the case of the SE. As was clearly illustrated by the discussion about an introduction of such a choice in Germany at the 67th DJT 2008,[134] the critics appear to have the upper hand on this point – at least for now. In the long term, both European and German lawmakers will very likely hardly be able to avoid the pressure emanating from the example of some national legal systems and the SE to introduce optional forms or organisational structure as demanded in the literature[135] and the European Parliament[136].[137] The Reflection Group also indicated its support in April 2011 for the introduction of an election with regard to organisational structure, at least in the case of non-listed companies.[138]

On the topic of organisational structure, the report of the "Reflection Group" of 5 April 2011[139] includes the assessment that the legislative **distinction between large and small corporations** – i. e. between public limited companies and private limited companies – **is outdated** because in reality there are public limited liability companies with a small number of shareholders and – vice versa – private limited companies with a large number of shareholders.[140] Accordingly, distinctions in legislation between listed and non-listed companies would be more appropriate to the times.[141] However, as a generality this opinion cannot be joined regarding the organisational structure of

[131] Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 68.

[132] COM(2012) 740/2 v. 12.12.2012, p. 13 (at 4.4): "In Europe, different board structures exist. (…) The Commission acknowledges the coexistence of these board structures, which are often deeply rooted in the country's overall economic governance system, and has no intention of challenging or modifying this arrangement." Cf. Baums, Bericht der Regierungskommission "Corporate Governance", BT-Drs. 14/7515, marginal no. 18; Fleischer, AcP 204 (2004), 502, 527; Jungmann, ECFR 2006, 426, 473; Leyens, RabelsZ 67 (2003), 57, 96; Schiessl, ZHR 167 (2003), 235, 250; Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 68; C. Teichmann, ZGR 2001, 645, 675.

[133] As explained, there is an election available in France (monistic system): Art. L225-16 et seq. Ccom.; dualistic system: Art. L225-57 et seq. Ccom.) and Italy; however English law also allows freedom of drafting company statutes to create a monistic as well as a dualistic management structure, cf. Leyens, in: FS Hopt 2012, p. 3135, 3140 et seq.; J. Schmidt, "Deutsche" vs. "britische" Societas Europaea (SE), 2006, p. 477 et seq. with further citations; for a comparative legal analysis see Fleischer, AcP 204 (2004), 502, 528 et seq.

[134] On this, namely J. Schmidt (2008) 9 EBOR 637, 646 et seq., with additional citations.

[135] Regarding European law, e.g: Habersack, ZIP 2006, 445, 450; Hopt, in: FS Westermann, 2008, p. 1039, 1051 f.; van Hulle/Maul, ZGR 2004, 484, 494; Wiesner, ZIP 2003, 977, 979; for Germany, e.g Bayer, Gutachten E zum 67. Deutschen Juristentag, 2008, E 113; Eidenmüller/Engert/Hornuf, AG 2009, 845, 854; Fleischer, AcP 204 (2004), 502, 528; Group of German Experts on Corporate Law, ZIP 2003, 863, 869; Handelsrechtsausschuss des DAV, ZIP 2003, 1909, 1911; Hopt, in: Hommelhoff et al. (eds.), Handbuch Corporate Governance, p. 27, 45 et seq.; Lieder, (2010) 11 GLJ 115, 157; Schiessl, ZHR 167 (2003), 235, 256; J. Schmidt, (2008) 9 EBOR 637, 647 f.; Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 68.

[136] Cf. Resolution of the European Parliament on the newest developments and perspectives of company law dated 4 July 2006; OJ dated 13 December 2006, C 303 E/114, no. 26.

[137] Cf. for Germany: Bayer, Gutachten E zum 67. Deutschen Juristentag, 2008, E 113; J. Schmidt, EBOR 9 (2008), 637, 648; Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 68.

[138] Cf. Report of the Reflection Group (fn. 5), p. 55.

[139] See fn. 5 above, with additional citations.

[140] Reflection Group (fn. 5), p. 8 et seq.

[141] Reflection Group (fn. 5), p. 9.

corporations. In practice, most small corporations remain characterised by a person-driven structure and low levels of capitalisation. National laws even provide a limit on the number of shareholders in some instances.[142] Accordingly, the regulatory distinction between "large" and "small" corporations corresponds to a necessary, and at least legitimate statutory classification based on circumstances in the real world. In this regard as well, the increase in **contractual freedom** endorsed by the Reflection Group ("flexibility")[143] in the case of large corporations – meaning a harmonisation of both forms – is **not a value as such**: The stronger the influence of the shareholders on company management, the weaker is the protection of third parties.[144] In the case of the small corporation, flexibility as to internal relations between the shareholders – this should have become clear from the discussion above – sufficiently assured.[145] In fact, in the small corporation, the shareholders are free to establish a strong or a weak management body. This follows from the status of management body members as mandataries (see III., above p. 77 et seq.). However, the freedom to make structural decisions cannot relate to obligations and positions on the part of the management body designed to protect the interests of third parties (for example as is the case with the disclosure obligations, the material scope of the authority to represent the company, capital protection and protecting corporate assets during a crisis). This is well defined in national corporate law and should remain so. In this respect, the report of the "Reflection Group" is not clear. The report states simply that contractual freedom in relation to organisational structure should be further expanded for all entity forms.[146] The Action Plan 2012 emphasizes the expansion of freedom to make structural decisions for small and mid-size enterprises.[147]

The EU Commission likewise presented a comprehensive Green Paper entitled "The EU Corporate Governance Framework" on 5 April 2011,[148] the goal of which

[142] The case in France (Art. L223-3 CCom): 100.

[143] Reflection Group (fn. 5), p. 12: "EU harmonisation should respect the national corporate governance systems of the Member States and *should strive to further the trend towards increased flexibility and freedom of choice in respect of company forms and the internal distribution of powers.*" (emphasis added).

[144] Regarding this correlation, see previously Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 14 with fn. 11; missed by Bachmann et al., Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 13–16, who regard freedom of contract as the guiding principle of future lawmaking for the small corporation: the protection of third parties (Art. 50 (2) (g) TFEU) in such a legislative environment fails by the wayside.

[145] Other assessment contained in Hopt, EuZW 2012, 481, 482 (with the demand for more freedom in design for all non-listed companies): "The watershed is the recourse to the capital market, then investor and creditor protection must be ensured. By contrast, in the case of the SME freedom of contract, flexibility, initiative and manoeuvring space for founders must have priority."

[146] Reflection Group (fn. 5), p.12: "Thus, there is reason to expect that governance structures will be subject to even more diversity in the future with more options and flexibility within the individual Member States as they introduce and adjust to options available in each other's laws."

[147] COM(2012) 740/2 v. 12.12.2012, p. 13 (at 4.4): "As regards company law in particular, the Commission believes that SMEs need simpler and less burdensome conditions for doing business across the EU and it remains a clear priority for the Commission to take concrete measures in this regard."

[148] Green Paper The EU Corporate Governance Framework, COM (2011) 164/3; accessible at http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_de.pdf; overview in Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 76 et seq., p. 396 et seq.; Bayer/J. Schmidt, BB 2012, 3, 9.

is to improve corporate governance not only for financial institutions but rather for European businesses in general based on what has been learned from the financial crisis.[149]

V. Duties and liability of members of the management body

1. Plurality of interests and conflicting obligations.

The members of the management body are subject to dual, conflicting interests and obligations.[150] As the mandataries of the shareholders (see III., above p. 77 et seq.), they are responsible on the one hand to implement the business object to the best of their abilities, to avoid or overcome crises and to recognise and take advantage of business opportunities for the company. They should act as successful entrepreneurs. On the other hand, the members of the management body are also responsible for ensuring that the company complies with all statutory rules and regulations of the relevant legal system (principle of legality) and that they satisfy their personal duties as part of the management body which exist to protect each individual shareholder, the employees, the company's creditors and the public.[151] The organisational structure of the corporation must take this plurality of interests into account (see I., above p. 71 et seq.). In the event of a breach of an obligation, the members of the management body face three (groups of) private law creditors: the company itself, the shareholders and the creditors of the company under private law.[152] In addition, there are liabilities – not to be addressed here – owed to tax authorities, social insurance institutions, obligations under public law as well as for breaches of the duty of care [Störerhaftung] related to anticompetitive conduct and infringements of intellectual property rights.[153]

2. General obligation of diligent management vis-à-vis the company.

a) Duties of a manager. Under *Raiser* and *Veil*,[154] the **duties** of members of corporate management bodies may be divided into **five partially overlapping groups of obligations**:

[149] See additionally, Bachmann, WM 2011, 1301 et seq.; Hennrichs, GmbHR 2011, R 257 et seq.; Hopt, EuZW 2011, 609 et seq.; identical, Hommelhoff, in: Liber amicorum M. Winter, 2011, p. 255 et seq.; Institut für Gesellschaftsrecht der Universität zu Köln, NZG 2011, 975 et seq.; Jahn, AG 2011, 454 et seq.; Jung, BB 2011, 1987 et seq.; Peltzer, NZG 2011, 961 et seq.; Scheffler, AG 2011, R262 et seq.; Tomasic, (2011) 8 ECL 152 et seq.; see additionally the statement of the Federal Council [Bundesrat], BR-Drs. 189/11(B); statement of the Parliament [Bundestag], BT-Drs. 17/6506 (enacted: BT-PlPr. 17/13936); statement BDI/BDA, 21.7.2011, BDI D 0451; Handelsrechtsausschuss des DAV, NZG 2011, 936 et seq.; statement Regierungskommission DCGK (accessible at: http://www.corporate-governance-code.de/ger/download/Stellungnahme_Gruenbuch.pdf).

[150] With emphasis, Drygala/Staake/Szalai, Kapitalgesellschaftsrecht, § 11 marginal no. 60.

[151] Regarding the third party protective purpose of numerous duties of management body members, see Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, 2012, p. 90 et seq.

[152] Cf. regarding manager liability following the MoMiG K. Schmidt, GmbHR 2008, 449 et seq.; Kleindiek, in: FS K. Schmidt, 2009, p. 893 et seq; regarding current trends in the jurisprudence, see Kindler, in: FS Goette, 2011, p. 146 et seq.; for a monograph in English see Gubitz et al., Manager Liability in Germany, 2012.

[153] On the latter, see BGH NJW 2012, 3439 marginal no. 25.

[154] Raiser/Veil, Recht der Kapitalgesellschaften, § 32 marginal no. 79 et seq.

- First, members of the management body must comply with **statutorily mandated requirements and prohibitions** (expressly stated in Art. 223–22 (1) CCom; Art. 2476 (1) CC). For example, these include the obligation to provide correct information when forming the company and in the case of increases in capital (sections 9 a, 57 (4) dGmbHG; section 10 (3) öGmbHG), the obligation to preserve capital pursuant to section 30 et seq. dGmbHG (sections 74, 82 (1) öGmbHG), the prohibition on acquiring own shares under section 33 dGmbHG (section 81 öGmbHG), following instructions from the shareholders (section 37 (1) dGmbHG, section 20 (1) öGmbHG), the obligation to report certain facts to the commercial registry, bookkeeping and accounting obligations under section 41 et seq. dGmbHG (section 22 öGmbHG), the prohibition on granting loans to corporate representatives under section 43 a dGmbHG, the obligation to initiate insolvency proceedings (section 15 a InsO) and the prohibition on depleting assets (section 64 first sentence dGmbHG; section 25 (3) no. 2 öGmbHG; Art. 2634 CC).
  Pursuant to statute law (expressly stated for example in section 43 (1) dGmbHG; section 25 (1) öGmbHG; similar in Art. 812 Abs. 1 OR), the member of the management body must exercise the **standard of care of a diligent business man** in the affairs of the company. If a member of the management body is at fault for a violation of one of his obligations, he is liable to the company (based on section 43 (2) dGmbHG; section 25 (2) öGmbHG; Art. 827 in conjunction with Art. 754 OR; Art. 223–22 (1) CCom; Art. 2476 (1) CC) for any resulting damages. Liability to the company based on a breach of the duty of care on the part of management body members **promotes creditor protection** only indirectly and may therefore be limited in the company's articles under German law, for example in cases of simple negligence.[155] In addition, members of the management body are also subject to the general obligation to respect the division of competences between the different company organs (general meeting of the shareholders, company management and supervisory board if applicable). For example, this includes keeping business activities within the limits of the object of the company established by the shareholders (section 3 (1) no. 2 dGmbHG; Art. L223-18 CCom). In addition, limitations on competences, for example in relation to matters reserved to a vote of the shareholders, contained in the company's articles, in rules of procedure adopted by the shareholders or in an employment agreement are binding on the members of the management body.
- As a legal entity, the **company** itself is subject to a series of **duties from various fields of law**, e. g. the obligation to remit taxes and social insurance contributions and to comply with criminal law, employment law, commercial law or environmental protection rules and regulations, anti-trust regulations, etc. The members of the management body are responsible vis-à-vis the company for ensuring that these obligations are satisfied (legality principle[156]) and they expose themselves to liability for damages if the company suffers any damages as a result. If for example a member of the management body enters into a price-fixing agreement with a competitor of the private limited company in the company's name in contra-

[155] BGH NJW 2002, 3777 (regarding the reduction of the limitations period in § 43 (4) GmbHG). See additionally, Roth/Altmeppen, GmbHG, § 43 marginal no. 82.

[156] BGH NJW 2012, 3439 marginal no. 22; comprehensive treatment in: Rieger, Die aktienrechtliche Legalitätspflicht des Vorstands, 2012.

vention of anti-trust law (Art. 101 TFEU) and if a fine is imposed on the company as a result, then the management body member owes the company compensation: In the event of a wrongful act, and an exclusion is not applicable, he must pay this amount to the company as compensation for damages.

- Every member of the management body must ensure **cooperation** with the other managers and with the other corporate bodies (general meeting of the shareholders and supervisory board if applicable) by means of duties to furnish reports and information. Accordingly, important information cannot be withheld from the shareholder or other managers.
- The members of the management body are subject to a **duty of prudent management**. This includes in particular:[157]
  - the lawful behaviour of the company in external dealings (legality principle);[158]
  - planning company policy and advising the shareholders;
  - implementing the principles of company policy established by the shareholders;
  - implementing specific instructions from the shareholders;
  - all entrepreneurial decisions to the extent not already determined by the shareholders;
  - arranging the company's internal organisation according to law and company articles.

  Additional guidelines for these types of obligations on the part of the manager of a private limited company may be taken from the codes of conduct for members of the management bodies of listed companies published in various countries, such as the **German Corporate Governance Codex (DCGK)**, to the extent the rules set out there have not been specifically tailored to the circumstances of the listed public limited company.[159]
- The **fiduciary or loyalty duty** (expressly codified analogous to the duty of loyalty owed by the shareholders, e. g. in Art. 812 (2) OR) is based on the requirement that members of the management body must subordinate their private interests to those of the business and may not use their management position to their own benefit. This also includes the duty to keep information and secrets of the company confidential (cf. also sections 85 dGmbHG, 17 et seq. dUWG). In particular, the duty of loyalty includes a **prohibition of competition**, which corresponds to the substance of sections 112 dHGB, 88 dAktG, section 24 öGmbHG. Based on this prohibition, during their term of office, and in some circumstances for subsequent periods, the members of the management body may not engage in any trade or enter into any dealings in the same business as the company either for their own account or on account of a third party.[160] Furthermore, a manager of a private limited company also breaches the duty of loyalty if he personally exploits business opportunities to which the company is

[157] Cf. Scholz/U. H. Schneider, GmbHG 43 marginal no. 42.

[158] BGH ZIP 2012, 1552 = BeckRS 2012, 16295, marginal no. 22; see Rieger, Die aktienrechtliche Legalitätspflicht des Vorstands, 2012.

[159] Cf. www.corporate-governance-code.de (German website); www.ecgi.org (international website); see Konnertz-Häußler, GmbHR 2012, 68, 70 et. seq. regarding additional Corporate Governance Codices for non-listed companies.

[160] BGHZ 49, 30, 31 = NJW 1968, 396; BGH NJW-RR 1989, 1255, 1256.

entitled (business opportunity doctrine). Example:[161] A manager transfers a lease for premises which the private limited company could sub-let at a profit to a third company for whom he is an authorised officer [Prokurist]. There is no agreement as to consideration for the private limited company represented by the disloyal manager.

b) Standard of care and fault. A member of the management body is liable for breaches of duties based on the standard of care set out in section 43 (1) dGmbHG, section 93 (1) dAktG, section 25 (1) öGmbHG, section 84 (1) öAktG. The "prudent" business man or manager referred to in these provisions orients himself – again inspired by the function of a 'mandatary' (see above, III., p. 77 et seq.) – on the standard for managing the assets of a third party, i. e. an independent, fiduciary safeguarding of third-party property interests.[162] In the event the company suffers damage as a result of conduct of the manager within the scope of his responsibility, the breach of a duty and the fault of the manager will be subject to a rebuttable presumption.[163] Of course the members of the management body have a degree of **entrepreneurial discretion** which is why not every incorrect decision or every mistake must be viewed as a breach of the standard of care ("business judgment rule"; cf. section 93 (1) second sentence AktG).[164] However, the exemption from liability on the part of the manager within the scope of business judgment to which he is entitled presumes that a business decision is based on a careful investigation of the bases for the decision. This requires that he exhaust all available sources of information, factual and legal, regarding the specific decision to be made and carefully weigh the advantages and disadvantages of the available options based on such information and take identifiable risks into account.[165] As a result, within the scope of business judgment, only plainly indefensible management decisions give rise to an obligation for damages, e. g. an irresponsible assumption of risk. Example:[166] Delivery of vehicles abroad without corresponding purchase price security. In such cases, the member of the management body is liable to the private limited company for a default of the receivable.

c) Joint responsibility. No uniform picture emerges when looking at the joint responsibility of the members of a management body. Under German, Austrian and Italian law (section 43 (2) dGmbHG; section 25 (2) öGmbHG; Art. 223-22 (1) CCom; Art. 2476 (1) CC), the members of the management body have joint and several liability vis-à-vis the company. This presupposes that every member of the management body individually satisfies the criteria for imposing liability (position

[161] Following KG NZG 2001, 129; see additionally KG GmbHR 2010, 869 = EWiR 2011, 151, with brief commentary from Schodder.

[162] Bayer, in: Lutter/Hommelhoff, § 43 marginal no. 21.

[163] BGHZ 152, 280 = NJW 2003, 358 citing § 93 (2) AktG, § 34 (2) GenG.

[164] BGHZ 135, 244 = NJW 1997, 1926 – ARAG (on the public limited company); see Kindler, ZHR 162 (1998), 101 et seq.; regarding Italy and Austria, see above fn. 10; see additionally Enriques/Hansmann/Kraakman, in: Kraakman et al., The Anatomy of Corporate Law, p. 79 et seq.; as to French Law see Redenius/Hoevermann, La responsabilité des dirigeants dans les sociétés anonymes en droit français et droit allemand, 2010, no. 112 et seq.; for a summary, see Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 88.

[165] BGH NJW 2008, 3361 marginal no. 11; NZG 2009, 117; see additionally Kindler, in: FS Goette, 2011, p. 231 et seq.; Fleischer, NZG 2011, 521 et seq.

[166] Following OLG Jena NZG 2001, 86.

as manager, breach of a duty, breach of the standard of care, responsible for the loss). This is not problematic in cases where they have acted or failed to act in common. However, in practice there is often an **allocation of responsibilities**, e. g. in the company's articles or in rules of procedure. Thus, to the extent a "non-responsible" manager does not himself act improperly, he is only liable, for example under German law, if he has violated his duties to monitor the other managers.[167] French law contains a more refined liability scheme in this regard. According to French law (Art. 223-22 (1), (2) CCom), the managers are solely or jointly and severally liable depending on the specific circumstances; where several managers have acted together to perform the same act, the court determines the liability amount of each of them. Swiss law contains no express rule on this point (Art. 827 in conjunction with Art. 754 OR).

d) Exclusions. Liability is not imposed where the member of the management body acted following a binding **instruction** from another corporate organ.[168] A management body member must abide by an instruction to the extent it does not violate statutory obligations designed to protect third parties – for example related to capital protection – and therefore does not owe the company compensation for any resulting damages; this is especially the case where the company only has a sole shareholder and manager.[169] A discharge decision on the part of the shareholders releases a member of a management body from all liabilities which were identifiable and/or privately known to the shareholders (section 46 no. 5 dGmbHG; Art. 804 (2) no. 7 OR).[170]

e) Enforcement. Pursuant to section 46 no. 8 dGmbHG/section 35 (1) no. 6 öGmbHG, a **shareholder resolution** is required in order to assert a claim for damages against a manager. Although permissible, an action for damages brought by the company without such a resolution is unfounded.[171] This follows from the purpose of the general meeting of the shareholder's decision-making competence. The requirement for a resolution is not only intended to protect shareholders and management body members against the pursuit of unfounded claims, but also to protect the company itself from having internal matters discussed externally during negotiations and litigation.[172] French law takes a diametrically opposed position on this issue and places emphasis on the **creditor protection aspect of executive liability**. Pursuant to Art. 223-22 (4) CCom, the general meeting of the shareholders has no statutory competence in this regard and any corresponding provision in the articles are void.[173]

[167] BGHZ 133, 370, 377 et seq. = NJW 1997, 130; BGH NJW 2001, 969, 971.
[168] BGHZ 122, 333, 336 = NJW 1993, 1922.
[169] BGH NJW 2010, 64 subsection 10 et seq. = NZG 2009, 1385 = EWiR 2010, 151 with brief comments from Schodder = DStR 2010, 63, with instructive comments from Goette.
[170] BGH NJW 1986, 2250; NJW-RR 2003, 895.
[171] BGHZ 28, 355, 359 = NJW 1959, 194.
[172] Zöllner/Noack, in: Baumbach/Hueck, § 46 marginal no. 61.
[173] "Est réputée non écrite toute clause des statuts ayant pour effet de subordonner l'exercice de l'action sociale à l'avis préalable ou à l'autorisation de l'assemblée, ou qui comporterait par avance renonciation à l'exercice de cette action."; see above, p. 84.

3. Liability vis-à-vis the private limited company based on specific rules of corporate law and based on tort

a) Breaches of prohibitions on disbursements. In some legal systems (section 43 (3) first sentence 1 dGmbHG; section 83 (2) öGmbHG; Art. 2626, 2627 CC in conjunction with Art. 185 CP) members of the management body are liable for **payments to shareholders** from registered capital made in contravention of capital protection regulations (section 30 (1) dGmbHG; sections 25 (3) no. 1, 82 öGmbHG; Art. 2626, 2627 CC).[174] The recipient of the payment is liable in addition to the members of the management body (on this point, see section 31 (1) dGmbHG; section 83 (1) öGmbHG). In the case of an unlawful removal of corporate assets on the part of the shareholders above the registered capital amount (section 826 BGB), executive liability is in any event conceivable under the theory of joint tortfeasors (in German law under section 830 BGB). Section 64 third sentence GmbHG closes this gap since 2008 and establishes a **liability for causing insolvency**. This provision covers the already-existing prohibition of – negligent – payments which erode corporate assets, including payments to shareholders, to the extent such payments would have to lead to the company's insolvency and this is the case even if the corporate assets required to maintain registered capital are not accessed.[175] This provision is directed at asset movements ahead of an insolvency ("company burials"/"Firmenbestattung") and also at an abusive conduct on the part of investors who drive the company into insolvency as a result of plundering or excessive debt related to the purchase price (*leveraged finance*).[176]

b) Acquisition of own shares. Like domestic laws related to small corporations, European law (Art. 18 Capital Directive) contains a broad prohibition – among others in the interests of capital protection – on the acquisition of own shares (e. g. section 33 dGmbHG; section 81 öGmbHG; Art. 2628 CC). Violations result in liability to the company on the part of the members of the management body (section 43 (3) first sentence dGmbHG; section 25 (3) no. 1 öGmbHG; Art. 2628 CC in conjunction with Art. 185 CP).

c) Asset erosion. Under the provisions of a series of legal systems (cf. section 64 sentences 1 and 2 dGmbHG; section 92 (2) dAktG; section 25 (3) no. 2 öGmbHG; Art. 2634 CC), the members of the company's management body are obligated to compensate for payments made after the company has become insolvent or after it has been determined to be over-indebted. This rule serves the purpose of safeguarding the **equal treatment of creditors** (par condicio creditorum/pari passu principle) required under insolvency law. It obligates the members of the management body to keep corporate assets on hand at the time the company becomes

[174] At the same time, the manager may be punishable for embezzlement and abuse of trust (§ 266 StGB), Mahler, GmbHR 2012, 504 et seq.

[175] BegrRegE vom 23. 7. 2007, BT-Drs. 16/6140, p. 46 et seq.; see also Kindler, NJW 2008, 3249, 3255; see additionally Casper, in: Goette/Habersack (eds.), Das MoMiG in Wissenschaft und Praxis, p. 185, 208 et seq.

[176] Kleindiek, GWR 2010, 75, 76 f., also regarding the – limited – exculpatory options for the manager.

factually insolvent intact and to avoid the unequal satisfaction of company creditors. Only the liquidator should decide to whom money may be paid.[177]

d) False information in connection with company formation or a share capital increase. In the event false information is provided in connection with the formation of the company ("formation fraud"), the members of the company's management body are liable – in addition to the shareholders – for, inter alia, missing contributions and any additional damages. All false information provided to the registry court during the formation process provides a basis for liability (section 9 a dGmbHG; section 10 (4) öGmbHG; Art. L223-10 CCom; Art. 2621 CC). The law establishes a similar liability in the case of false information provided in connection with a capital increase (section 57 (4) dGmbHG; section 52 (6) öGmbHG – "capital increase fraud").

e) Tort liability to the company. In any event, German law governing the liability of members of corporate management bodies does not exclude liability in tort on their part vis-à-vis the company itself (sections 823 et seq. BGB).[178] Of practical interest, primary focus is on the obligation to pay compensation for damages under section 823 (2) BGB together with a provision of criminal law that is intended to protect individuals ("protective law"/"Schutzgestz") (e. g. section 266 StGB regarding embezzlement and abuse of trust or section 263 StGB regarding fraud).[179] A right to claim compensation under section 826 BGB (intentional damage) may be considered in the event of wilful, unethical conduct. This primarily involves cases in which a member of the management body abuses his position to assert his own interests and in doing so disregards the required minimum standard of loyalty and consideration for the company.[180] In such cases, liability in tort comes along with liability as a member of a management body. Example:[181] A private limited company is in the residential construction business. It plans to acquire real estate it needs for its business. The manager acts unethically if he does not take advantage of an opportunity to buy a piece of land at a good price but rather allows another company, in which he has a profits interest, to make the purchase and does so with the intent of having the company he manages buy the property from the other company at an unreasonably high price.

4. Liability vis-à-vis individual shareholders

In some legal systems which follow the mandate theory (see III., above, p. 77 et seq.) particularly closely, liability on the part of the members of the management body vis-à-vis the individual shareholders is extensively developed; other legal systems limit themselves to certain, narrowly-defined circumstances in this regard. Switzerland provides an example of a vast liability scheme in this respect. Under Art. 754

[177] BGH NJW 2003, 2316; Goette, DStR 2003, 887, 893; hereinafter BGH NZG 2009, 346 subsection 10.

[178] For an introduction to German tort law, see Markesinis/Unberath, German Law of Torts, 2002.

[179] Cf. BGHZ 149, 10 = NJW 2001, 3622 – Bremer Vulkan (on shareholder liability); BGH NZG 2005, 755.

[180] BGH NJW-RR 1989, 1255.

[181] According to BGH ibid.

OR,[182] the member of the administrative board and all persons involved in management or dissolution are liable not only to the company but also to individual shareholders and company creditors for damage they have caused as a result of an intentional or negligent breach of their duties. Art. L223-22 (3) CCom and Art. 2476 (6) CC contain similarly broad provisions.

By contrast, German law is rather restrictive and codifies only certain specific cases: In the case of a breach of **capital preservation rules** in the small corporation (section 30 (1) dGmbHG), the remaining shareholders are liable under section 31 (3) dGmbHG to the company for repayment of amounts distributed as are the recipients of the payment and management body member ("deficiency liability"). However, a member of the management body is fully liable to such shareholders under section 31 (6) dGmbHG. Section 31 (6) dGmbHG is the sole scenario expressly described in German law for liability on the part of management body members to individual shareholders.

It is possible that the restrictive posture of German corporate law in the case of liability on the part of management body members vis-à-vis individual shareholders was the reason for expanding shareholder protection from acts on the part of management body members in the form of **tort law**. The **membership** – i. e. the catalogue of all of the rights of a shareholder, namely in relation to the company itself as well as in relation to the other shareholders – has been recognised as an absolute right within the meaning of section 823 (1) BGB. This absolute right may be violated, for example, through measures which alter the structure, de facto changes in the object of the company, disregarding the duty of equal treatment vis-à-vis the shareholders, encroachments on the competences of the general meeting of the shareholders or initiating an illegitimate squeeze-out procedure.[183] In general, managers are liable under section 823 (1) BGB to the extent they harm the protected membership rights of a member of the association either through their own tortious conduct or instigation or abetting such conduct.[184] This is in addition to the company's vicarious liability for its representatives (cf. section 31 BGB; Art. 817 OR).[185]

5. Instances of liability under general private law vis-à-vis private law company creditors

Circumstances giving rise to liability to private creditors under general principles of private law can only be discussed here briefly using German law as an example. Within the legal systems which already recognise "all-around liability" on the part of members of the management body – including liability to company creditors (Art. L223-22 (1) CCom; Art. 754 OR, also in conjunction with Art. 827 OR; Art. 2392–2395 CC), liability of the management body based on general principles of private law does not appear to play a very large role. In general, what applies in

[182] Also applicable to the private limited company pursuant to Art. 827 OR.

[183] Cf. the examples in Marsch-Barner/Diekmann, in: Priester/Mayer (eds.), Münchener Handbuch des Gesellschaftsrechts, Bd. 3, GmbH, 2nd ed., 2003, § 46 marginal no. 59; Habersack, Die Mitgliedschaft – subjektives und "sonstiges" Recht, p. 209.

[184] BGHZ 110, 323, 334 et seq. = NJW 1990, 2877 – Schärenkreuzer; concurring Habersack, Die Mitgliedschaft – subjektives und "sonstiges" Recht, p. 202 et seq. and p. 209; see additionally Zöllner/Noack, in: Baumbach/Hueck, § 43 marginal no. 65.

[185] Cf. BGHZ 99, 298 = NJW 1987, 1193; BGH NJW 2005, 2450, 2451 et seq. (public limited company).

these cases is that the member of the management body – in contrast to the case of liability vis-à-vis the company – cannot claim to have exercised business judgment. This is so because the member of the management body is granted entrepreneurial discretion only in the interests of the association and its members who may also solely benefit from its exercise.[186]

a) Personal liability based on estoppel. Under German law, a member of a management body is liable to company creditors based on principles of estoppel if such member (1) may be imputed to have created the impression of acting as a sole trader or on behalf of one or on behalf of a commercial partnership and (2) belief in liability on the part of at least one natural person is legitimate as a result.[187] The member of the management body cannot assert the fact that it is evident from the commercial registry (Art. 3 (6) Disclosure Directive; section 15 (2) first sentence HGB) that the private limited company is the commercial entity because the purpose of the obligation to indicate the form of legal entity in commerce (Art. 5 Disclosure Directive; section 35 a dGmbHG) is to provide special protection of expectations. Example:[188] G is the manager of the "Heinrich F. Carpentry GmbH". Upon accepting a bill of exchange, he stamps it "Heinrich F. Carpentry" and signs his name without including the identification of legal form "GmbH". In doing so, the manager creates the impression that an individual rather than a company became liable upon accepting the bill of exchange, namely the sole proprietor of the "Heinrich F. Carpenty". Accordingly, the manager is personally liable under the bill of exchange based on the principle of estoppel.

b) Pre-contractual liability (culpa in contrahendo). German statute law has recognised culpa in contrahendo (cf. Art. 1337, 1338 CC in Italian law) in sections 241 (2), 311 (2), (3) BGB. Based on cases decided thereunder, liability under the principle of culpa in contrahendo generally only affects the parties to the contract under negotiation; as a rule, representatives and negotiators may only be pursued in tort.[189] However, based on the principles developed in case law, a representative is personally liable under the principle of culpa in contrahendo in two specific circumstances: (1) if he has taken advantage of personal trust on the part of the business partners of the represented party beyond the normal level of mutual trust in negotiations, or (2) if he has a direct economic interest in the conclusion of the agreement.[190] Third party liability based on the principle of culpa in contrahendo is reflected in section 311 (3) first sentence BGB in which it states that an obligation with duties under section 241 (2) may also come into existence in relation to persons who are not themselves intended to be parties to the contract. The *first*

[186] Fundamentally different opinion in Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 93 according to which it should not be contradictory to understand the duty of care to relate to third parties including a broad business discretion of the manager.

[187] BGH NJW 1996, 2645; NZG 2007, 426 = NJW 2007, 1529 with a comment by Kindler, 1785 et seq.; Kindler, Grundkurs Handels- und Gesellschaftsrecht, § 4 marginal no. 52.

[188] Nach BGHZ 64, 11, 17 et seq. = NJW 1975, 1166; for comprehensive treatment see Canaris, Handelsrecht, § 6 marginal no. 36 et seq.

[189] Ellenberger, in: Palandt, BGB § 311 marginal no. 52.

[190] BGHZ 126, 181, 183 = NJW 1994, 2220; BGHZ 129, 136, 170 = NJW 1995, 1739; BGH NJW 2002, 208, 212.

group of cases of third party liability based on the principle of culpa in contrahendo (laying claim to being given a particularly high degree of trust) is separately emphasized in section 311 (3) second sentence. Based on the foregoing, a GmbH manager claims a particularly high degree of personal trust if he creates the impression that he will ensure the proper execution of the transaction without consideration of the company's situation and reliance thereon is decisive for the third party. Judges are reluctant to assume that these requirements have been satisfied.[191]

Liability under the *second* of the *group of cases* referred to above (personal interest on the part of the manager) is not excluded by section 311 (3) second sentence BGB; the provision includes only an example for third party liability generally codified in section 311 (3) first sentence BGB. German courts are likewise very restrained with regard to the assumption of personal liability on the part of the representative due to **personal interest**. Indeed, this basis for liability is generally acknowledged because the representative is acting on his own behalf (procurator in rem suam) so to speak,[192] e. g. when the member of the management body already had the intent at the time the contract was concluded with the third party not to duly forward consideration to the company but rather to use it for purposes of furthering personal interests.[193] Otherwise, a direct, personal economic interest on the part of the manager may not merely be presumed based on the fact that he has a significant personal interest in the private limited company or is its sole shareholder. The irrelevance of this circumstance simply follows from the liability privilege to which even such a shareholder/manager is entitled under section 13 (2) dGmbHG[194] as well as the liability privilege provided under EU law in Art. 2 of the directive on single-member private limited liability companies.

c) Violation of rights and legal interests protected under tort law. A member of a management body is liable for damages to external third parties caused by a tortious act for which he is at fault. He is subject to general principles of tort law just as are all others. This liability comes along with the company's vicarious liability for representatives (cf. section 31 BGB; art. 817 OR; art. 55 subsection 2 ZGB). As interpreted by the courts, a member of a management body commits a tortious act for example if he causes, or even directs, the company to sell the property of another. If the owner loses his ownership rights in the property based on a good faith purchase, this constitutes a tortious interference in property rights according to the BGB (section 823 (1) BGB) for which the member of the management body is personally liable.[195] The BGH corrected this line of cases just recently: According to a ruling dated 10 July 2012, the managers' obligation to act in accordance with the law should only apply vis-à-vis the company and not vis-à-vis third parties. This represents a significant difference to those legal systems which very matter-of-factly

[191] BGHZ 126, 181 = NJW 1994, 2220; see additionally Kindler, Grundkurs Handels- und Gesellschaftsrecht, § 16 marginal no. 77 et seq.

[192] Roth/Altmeppen, GmbHG, § 43 marginal no. 36.

[193] BGHZ 126, 181, 184 et seq. = NJW 1994, 2220; followed by, e. g. BGH NJW 2002, 208, 212.

[194] BGH NJW 1986, 586, 587 ("Wertungswiderspruch zu der in der GmbH geltenden Haftungsordnung"); 1989, 292; Roth/Altmeppen, GmbHG, § 43 marginal no. 37.

[195] The leading case is BGHZ 109, 297, 303 et seq. = NJW 1990, 976 – "Baustoff"-Fall; followed by BGH NJW 1996, 1535, 1536 – Lamborghini; see also from a tort standpoint Wagner, in: MüKoBGB, § 823 marginal no. 414 et seq.

assume a liability on the part of the management member vis-à-vis third parties based on corporate law where there is a violation of any rule or statute (France, Italy, Switzerland). By contrast, in the view of the BGH, the provisions of internal liability relating to management bodies (section 43 (1) dGmbHG, section 93 (1) first sentence dAktG; section 25 (1) öGmbHG; section 84 (1) öAktG; art. L223-22 CCom; art. 2392 CC) solely govern the obligations of the members of the management body resulting from their legal relationship *to the company* arising out of their appointment. In other words, they have their origin in the 'mandate nature' of the legal relationship between the management body and the company emphasized in III above (p. 77 et seq.). Accordingly, the court stated that **internal liability** on the part of the members of the management body vis-à-vis the company does not serve to protect company creditors against the indirect consequences of management actions which contravene the standard of care. As could be taken from principles of liability codified in corporate law, a violation of the duty of diligent management only gives rise to a right to claim damages on the part of the company and not on the part of its creditors.[196]

On the other hand, the judges hold that **external liability** vis-à-vis third parties should similarly not be established via tort law. Accordingly, duties of the members of the management body likewise do not constitute obligations with relevance for tort purposes, e. g. in German law under section 823 (2) BGB. For this reason, German law draws a bright line between the interests of the company and those of outside third parties. Liability to third parties on the part of members of a corporation's management body is only possible to a limited extent based on exceptional grounds. For example, a member of a management body is personally liable if he personally caused the damage through a tortious act. The fact that imposing broad tort-based personal liability on the manager of a private limited company would result in a doubling of the company's duties of care – applying the same duties onto the company *and* onto the manager – of course speaks against imposing such liability. Furthermore, personal liability in tort on the part of the manager of a private limited company under section 823 (1) BGB in conjunction with protective duties for which *the company* is responsible is incompatible with the rationale of the general corporate law provisions on management liability: they are not meant to protect third parties ("characteristic of a protective law") (cf. section 823 (2) BGB).[197]

d) Violation of protective laws; liability for manager's delay in filing for insolvency proceedings. However, personal liability in tort to a third party on the part of the manager may result from section 823 (2) BGB in conjunction with a protective law (Schutzgesetz).[198] The company is liable in addition to the member of the management body in such cases as well (cf. the vicarious liability under section 31 BGB; art. 817 OR; art. 55 (2) ZGB).[199] From a practical standpoint, the **offences** of fraud and embezzlement/abuse of trust are of primary relevance. If for example a member of a management body deceives a business partner regarding the company's financial situation and thereby knowingly risks causing a damage for that business partner (debt default), he is liable under section 823 (2) BGB in conjunction with

[196] BGH NJW 2012, 3439 marginal no. 23 et seq.
[197] Lutter/Hommelhoff, GmbHG, § 43 marginal no. 46 et seq.
[198] Italian law contains a provision corresponding to section 823 (2) BGB in Art. 185 CP.
[199] On section 31 BGB, see above § 10 marginal no. 85 et seq.

section 263 StGB [German Criminal Code] based on the principle of fraudulent inducement. Additional protective laws include, for example, the prohibition on conducting banking business or providing financial services without authorisation (section 32 KWG [German Banking Act]) or the offence described in section 265 b StGB (credit fraud).

Breaches of the duty to file for insolvency represent an important instance of liability on the part of management body members for the violation of a protective law. Based on section 15 a InsO (German Insolvency Statute), the members of the management body are required to petition for the commencement of insolvency proceedings within three weeks of a company becoming illiquid; the same applies correspondingly where the company has become over-indebted. The purpose of the rule is to exclude a business with limited assets available to cover its liabilities from trading and in so doing prevent jeopardy or injury to the business interests of third parties which they otherwise would experience by lending funds or property to an insolvent private limited company; accordingly section 15 a InsO is a protective law within the meaning of section 823 (2) BGB. The ratio legis of creditor protection behind the duty to file for insolvency, results from the fact that the creditors *regularly* incur damage where insolvency proceedings are delayed or where there is no filing for insolvency at all.[200] Austrian law also recognises tortious liability for not timely filing an insolvency petition based a breach of section 159 and section 69 öKO. These are seen as protective laws for the benefit of creditors under section 1311 ABGB; in addition to proportional liability for prior creditors, Austrian law – as does German law – also recognises liability for the full loss on the part of the new creditors.[201] Other countries regulate this kind of liability as part of their commercial law. In France, the Code de commerce provides for contingent liability which is claimed by bringing an action en comblement de passif (arts. L225-255, L651-3 CCom); practice shows that the restrictive approach prevails.[202] In Italy the responsibility vis-à-vis the company is based on the general provision on manager responsibility (2392 CC).[203]

e) Intentional immoral harm. Under section 826 BGB, a person who, in a manner contrary to basic moral standards, intentionally inflicts damage onto another person, is liable to the other person to compensate for the damage. A manager is liable under section 826 BGB – in addition to the private limited company (cf. 31 BGB; vicarious

[200] Fundamental, BGHZ 29, 100, 102 et seq. = NJW 1959, 623, also with reference to the fact that this creditor protection is all the more appropriate because the shareholder in a private limited company is not personally liable for the liabilities of the company (§ 13 II GmbHG); followed by, e. g. BGHZ 126, 181, 190 = NJW 1994, 2220; BGH ZIP 2001, 1496, 1497 = DStR 2001, 1671; BGHZ 164, 50 = NJW 2005, 3137; BGH ZIP 2012, 723 (simplified evidence of cessation of payments in the case of a breach of the obligation to maintain books of account by a management body member); for a comparative analysis see additionally Stöber, ZHR 176 (2012), 326.

[201] OGH ÖBA 1998, 488; Kalss/Adensamer/Oelkers, Directors's Duties in the Vicinity of Insolvency, in: Lutter (ed.), Legal Capital in Europe, 2006, p. 112, 116 et seq.; regarding the scope of liability for damages in the case of failure to timely petition for insolvency, see BGH ZIP 2012, 1455.

[202] Kalss/Adensamer/Oelkers, Directors's Duties in the Vicinity of Insolvency, in: Lutter (ed.), Legal Capital in Europe, 2006, p. 112, 125 et seq.; Kindler, Internationales Handels- und Gesellschaftsrecht, in: MüKoBGB, vol. 11, marginal no.674 et seq.

[203] Cass., 27 febbraio 2002, n. 2906, Foro Italiano 2002, I, 3156; Kindler, Internationales Handels- und Gesellschaftsrecht, in: MüKoBGB, vol. 11, marginal no.677 et seq.

liability) – outside of the fraud context if such member makes **claims as to the economic standing of the company against his better knowledge** and the other party to a contract is harmed as a result.[204] An additional significant group of cases involves situations in which a member of the management body enters into **risky transactions** with inexperienced customers without informing them accordingly. Example:[205] An investor sues the manager of a private limited company for damages related to losses from option forward contracts on U.S. exchanges. The private limited company brokered options contracts commercially. The investor, a person with limited business experience, entered into an option brokerage and management agreement with the private limited company and was provided insufficient information regarding the risks. The option contracts concluded with very large losses on the whole. In this case, the member of the management body of a private limited company which brokers financial investments must ensure that risks are explained precisely. The manager of a private limited company who concludes, causes to be concluded, or knowingly does not prevent the conclusion of such transactions with a client without providing sufficient information, acts immorally as defined in section 826 BGB.[206]

6. Analysis.

Our review of the liability of the members of corporate management bodies has made clear that generally, **managers' duties** are a part of an overall system of **creditor protection**;[207] as for the details, our review yields an inconsistent picture. Apart from perhaps acknowledging an exception in the context of exercising entrepreneurial discretion ("business judgment rule"), a common understanding on the part of European legal systems is still very far off. This is evident not in the least through the lack of a rule at the European level. According to Art. 51 SE Regulation, the members of the management, supervisory and administrative organs are only liable *in accordance with the provisions applicable to public limited-liability companies in the Member State in which the SE's registered office is situated.* The planned SPE statute does not even contain a rule on management liability.[208] Among the legal systems reviewed in the present study, the liability standards are broadest in the Latin countries which have a form of corporate law "all around liability" of management body members who breach their obligations. For example, under French law, the manager of a s.a.r.l. is liable for every breach of law or of the company's articles as well as being liable in tort ("faute") vis-à-vis the company, third parties and individual shareholders (Art. L223-22 (1), 3 CCom). Liability for the manager is similarly broad under Italian corporate law (Art. 2392 to 2395 CC) and for members of the administrative board under Swiss law (Art. 754 OR, also in conjunction with Art. 827 OR). Under Italian law, only slight accommodations are made in the case of the small corporation where grounds for liability only exist in relation to the company and the shareholders (Art. 2476 (1), (6) CC). At first glance, provisions regarding liability on the part of management body

[204] BGH NJW-RR 1991, 1312, 1314 et seq.; 1992, 1061, 1062.

[205] Following BGH NJW 2002, 2777; similar BGH NJW-RR 2005, 558.

[206] BGH ibid.; see additionally BGH ZIP 2003, 1782, 1784.

[207] Same conclusion – based on a comparative analysis – in Drygala, Directors' Liability in the Member States of the EU, in: Lutter (ed.), Legal Capital in Europe, 2006, p. 232, 235 et seq.

[208] Cf. the Hungarian proposal dated 20 June 2011 (Council Doc. 11786/11); cf. Bayer/J. Schmidt, BB 2012, 3.

members appear to be restrained in the case of German and Austrian corporate law. In general, it only applies in relation to the company itself (section 43 (2) dGmbHG; section 93 (2) dAktG; section 25 (2) öAktG; section 84 (2) öAktG). Liability in relation to individual shareholders is only provided in exceptional circumstances (e. g. under section 31 (6) dGmbHG in the case of violations of capital commitment), whereby liability in tort may apply on a supplemental basis.[209] General liability on the part of company management in relation to third parties, in particular company creditors, is unknown in German and Austrian statute law. However, in this regard German case law has developed a comprehensive arsenal of actions giving rise to liability which are based on general principles of private law (promissory estoppel, culpa in contrahendo, tort). Viewed on the whole, the differences which have been found do not appear to be so serious such that European harmonisation in the realm of liability on the part of members of a corporate management body is needed.[210] However, the Commission's efforts to achieve recognition of group interests in management body obligations under its Action Plan 2012 must be watched closely:[211] These efforts cannot be allowed to reach the point that members of the management body – as is the case for example with decisions on exploiting business opportunities or financing the company (e. g. in the case of cash-pooling) – may place the interests of the group ahead of those of the company thereby ultimately harming the interests of the creditors of the company they manage.[212]

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[209] BGHZ 110, 323, 334 et seq. = NJW 1990, 2877 – Schärenkreuzer.

[210] See also, e. g. Habersack/Verse, ZHR 168 (2004), 174 et seq. on the topic of liability for failing to timely file an insolvency petition; Kalss/Adensamer/Oelkers, Directors's Duties in the Vicinity of Insolvency, in: Lutter (ed.), Legal Capital in Europe, 2006, p. 112, 143: "difficult to welcome the attempt to unify at European level."

[211] COM(2012) 740/2 v. 12.12.2012, p. 15 (at 4.6): The Commission intends, in 2014, to come with an initiative to improve both the information available on groups and *recognition of the concept of* '*group interest*' (emphasis added by the authors); see also Bremer, NZG 2012, 817.

[212] This is the trend in French law following the "Rozenblum" doctrine according to which a primary interest of the group should be recognised under certain circumstances which permits the use of subsidiaries for group purposes contrary to their interests; Cass Crim V 4.2.1985, JCP/E 1985, II, 14614 = Rev Soc 1985, 648, 650 et seq.: regarding the Rozenblum concept, see Hopt, ZHR 171 (2007), 199, 222 et seq.; Hopt, ZGR 2013, 165, 210 et seq.; Maul, NZG 1998, 965, 966; Lutter, in: FS Kellermann, 1991, p. 257 et seq.; Falcke, Konzernrecht in Frankreich, p. 41 et seq. in each case with additional citations.; providing a summary, Sonnenberger/Dammann, Französisches Handels- und Wirtschaftsrecht, p. 152 et seq.

Chapter 4. Protection of Minority Interests

I. General principles

1. Principle of unanimity and majority decision-making

As the economic owners of the enterprise the shareholders are in principle the masters of the company; their interests constitute (solely or primarily) the interests of the company. They define these interests themselves independently and their will accordingly determines business activities except for certain limitations related to the public limited company form (Ch. 3). As is generally the case in the exercise of private autonomy in private law, this will is expressed in the form of a legal act; the act provided for such purposes in corporate law is the **shareholder resolution**. This is the appropriate method in light of an indefinite multitude of shareholders.[1] A decision is made by having the individual shareholders cast their votes which, in turn is the expression of their will from a legal perspective. For the shareholder, exercising his voting rights represents a material component of his membership (i. e. with the exception of the non-voting shares as well as exclusions on voting in specific cases).

As long as all shareholders are in agreement or a sole shareholder holds all of the shares, the exercise of their control, i. e. the formation of the authoritative intent for the company in this manner is not problematic. However, if the shareholders are pursuing different goals in a specific case, **unanimity** cannot be achieved but rather a **majority** will fall into place for a specific decision which, in turn, may be an absolute majority of more than 50 % of all votes or a relative majority. This will be confronted by one or more competing ideas which are all held by a minority. For such purposes, the voting power of each individual shareholder may be determined in a variety of manners primarily by person ("per capita") or by equity. Especially in the case of two shareholders with equal ownership interests, it is also possible to have a stalemate in which no view is held by a majority.

A consistent expression of private autonomy should provide that within a plurality of persons every decision should be supported by the will of every individual member. As is required in every two-party contract, multi-party contracts require the consensus of every party and the adoption of the company agreement is the characteristic example of this. Consequently, this should apply just as well to later amendments and to other decisions by the shareholders all the same. Nevertheless, this is not compatible with the required degree of **responsiveness and efficiency** required for successful company management. This is required not only at the management level but also at the level where shareholder decisions are made. For this reason it is characteristic and surprising at the same time that until its reform in 1884, German law on stock corporations still largely embodied the principle of unanimity.[2]

[1] See Roth/Weller, Handels- und Gesellschaftsrecht, marginal no. 278 et seq.; Roth/Altmeppen, GmbHG, § 47 marginal no. 2 et seq.

[2] See Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 1 and fn. 1.

If one wishes to dispense with the requirement of unanimity for the reasons referred to above, this may be accomplished by means of a private agreement among the parties in the articles of association or from the outset by the legislator in the form of mandatory or optional provisions of law. In the case of Continental European corporations, laws already provide primarily for majority decisions and then, in some respects, subject this to the discretion of the shareholders.

Majority in this sense at first glance is likely supposed to mean the **majority of all shareholders**. Precisely in the case of corporations with dispersed ownership, with respect to which a larger number of shareholders is either not interested or not able to actively participate in business functions, experience teaches us that some of them will not participate or will abstain from certain decisions. If the required majority in these cases is a simple majority **of votes cast**, then for practical purposes a minority of all shareholders may determine the authoritative intent of the company. For example, in the case of a widely-held public limited company with 60 % shareholder participation at the general meeting, a 31 % share of the votes is sufficient to constitute the required majority.[3] Of course, this may be avoided by requiring an absolute majority of all votes or a quorum higher than 60 % to pass a resolution. However this once more raises the spectre that eligible majorities cannot be found quickly enough or at all.

French law on private limited companies has taken a middle approach on this issue by generally requiring a majority of all shares in order to pass a resolution or alternatively the majority of all votes cast upon a second vote (Art. L223-29). In the case of a capital increase, at least one-half of all votes are mandatory (Art. L223-30 (6)), otherwise for amendments to company statutes a quorum of one-quarter of all votes is required, a quorum of one-fifth on the second vote and a majority of two-thirds of votes cast (Art. L223-30 (3)).

However, it appears to be more useful to simplify the act of voting by shareholders as such by correspondingly designing voting methods and enabling well-informed decisions. These types of rules also provide a form of protection to minorities and will be addressed below on at least a cursory basis.

In addition, the criteria used for determining a majority need to be specified in cases where a majority of the shareholders is being referred to. It is in the nature of the corporation to determine **voting power** based on equity whereas person-based considerations prevail in the case of a partnership. However, voting power may be determined otherwise in the case of a corporation as well, primarily by contractual agreement based on an optional provision of law,[4] namely not merely per capita but also based on the amount of contributions paid in, for example and in such cases the law sometimes requires a double-majority, namely a capital majority in addition to the majority of votes determined in this manner (e. g. section 179 (2) first sentence dAktG).[5]

Finally, voting power may further be decoupled from the share of equity in that certain shares are vested with additional voting rights (shares with **multiple voting rights**, since eliminated in Germany and Austria, section 12 (2) and (3)

[3] See previously Roth, in: FS Paulick, 1973, p. 81.

[4] Zöllner, Schranken mitgliedschaftlicher Stimmrechtsmacht, p. 120; Roth/Altmeppen, GmbHG, §§ 13 marginal no. 61, 47 marginal no. 24.

[5] See Hüffer, AktG, § 179 marginal no. 14; BGH NJW 1975, 212.

AktG respectively) and others lack voting rights (**preferred shares** where the lack of a voting right is compensated for with preferred dividends, see sections 12 (1) second sentence in conjunction with 139 dAktG) or by "capping" the accumulated voting power on the part of an individual shareholder by setting a **maximum** amount or scale (ceiling on voting rights, section 134 (1) second sentence 2 dAktG). All of these features may increase the relative voting power of shareholders holding a minority interest in equity to the detriment of shareholders with a larger share of equity and may be viewed as mechanisms to protect minority interests in this regard.[6] On the other hand, this merely shifts but does not solve the problem of a minority which may be outvoted.

2. Majority rule and protection of minorities

a) Legitimacy and limits on majority control. The practical necessity of abandoning unanimity described above is certainly a plausible explanation for doing so. But in order to legitimise it from the private autonomy perspective, this move needs to be tied to the free will of every individual shareholder. If the shareholders themselves have provided for a **contractual** transition to the majority principle based on statutes providing them discretion to do so, e. g. under section 119 (2) dHGB, their concurrent will may be easily documented in precisely this agreement because such a contract may only be concluded based on unanimous consent. However, the substantive scope of the competence thus attributed to the majority may become a problem if it is described in general and non-specific terms. In German and Austrian partnership law, this is countered by the principle of objective certainty the protective and/or warning effect of which is in turn doubtful, too.[7]

In the case of corporations for which majority decision-making is already provided for **by law**, typically with subject-specific gradations, the considerations set out above only play a role however where the law permits contractual expansion of the competence of the majority, such as is the case for a reduction in the qualified majority requirement under section 179 (2) second sentence dAktG.[8] Otherwise, one could already view the decision in favour of the respective legal entity form in the act of formation as the choice of majority regime supported by the will of all participants. However, its validity is not dependent upon the parties having been aware of the majority rules, and on the whole, the underlying legislative decision is a sufficient form of legitimacy.

If one derives the majority rule from the original consent of all parties, this presents the question of how far such an ex ante waiver of consent on the part of each individual may be meaningful in a specific case. The question is frequently placed within the conceptual triad of irrevocable, mandatory and inalienable rights whereby for purposes of agreeing on majority decisions, mandatory is decisive.[9] In the case of corporations, these **core areas** to be protected from majority rule are mostly regulated by statute and that is namely such that an increase in the performance obligations on the part of the shareholders requires the consent of all

[6] Advocated by Enriques/Hansmann/Kraakman, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 91.
[7] Roth, JBl 2005, 80.
[8] Hüffer, AktG, § 179 marginal no. 18.
[9] Roth, in: FS Kramer, 2004, p. 973.

those affected (section 53 (3) dGmbHG, section 180 (1) dAktG, section 147 öAktG, Art L223-30 (5) French CCom; Art. 797 Swiss OR). Already under the law section 50 (4) öGmbHG, Art. 292 Spanish LSC put the reduction of special rights of individual shareholders on a par with this. This is likewise acknowledged in Germany.[10] The universally recognised principle of equal treatment is a factor as well (Capital Directive Art. 42, Art L225-204 (1) second sentence CCom, section 49 a öAktG, section 53 a dAktG): Any discrimination against individual shareholders compared to others requires their consent, any grant of preferential rights to individual shareholders requires in turn the consent of all other shareholders (see, e. g. Art. 807 (2) OR).[11] Finally, the common objective of the association is subject to unanimity, namely a change in the object of the company, in particular its profit-making activities.[12] French law also subjects the change of applicable corporate law, e. g. by way of a transfer of domicile abroad, to unanimous approval (Art. L223-30 (1) CCom).

On the other hand, it may appear reasonable to prohibit provisions in a company's statutes requiring unanimity or disproportionately large majorities in certain matters in order to prevent blocking tactics on the part of a small minority (e. g. Spain Art. 200.1, 223.2, 238 LSC).[13]

Another problem constellation, even if not uncommon in the person-based private limited company, must be left unaddressed at this point: the stalemate situation between equally-strong shareholders or groups of shareholders, namely in two-person private limited companies.[14]

b) Minority protection and divestment. The extent to which a minority which may be or has been outvoted deserves protection also depends on the extent to which it is interested at all in playing an active role in the relevant matters or, alternatively, is only pursuing a passive investment strategy, prefers to redeploy its investments based on the respective prospects for return and also has the opportunity to do so based on the legal and economic realities. Such distinction correlates to a certain extent with certain types of companies: The listed public limited company appeals to the broad investing public and the number of small investors in turn base their investment decisions on current price and profits expectations and are more likely to express their dissatisfaction in company performance by making a sale rather than actively participating in personnel and substantive decisions.[15] On the other hand, the capital markets also offer these investors the opportunity to dispose of their investment quickly and easily and, in the best case, the opportunity to react to impending downward developments on a timely basis, namely before incurring large losses. This is the factual connection between minority protection and capital market law. Or vice versa: Underdeveloped capital market law prevents the expansion of free float and is likely to leave the enterprise in family ownership.[16]

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[10] Roth/Altmeppen, GmbHG, § 53 marginal no. 33.

[11] The different unanimity requirements for the Spanish private limited company are described in Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain, marginal no. 182.

[12] Roth/Altmeppen, GmbHG, § 53 marginal no. 42; Kort, NZG 2011, 929.

[13] See Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 62 for a comparative law analysis of remedies from the aspect of abuse of law.

[14] See Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 68.

[15] See previously Roth, Treuhandmodell des Investmentrechts, pp. 178, 185.

[16] Schäfer/Ott, Lehrbuch der ökonomischen Analyse des Zivilrechts, p. 646.

On the other end of the corporate type spectrum, a partner in a partnership also has the ability to divest if the law provides the parties with a mandatory right of termination even if valuation and realisation of the investment are burdened with larger issues in that case. Corporations which do not provide for such a divestment right, and for which there is no liquid market for their ownership interests, if they may be freely disposed of at all, find themselves in the middle. This applies in particular to the private limited company. However it applies likewise to the large majority of public limited companies the shares of which are not traded on a functioning market.[17] Accordingly, a right of withdrawal accompanied by reasonable compensation would be an important element of minority protection – at least in cases of serious incompatibility – which nevertheless is not available everywhere and is in no event unlimited.

c) Proportionate consideration of the minority interests. The conflict between majority and minority would be solved if both positions were to be reflected proportionately in the substance of a decision; so in the case of numerical decisions, it is conceivable that compromises could be determined mathematically. For example if one-third vote for the figure of 100 in a decision regarding compensation and two-thirds vote for a figure of 130, the decision could be set at 120. As far as can be seen, this form of compromise is not provided anywhere by statute.

However, the **election of personnel** (Ch. 3, p. 83 et seq.) likely offers the opportunity to give proportionate consideration to the will of the minority in the selection. Following up on the example mentioned above, if 3 managers or supervisory board members are to be elected, a minority of one-third could be granted the right to elect one person. The system of proportional representation shows the path to this end which has been realised in Anglo-American law under the heading of cumulative voting.[18] This is not the system of choice under Continental European law, however section 87 (4) öAktG similarly requires minority representation in elections for the supervisory board if at least three persons are to be elected and the minority reaches at least one-third of the votes cast. Corporate laws in France and Italy have similar provisions.

In the case of the German AG, majority elections are the statutory and practical default, namely either for each person to be elected sequentially or based on a list. Both are permissible however neither offers representation for the minority.[19] The same applies generally in the case of the GmbH. However articles of association may also provide that, if applicable, multiple candidates may be voted on at the same time for a position to be filled and that the relative majority is sufficient. The articles may then just as well permit multiple positions to be filled to be elected in this manner, and this results in **proportional representation**.[20] Based on prevailing opinion, proportional representation may be provided for in the statutes of an AG as well.[21]

[17] Wiedemann, Gesellschaftsrecht, Vol. 1, § 8 I 1; Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, pp. 25, 29 et seq.

[18] See Enriques/Hansmann/Kraakmann, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 90.

[19] Hüffer, AktG, § 101 marginal no. 6.

[20] Hüffer, in: Ulmer, GmbHG, § 47 marginal no. 23; Zöllner, in: Baumbach/Hueck, GmbHG, § 47 marginal no. 24; Roth/Altmeppen, GmbHG, § 47 marginal no. 9; OLG Stuttgart NZG 2000, 159.

[21] Hüffer, in: Ulmer, GmbHG, § 133 marginal no. 33 citing section 133 marginal no. 33 AktG.

Austrian corporate law expressly provides (as is the case in France)[22] for proportional representation as an option (section 87 (5)). It may implemented by means of ballot by list with a sequential order on every list or also in the form of "cumulative voting" whereby every share receives the same number of votes as the number of positions to be filled and then such votes may be cumulated for a single candidate.[23] If the company statutes do not provide for this, the default option is majority voting. However, para. 4 ibid. still requires minority representation[24] in such cases. Of course, the threshold for such minority representation is high because the minority must be able to cumulate at least one-third of all votes cast for its candidate in order to prevail. The number of shareholders included in this minority is irrelevant. The terms of the individual supervisory board members (at most five years) need not be synchronised so that potentially the requirements for minority rights are not satisfied if less than 3 persons are to be elected at each general meeting.

As a result, if representation on the supervisory board is only of limited practical importance for purposes of minority protection, the **independence** of the supervisory board or the independence of certain board members is likely more important as an instrument for protecting minority interests regardless of the number of minority representatives.[25] This independence has become the perennial issue in academic and political discussion in Germany, the home country of the control body.[26] The issue may be approached from two sides: as the independence from the **management body**[27] and as the independence from the **large/majority shareholder** who dominates the vote. Starting from the duty of the supervisory board to monitor management on the one hand and the actual observation of close relationships between both of these groups of persons on the other, emphasis has been placed on the first form of independence, whereas the required independence from the controlling shareholder has been contradicted due to property rights and corporate-group rights concerns,[28] and has gained support in Germany only recently.[29] For this reason, the Anglo-American literature takes the position that the interests of the minority shareholders are in better hands with the independent directors on the American board than they are in the case of the Continental European supervisory board[30] and the same may likely have been said in respect of the representatives of the public interest under the earlier, since obsolete Dutch model[31].

The European Commission advocates for a larger "variety" in the composition of supervisory and administrative boards in its Action Plan 2012.[32] Whether this

[22] This is not utilised according to Enriques/Hansmann/Kraakman, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 91.

[23] Kalss, in: Doralt/Nowotny/Kalss, AktG, § 87 marginal no. 35.

[24] A provision in company statutes pursuant to section 5 also displaces minority protection under section 4; Kalss, in: Doralt/Nowotny/Kalss, AktG, § 87 marginal no. 34.

[25] Similar view, Enriques/Hansmann/Kraakman, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 94.

[26] German Corporate Governance Code no. 5.4.2; recommendation of the EU Commission 2005/162/EC; Spindler, ZIP 2005, 2033; Vetter, BB 2005, 1689; Hüffer, ZIP 2006, 637; identical AktG § 100 marginal no. 2 a.

[27] See Roth/Wörle, ZGR 2004, 565.

[28] Hüffer, AktG, § 101 marginal no. 6.

[29] German Corporate Governance Codex amendment of 2012; cf. Florstedt, ZIP 2013, 337.

[30] Enriques/Hansmann/Kraakmann, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 94.

[31] Roth, AWD BB 1974, 312.

[32] COM (2012) 740/2 dated 12.12.2012.

also represents an aspiration to provide better representation for minority shareholders remains to be seen.

d) Qualified majorities. Increasing the required majority to two-thirds or three-quarters of all votes cast in the case of important or structurally-relevant resolutions also represents a form of minority protection. Similar to the situation discussed above, legal protection is made dependent on the establishment of a certain, relatively high minority percentage here as well. If it reaches the threshold value, the minority can block the will of the majority, i. e. so-called blocking minority in the case of amendments to company statutes, etc. of 25 % for example, or to be precise, 25 % plus one vote.

e) Minority protection and individual rights. Where the discussion is of the minority in contrast to the majority, this implicates the inclusion of a quantitative element. A minority is defined by a numerical voting percentage which is less than 50 % in any event. For certain protective purposes a relevant threshold value is set much lower, however always specifically-indicated. To the extent minority rights are targeted toward bringing about a resolution, the fixed percentage does not relate to a share of the votes cast but rather to the total of all votes and/or equity interests.

This must be distinguished from rights to which every shareholder is entitled regardless of the size of his equity holding, whereby this does not refer to the primary membership rights – voting right, rights to share in profits and credit balances in case of dissolution – but rather individual rights which are granted as part of the formation of intent. Of course, the distinctions are fluid here as well, e. g. because the right to information is related to the formation of intent and, at the same time, as an element of membership expresses the fact that the affairs of the shareholder affect every individual shareholder. However, within the context to be discussed here, it is more important to protecting minority shareholder rights that the rights depending on percentages and individual rights work together. This will be shown presently in relation to participation rights. For this reason a strict separation is not useful from a functional perspective.

f) Minority participation rights. The minority may be subject to being outvoted however it may not be ignored. This is the reason for the procedural guarantees of proper invitations to the meetings where resolutions are to be passed and for the right to attend and to be heard on the part of every individual shareholder; and depending on a minority quota, the right to make proposals for the agenda and the right to convene meetings.

g) Minority control rights for minorities above a certain percentage. For example, sections 130 (2), 134 (1) second and third sentences öAktG regarding the special audit and assertion of claims for damages.

h) Individual right to information. The right to information on the part of the GmbH shareholders, sections 51 a, b dGmbHG, information rights of the corporate shareholder at the general meeting.

i) Substantive limitation on majority rule by means of exclusions from voting. By statute in the case of conflicts of interest, section 47 (4) dGmbHG.

j) Individual right to petition to nullify a resolution. A minority may challenge procedural and substantive breaches related to approval of resolutions on the part of the majority in this manner. The minority may avoid the defective resolution in this manner and potentially force the correct contents of a resolution.

Counterbalance to the benefit of the majority: the aspect of the abusive petition for avoidance.

k) Substantive review of the contents of a resolution. In certain cases with structural significance, the law provides substantive criteria for the contents of a resolution which are not simply subject to the discretion of the majority but rather which the minority may force to be reviewed in the form of a petition to avoid the resolution. The prime example of this is the exclusion of subscription rights set out in section 186 (4) dAktG. The core issue of substantive minority protection is whether and how this substantive control of decision-making may be extended. Possible starting points include: on the one hand, the shareholders' duty of loyalty as a means of limiting votes. This prohibits the unlimited pursuit of majority interests at the expense of the minority. Other approaches include the requirement of equal treatment in certain cases (section 47 a öAktG),[33] and the promotion of a substantive balancing of interests in the resolution which effects a cautious expansion of the rules governing the exclusion of subscription rights.

l) Right of withdrawal and protection against exclusion. The exclusion of minority shareholders is probably the most serious encroachment on their membership against which they require protection. On the other hand, their withdrawal is the ultima ratio in order to terminate a business relationship which has become unbearable. A withdrawal in this sense is the extreme form of divestment (see b, above). However due to its radical nature this is always only the second-best option for the minority.

For this reason, the effectiveness of minority protection should ultimately have to prove itself in the form of substantive control of decision-making. Still, formal minority protection (see immediately below) is frequently given too little importance.[34]

II. Formal minority protection

What is at issue here are the formal requirements and framework on the basis of which majority decisions may be approved over the objection of the minority (also called structural minority protection).[35]

1. Qualified majorities

a) Purpose. It is entirely doubtful whether minority protection in this sense may be quantified such that a larger minority is more worthy of protection than a smaller minority. In the case of encroachments on membership rights, worthiness

[33] See Enriques/Hansmann/Kraakmann, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 96.

[34] Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 7.

[35] Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 86.

of protection should principally be independent of the ownership percentage and accordingly the rule that such encroachments require the consent of the affected parties presents itself as a solution (see I 2 a, above). On the other hand, there are squeeze-out rules which apply at a threshold of 95 % majority participation and permit the exclusion of minority shareholders in exchange for cash compensation, i. e. they have no defence in the face of such measures, section 327 a dAktG.

However, where qualified majorities are otherwise required in corporate law – in most cases three-quarters or two-thirds – they typically involve **important decisions**, typically of structural relevance for the company, which however do not represent encroachments of the type discussed above and one may therefore be of the opinion that a larger minority, perhaps something like more than one-quarter or one-third, should be perhaps more entitled to prevent such changes against their will (= blocking minority) than a smaller minority. Traditionally, the presumption of correctness is put forward as an argument here: Just as it is the basic assumption in the case of private free choice that the consensus of the parties is the (subjectively) highest indicator of substantive correctness,[36] the same may be said that the will of a larger, qualified majority brings with it a presumption of correctness compared to that of a correspondingly smaller minority.[37] Historically, this presumption has been seen to apply where the majority is twice as large as the minority, namely two-thirds of the votes.[38]

b) Implementation. Some countries follow the historical example of the **two-thirds** majority, as is the case for the French private limited company formed after 2005 computed in the form of a two-thirds majority of votes represented in passing the resolution (Art. L 223–30 (3) CCom). In the case of Italy, a two-thirds majority of all votes is required for certain, specific resolutions[39] and the same is the case in Spain for reorganisations and other structural changes, the exclusion of subscription rights, transfer of domicile abroad and similar items (Art. 198 f LSC). Otherwise, Italy and Spain are satisfied with a simple majority for resolutions amending company statutes which however, is determined as the absolute majority of all shareholder votes or equity interests respectively[40] and only in the case of the public limited company as a simple majority of votes of a quorum of 50 % (LSC Art. 194 in conjunction with 201, making further distinctions). This alternative to the two-thirds majority is based on the Capital Directive (Art. 40) as is the case with the two-thirds majority itself.

On the other hand, France requires a quorum in addition to the majority requirements referred to above, which comprises one-quarter and in the second vote one-fifth of the entire capital (Art. 223–30 (3) CCom). The same rule applies in the case of the French public limited company (Art. L225-96 CCom). For certain amendments to company statutes, Switzerland requires a two-thirds majority of votes represented which, in the case of the public limited company must also constitute the

[36] Schmidt-Rimpler, AcP 147 (1941), 130, 149 et seq.; identical in: FS Raiser, 1974, p. 3.
[37] Critical view, Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 11.
[38] Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 52.
[39] According to Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Italy marginal no. 127.
[40] For Italy, see Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, marginal no. 126, for Spain see Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain marginal no. 180.

absolute majority of capital represented and in the case of the private limited company an absolute majority of the existing capital (Art. 704, 808 b OR). Finally, the two-thirds majority also represents the minimum threshold for capital increases and other capital measures for public limited companies under the Capital Directive – in this case in relation to votes present when the resolution is passed (Art. 40).

In the case of its pre-reform companies, France required and requires a **three-quarters** majority instead and that is even based on the total of all votes (Art. L223-30 (2) CCom). France has since reduced its qualified majority requirements in 2005. The three-quarters majority is generally the standard for the public limited company and the private limited company in Germany and Austria, however in this case only in relation to the number of votes cast (sections 179 dAktG, 53 dGmbHG, 146 öAktG, 50 öGmbHG). Examined in detail, the rules for the public limited company are somewhat more complex because they have to take into consideration the fact that voting power need not necessarily correspond to the share of equity. A double majority comprising the simple majority of votes is required for this reason in addition to the three-quarters majority referred to above based on equity shares.

The requirement of a qualified majority applies to all amendments to company statutes, which of necessity also includes all measures affecting capital, and furthermore the exclusion of subscription rights – which may only be approved as part of the resolution increasing capital itself (section 186 (3) dAktG) – and all structural changes including a resolution dissolving the company (section 262 dAktG).

The qualified majority requirements are generally made **subject to discretion** in drafting company articles of association, however this discretion is subject to various forms of limitations. For example, the three-quarters majority provided in German and Austrian corporate law is optional in both directions with the exception of an amendment of the company object for which the majority of equity may only be increased (sections 179 (2) second sentence dAktG, 146 (1) second sentence öAktG; this is similarly the case for the issuance of non-voting preferred shares, section 182 (1) second sentence dAktG). In the case of the private limited company, the statutory majority requirement is mandatory as a lower limit (sections 53 (2) second sentence dGmbHG, 50 (1) second sentence öGmbHG). By contrast, other laws sometimes place mandatory upper limits on required majorities, namely they do not permit increases. For example France in the case of pre-reform private limited companies in respect of its already-high statutory majority, Art. L223-30 (2) second sentence. Spain imposes the same limitation for resolutions which relate to measures to be taken against management, i. e. their implementation should not be made more difficult.[41]

2. Ensuring participation

a) Purpose. In situations in which the minority may be outvoted, this means that its will is subordinated to that of the majority. Nevertheless, it may not be excluded from the decision-making process. From a practical standpoint, the right to participate in the process promises that the individual shareholder may articulate his opinion (right to be heard) thereby employing the power of persuasion and the opportunity to gain support among fellow shareholders; it further enables each

[41] According to Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain marginal no. 181.

individual to organise with others, to disrupt the majority of the others, to split off individual votes and, where applicable, to form a majority or blocking minority of his own. In order for a shareholder to have the opportunity to assert his own will in the company, the right to participation must be accompanied by a right of initiative.

However, this no longer helps in cases where the blocks are firm, agreements have been made in advance or interests have already coordinated themselves. In such cases, the individual still has the advantage that participation provides comprehensive information, not in the least with regard to the motives of and interrelations within the majority. Finally, the fundamental value of the right of participation may be seen in the fact that it ensures the individual the regard and respect of his person and membership which he may assert by virtue of the requirement of equality of treatment.

b) Implementation. In the case of the corporations, the first step consists of having shareholder resolutions formalised in a certain form, namely either by being voted upon at required shareholder meetings or in a prescribed written process. Furthermore it must be ensured that every shareholder may prepare for the process in advance, may form an opinion on the basis of information and potentially coordinate his actions with other shareholders.

aa) Invitation and notice of the agenda. All shareholders must be notified of a pending general meeting of the shareholders on a reliable and timely basis. The laws provide certain forms and deadlines for such purposes, e. g. in the case of the private limited company by registered letter at last one week prior to the date of the meeting (section 51 (1) dGmbHG, section 38 (1) öGmbHG, similar rule in Italy).[42] Spain and France require fifteen days' notice (Art. R223-20 (1) CCom, Art. 176 LSC). In the case of the public limited company, the notice period is generally longer (30 days under section 123 (1) dAktG, 28 or 21 days pursuant to section 107 öAktG, 21 days based on the Shareholders Rights Directive), however the form is simplified in keeping with the large and fluctuating group of shareholders. In most cases, a suitable form of public notice is sufficient (section 121 dAktG, section 107 öAktG). In most legal systems, the agenda must be sent along with the invitation; pursuant to German GmbH law, it may be sent on even shorter notice of three days (section 51 (4)).

The **time and place** of the meeting are important for the actual ability of shareholders to participate. They must be set such that the interests of the company and those of the shareholder are taken into account to the extent possible. In some cases, the location of the company's registered office is required. In most cases, this point is left to the discretion of the company statutes as is the case with the formalities related to the invitations, at least in the case of the private limited company.[43]

[42] For Italy, see Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Italy marginal no. 121.

[43] The same for Spain Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain marginal no. 170 et seq.; for Italy, see Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Italy marginal no. 121, regarding the location of the general meeting of a public limited company, see section 121 (5) dAktG, for the private limited company, Art. 2479-bis Codice Civile.

Compliance with the provisions regarding notice of the agenda are ensured in that a valid resolution may not be approved concerning subjects for which proper notice was not provided in advance. By contrast, this is not required in cases where **all shareholders** consent to the resolution (section 51 (3), (4) dGmbHG). What is meant however are all shareholders, not merely those present at the meeting, as a shareholder could have decided not to participate in a meeting because the items on the agenda did not appear to require his presence. The same applies in most cases for mistakes in calling a meeting in any event. Where all shareholders nevertheless appear at a so-called plenary meeting and are prepared to make decisions, the error is harmless because it is not a causal factor in the decision-making process (Art. L223-27 (7) CCom, Art. 178 LSC, section 51 (3) dGmbHG, section 38 (4) öGmbHG).[44] The same applies to the general meeting of a public limited company pursuant to sections 121 (6) dAktG, 105 (5) öAktG.

The rules under discussion here, which are intended to protect the participation rights of the individual shareholders, are in part seen as so important that a failure to observe them renders a resolution passed such rights notwithstanding **void**.[45] This is necessary in any event where a shareholder would otherwise be unaware of the resolution and accordingly could no longer exercise his rights. In other, less serious cases, it may be sufficient that the shareholder is able to challenge the resolution using the procedure provided for this purpose and then only subject to the requirement that the procedural error had or could have an effect on the results of the resolution or was relevant to the shareholder's participation interest.[46]

Minority rights of initiative. General meetings of the shareholders are normally called by the managers who act on their own initiative if they are not following statutory requirements or are complying with the wishes of a majority of the shareholders. The agenda is created in the same manner. Nevertheless, the laws grant a specified qualified minority the right to demand that a meeting be called or to place items of their choice on the agenda. In the case of the public limited company, the Shareholders Rights Directive of 2007[47] established minimum minority protection thresholds in this instance and in the cases to be discussed below.

In France, the ratio had originally been set rather high at one-quarter of the shareholders and equity interests. At present, the double ratio of one-tenth of the shareholders and one-tenth of equity interests is sufficient, otherwise one-half of equity is required (Art. L223-27 (4) CCom). Under German and Austrian laws on private limited companies, one-tenth of equity is sufficient (sections 50 dGmbHG, 37, 38 (2) öGmbHG). For public limited companies, one-twentieth of equity is sufficient (sections 122 dAktG, 105 (3) öAktG). In the case of the German AG, equity representing EUR 500,000 is required to make additions to the agenda. All of these are mandatory law for purposes of minimum thresholds. Based on the

[44] Still somewhat stricter, Italian private limited company law, see Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Italy marginal no. 126.

[45] Roth/Altmeppen, GmbHG, § 47 marginal no. 102; going further, Spanish law on private limited companies, see Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain marginal no. 173.

[46] Roth/Altmeppen, GmbHG, § 47 marginal no. 125 f; presenting a simplified view Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 137.

[47] 2007/36/EC; see Müller-Graff/Teichmann, Europäisches Gesellschaftsrecht auf neuen Wegen, p. 169.

foregoing, the minority can compel the shareholder body to address its concerns however only insofar as they may present their position and submit requests. This means that the majority will also be represented in sufficient numbers in order to be able to outvote them as needed. However, the minority cannot prevent the latter and can similarly not force a substantive debate.

bb) Rights to attend and to speak. The goal of all of the provisions addressed above is to ensure the shareholder active participation in the decision-making body, representation of his opinion and his interests. The core of the entire body of rules is thus the right to attend and speak at the meeting. The right of participation fundamentally includes the right to send a representative as well and accordingly the right to have a proxy cast a vote (section 47 (3) dGmbHG). In exceptional cases, personal attendance may be required and vice versa sending a suitable representative may be required in certain conflicts of interest. That aside, there is also a right of attendance even if the voting right is excluded generally or in a specific case.[48]

The exercise of the right of attendance, practically: access to the meeting may be tied to certain formalities. These are required especially in the case of a larger and anonymous group of shareholders as is the case for the public limited company. The shareholder must be able to document his right in a specified manner. For such purposes, presentation of the share certificate has been replaced by more simplified means. In the case of a small shareholder, the exercise of voting rights by a **proxy** plays a large role for practical purposes because his personal participation in the meeting will generally not be the rule for a variety of reasons;[49] the laws endeavour to make this form of representation as effective as possible a form of participation, even if indirect, on the part of the shareholder through a variety of sophisticated rules. This creates difficulties in case of a multitude of small shareholders (more on this topic later), in the face of which Spanish law surrenders to a certain degree when it permits the public limited company to make participation contingent on an equity interest of 0.1 % or less (Art. 179 (2) LSC).

The right to speak may likewise not be granted unconditionally but rather must be integrated into the framework of the **orderly sequence** of the meeting and must also take into consideration the equally important rights of all other participants. This also includes ensuring that the meeting may be concluded within a reasonable amount of time. For this reason, limits on speaking time are permissible, even in the form of ad hoc measures by the chair of the meeting. It is similarly permissible to revoke one's speaking right if such right is being exercised inappropriately. The right to cast one's vote is fundamentally unaffected by this as is the right to ask questions or to submit requests for the agenda and/or counter-proposals to agenda items. However, this may be revoked in exceptional cases where the exercise is unlawful or if exercised in an obstructive manner.

The company may set out detailed rules, including with regard to management/ leadership of the meeting, in its statutes or rules of procedure.[50]

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[48] Roth/Altmeppen, GmbHG, § 48 marginal no. 4.

[49] Roth, Treuhandmodell, p. 175 et seqq. and in: FS Paulick, 1973, p. 81.

[50] For the private limited company, see Eickhoff, Die Praxis der Gesellschafterversammlung, for the public limited company, see Schaaf, Praxis der Hauptversammlung.

cc) Written procedure for adopting resolutions. From a practical standpoint, holding a general meeting of the shareholders in order to exercise the right to vote has obvious disadvantages where larger groups of shareholders are involved who are geographically spread out and who are not actively involved in the activities of the company. In such cases, it would be easier for them to be able to cast their votes in another manner, from a distance and with greater freedom to set a time. This would also permit higher participation levels up to full participation. Written procedures lend themselves to this purpose. On the other hand, this alternative has the just as obvious disadvantage that the shareholders do not discuss the subject matter of the resolutions "at one table", do not better inform themselves in this manner, cannot attempt to persuade others, and in the best case, reach a consensus or compromise in a cooperative atmosphere. For this reason, many legal systems provide for a written procedure as an alternative, however not all of them and not for all entity forms and to some extent with significant limitations. In addition, an alternative solution may be realised by means of (potentially organised) **proxy voting** based on written authorisation and instructions. This has gained in significance based on the American proxy system.

Essentially, a written vote may be conducted either by means of circulation, in which a written proposal is sent to the shareholders in sequence with the request to note their approval or rejection or by sending a proposal with the request to transmit approval or rejection within a given period to a designated recipient. However, to the extent such a process represents the exception for adopting resolutions, consent to such process must be inquired about and established prior or simultaneously.

In the case of the private limited company, where permitting a written voting process may be the rule, this may be provided for in the articles of association or may be held with the consent of all shareholders, whereby serious or structurally significant matters are frequently excepted (France Art. L223-27 (1) CCom;[51] Germany section 48 (2) GmbHG).[52] Consenting to the matter itself may be equivalent to consent to the particulars of the procedure. By contrast, Art. 805 (4) Swiss OR permits written decision-making to the extent a shareholder does not object, whereby the rule turns the relationship between default and exception on its head, however the method as such is again subject to the discretion of every individual shareholder.

In the case of the public limited company, participation by the shareholder in decision-making **without being physically present** is essential if the company has a large and widely-dispersed group of shareholders. In such cases, the task is to have the formation of consent at the general meeting rest on as broad a base as possible on the one hand and to take into consideration the impossibility of meaningfully holding a meeting with thousands of shareholders on the other. In light of the foregoing, it is somewhat surprising that written voting is not provided for in the laws from the outset. The explanation for this may well be that in light of the allocation of decision-making competence one ordinary general meeting per year is sufficient for purposes of establishing the intent of the shareholders and that in

[51] Similar for Italy, see Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Italy marginal no. 119.

[52] The exception for amendments to company statutes is subject to dispute in Germany, see Roth/Altmeppen, GmbHG, § 53 marginal no. 17.

Continental Europe public limited companies dominated by large shareholders are the norm which then can ensure voting participation of more than 50 %.

The practice has initially taken advantage of the circumstance that most shareholders permit their shares to be administered by banks via custodial accounts and has developed the system of bank voting rights by means of which the **banks exercise voting rights** via written authorisation. Section 135 dAktG attempts to expand this to a form of written voting as part of which the bank procures information for the shareholder in each case and follows his instructions for casting his vote. This method may exclude the main problem of the American proxy system in which the board of the company itself is commissioned. However, the banks are frequently subject to conflicts of interest and so the next step consisted of promoting other voting representatives, for example, through shareholder associations, as well (cf. section 135 (8) with (1) fifth sentence dAktG). The Shareholders Rights Directive brought significant progress with it in 2007 (2007/36/EC): It first established the requirements for **virtual participation** in the general meeting via on-line access (two-way direct connection, Directive Art. 8) and second it established requirements for submitting a vote by letter or electronic communication (Directive Art. 12).[53] However, pursuant to section 118 (1) second sentence dAktG, both of these are merely optional provisions which may be included in a company's statutes.[54] The opposite is true of Art. L225-107 CCom which makes them mandatory law.[55]

The Commission sketched out additional steps which could assist collective action on the part of small shareholders in its Action Plan 2012.[56] For example, establishing contacts among them could be made easier, the voting behaviour of institutional investors could be made more transparent and the extension of decision-making competence to include sensitive areas such as board compensation may be suitable to promote interest in active participation.

3. Minority control rights

a) Purpose. The external review of certain critical processes by an outside expert (**accountants and auditors**) generally plays a large role in corporate law, e. g. review of contributions in kind upon formation (sections 33 dAktG, 6 a (4) öGmbHG), auditing of the accounts in the case of a capital increase from company funds (sections 57 e, f dGmbHG) and especially in the form of a regular audit of the annual financial statements which is provided for in standardised manner in the Fourth, Seventh and Eighth Company Law Directives (see Chapter 5, p. 151 et seq.). Ongoing control of company management or at least accounting by the commissaires aux comptes or the consiglio sindacale respectively provided for under French and Italian law goes even further (Art. L225-218, L225-228 CCom, Art. 2397 f CC, for the private limited company as well pursuant to the provisions of Art. 2477 CC).

This control supports realisation of the statutorily intended legal protection in its entire breadth, from the protection of creditors to that of the shareholder from management, through to protecting the interests of the public. It has a disciplinary

[53] Details found in Lutter/Bayer/Schmidt, EuropUR, § 31.

[54] Hüffer, AktG, § 118 marginal no. 8 a, e.

[55] Similar forms of participation are made available in the case of the private limited company, Art. L223-27 (3) CCom.

[56] COM (2012) 740/2 dated 12.12.2012.

effect on the one hand due to the level of transparency it creates and on the other its results in sanctions in the event irregularities are discovered, for example in that the registry court will not complete registration upon discovery of defects related to formation. The appointment of the auditor is fundamentally the duty and responsibility of the shareholders however is also a matter for the courts to some extent (formation review, section 33 (3) second sentence dAktG).

In certain cases, this control mechanism is made available to the **minority** in order to enable it to protect its interests in this manner against the majority of the shareholders. In essence, a distinction must be made between two options at this point: First, the minority may assert its interests through the appointment of a suitable and (primarily) independent auditor for audits which must be conducted in any event. Second, under certain circumstances it may initiate special audits and, in the event these special audits discover irregularities, enforce any resulting claims, for example against company management, even against the will of the majority.

b) Implementation. In connection with the appointment of the auditors, the minority may request that a court appoint a different auditor if they have legitimate objections to the auditor selected by the majority. Austrian law requires a qualified minority for such purposes equal to 5 % of nominal capital or an equity share of EUR 350,000 (section 270 (3) UGB). The prior version of Art. L225-230 CCom also granted this right to a 5 % minority.[57]

A minority may request at the general meeting that a **special audit** be conducted concerning processes related to the formation or procurement of capital or related to management in general. The shareholders may approve the request and appoint the special auditor by majority vote. The minority may also request the court to appoint a special auditor even without such a resolution based on specific important grounds – primarily the legitimate suspicion of dishonest conduct or gross violations of law. Based on German corporate law, an equity share of 1 % or EUR 100,000 is sufficient for such purposes (section 142 dAktG). Section 130 öAktG requires a share of 10 % as does section 45 öGmbHG in the case of a private limited company. In the case of a Swiss public limited company (Aktiengesellschaft), Art. 697 b OR 10 requires 10 % or CHF 2 million. Similarly, in France 5 % of shareholders in a public limited company and 10 % of shareholders in a private limited company may have a court order a special audit by an expert de gestion (Art. L225-231, L223-37 CCom). By contrast, the German GmbHG contains no similar minority rights even though the reform of 1980 had originally provided for the right to a special audit as an individual right.[58]

In the same manner, the minority may raise objections to a special auditor engaged by the general meeting and petition the court to appoint another expert.

Section 258 dAktG governs a special case for a special audit which is tied to the minority share of section 142 dAktG. Under this section, certain defects in the annual financial statements may be subject to review, namely under-valuations which reduce profits on the one hand and information which has been withheld or which should have been disclosed in the explanatory notes on the other.

[57] Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 152.

[58] Roth/Altmeppen, GmbHG, § 51 a marginal no. 1. In favour, see also Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 62 and in GmbHR 2001, 45.

If indicators for claims on the part of the company against the manager or other persons are discovered based on a special audit, or in another manner, and the general meeting or other competent body does not want to enforce them, the same minority may seek authorisation from the court to sue to **enforce these claims** in their own name on behalf of the company (section 148 dAktG). In the event the general meeting appoints a legal representative for such a suit, a (albeit larger) minority may assert objections to such representative and petition the court to appoint another representative.

In all of these cases, the minority acts as a fiduciary of the interests of the company. For this reason, the company also bears all related costs unless the applicant raised illegitimate suspicions through gross negligence.

In a similar manner, French law provides the minority a right to sue directed at the managers and the general director which follows the minority share referred to above with respect to special audits, however in the case of the public limited company, the share declines to 1 % in relation to ownership at higher levels of corporate capital and is additionally tied to other requirements (Art. L223-22 (3), L225-120 in conjunction with L225-252 CCom).

c) Excursus: The individual shareholder suit. The right of the minority to pursue enforcement of claims for compensation for damages on the part of the company is less important if and to the extent each individual shareholder already has such a right to file suit. Then it is mainly the assumption of costs by the company which makes a difference. This form of a right to sue is a fixed component of the American legal system under the term *derivative suit*.[59] In the German legal tradition this is primarily discussed under the key word *actio pro socio*.[60]

In fact, there are constellations under which individual shareholders may enforce these types of claims and the dAktG makes explicit reference to an applicable situation: Section 117 (1) second sentence. This relates to claims for compensation on the part of shareholders who have been harmed, namely for damages which they have experienced directly, not indirectly based on harm to the company. However, as the text of the statute makes very clear, these are claims on the part of the shareholder based on his own right to compensation for **damages he has personally incurred**, namely claims, based on whatever legal basis, the enforcement of which is logically the concern of the individual shareholder.[61] French law makes similar references in CCom Art. L223-22 (3) and L225-120 as is the case in Spanish law on private limited companies in Art. 241 LSC. The right of initiative for enforcing **claims on behalf of the company** is somewhat different.

The latter form of individual rights to file suit are fundamentally not part of the German legal tradition,[62] they are however indeed part of the Latin legal systems. For example, the French CCom considers a right on the part of individual shareholders in the same breath as the minority right to file suit referred to above (Art. L223-22 (3),

[59] Regarding the derivative suit in English law, see Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 234. Comparative law analysis in Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 58.

[60] Hadding, Actio pro socio; Grunewald, Die Gesellschafterklage; Banerjea, Die Gesellschafterklage im GmbH- und Aktienrecht.

[61] Cf. BGH NJW 1969, 1712.

[62] Roth/Altmeppen, GmbHG, § 46 marginal no. 66.

L225-120). In addition, every shareholder may petition the court to remove a manager (Art. L223-25 (2)). In Spain, Art. 239.2 LSC grants the shareholders a right to file suit subject to narrow set of requirements[63] and the same applies now for the private limited company in Italy.[64] Even in Switzerland an individual shareholder may sue on behalf of the company for repayment of impermissible payments, Art. 678 (3) OR and the individual shareholder in a private limited company may sue to have a manager's management or representational authority rescinded for cause, Art. 815 (2) OR.

However, these individual rights of action appear to be of limited practical importance. In the literature this is attributed to the fact that the plaintiff bears the unmitigated **cost risk**.[65]

On the other hand, in German law on private limited companies, where similar minority rights are not emphasised, the obvious step is to discuss such suits as cases to which actio pro socio applies. However, the details conceal differences[66] and individual rights of action are generally recognised primarily for purposes of safeguarding membership rights or where they have been violated such as, in particular, the enforcement of individual rights to information and to challenge a shareholder resolution. See III 2, p. 135, below on this topic.

4. The individual right to information

a) Purpose. The right to be fully informed at all times regarding the affairs of the company is first a consistent acknowledgement of the fact that as a shareholder one is a co-owner of the company, that the company is "one's own" and second from a practical standpoint it is an important instrument of controlling those persons who actually manage the business: managing director, active majority shareholder. It functions as an instrument of control in the two-fold sense that the shareholder may derive counter-measures or sanctions based on misadministration, undesirable developments or misbehaviour revealed in such information and that the ability to monitor already has a preventative effect. What ultimately relates to the preventative effect, the information rights as such, i. e. the possibility for them to have effect, interrelate to the disclosure obligations and transparency requirements – which rest on other legal grounds – which demand an on-going, periodic or event-driven disclosure of certain circumstances. In the latter case the obligation is not only owed to individual shareholders but to all shareholders or the public in general. In the case of this publicly-focused disclosure, which starts with the annual financial statements in the case of the corporation and culminates in the related **disclosure obligations** on the part of a public limited company acting in the capital markets, the interests of the shareholders to information are no longer the focal point but rather what is involved is the protection of creditors, investors, employees and the public as such.

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[63] Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain marginal no. 227.

[64] Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Italy marginal no. 152 et seq. who mentions that prior to the reform in 2004 a minority of 10 % had a right of action.

[65] Ulmer, ZHR 163 (1999), 290, 300; Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 245.

[66] Roth/Altmeppen, GmbHG, § 13 marginal no. 15 ff; for a case of application in public limited company law, see Hüffer, AktG, § 53 a marginal no. 19.

Finally, information gains an additional aspect for the shareholders as a substantiated decision base ahead of a resolution.[67] The right to information is in part focused precisely on this situation whereby certain subjects to be decided upon such as the discharge or dismissal of managers in any event represent methods for sanctioning irregularities which have been discovered. It should be self-evident that certain documents must be disclosed in a timely manner prior to when a decision is to be made, namely the annual financial statements (cf. section 42 a dGmbHG). Additional documentation is only sometimes expressly required (e. g. France Art. L223-26 (2), L225-108 (2) CCom).

However, despite its roots in membership or co-ownership, the individual right to information must be limited by a countervailing interest, namely the practical functioning of management which should not be unduly burdened on the one hand and the interest in **confidentiality** on the other. This is especially the case in the face of impending conflicts of interest, i. e. where the accordance of individual shareholder interests and the interests of the company or the interests of the shareholders as a whole are no longer guaranteed.[68] For this reason, the right is not granted without restrictions and such restrictions – corresponding to the typical characteristics of the shareholder body – tend to be more marked in the case of the public limited company than is the case with a private limited company.

b) Implementation. The fact that the individual shareholder's right of information is part of the core of his membership is well expressed in Art. 93 of the Spanish LSC where it is fourth on the list of essential membership rights. Of course, this does not say anything about the specific features and limitations. In this regard, the primary differences relate to the substance of the right to information and to the timing and/or occasion of its assertion. By its substance, the right may relate to information and **inspection**. It may be asserted at any time based on the desire and needs of the shareholder or only upon certain occasions, practically only at the general meeting of the shareholders. The likely most expansive rights to inspect the books and records of a company or to inspect certain documents (inventories, minutes, reports, lists of shareholders and directors) exist in connection with the private limited company. These rights are more likely the exception in the case of the public limited company. For example, section 51 a dGmbHG grants a general right to inspect the books and records of the company, subject to limitations in Art. 802 (2) OR, subject to additional restrictions Art. L223-26 (4) CCom. In turn, French law grants shareholders in a public limited company a right of inspection which may be exercised at any time, albeit only with respect to specifically listed records (Art. L225-208 (1), L225-117 CCom).

In the case of the private limited company, section 51 a dGmbHG, Art. 802 (now para. 1) OR likewise grant a general right to **information**. Based on this right, any shareholder may demand information from the manager regarding the company's affairs. In the case of French law, information rights are the same at the outset for the private limited company and the public limited company. They may be asserted by an individual shareholder in advance of the general meeting of the shareholders and

[67] The central aspect for Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 345 et seq.

[68] Cf. K. Schmidt, Informationsrechte in Gesellschaften und Verbänden; Roth, in: Ruppe (ed.), Geheimnisschutz im Wirtschaftsleben, p. 69.

must be responded to there (Art. L223-26 (3), L225-108 (3) CCom). In addition, there is a right of information independent of the general meeting which is peculiarly limited to being exercised twice during each financial year and may only relate to threats to the future of the enterprise and in this case subject to the entity-form related difference that each individual shareholder has the right in the case of the private limited company (Art. L225-232 CCom). In the case of the public limited company the right is limited to an equity minority of at least 5 % (Art. L225-232 CCom, here additionally related to corporate group affairs, Art. 225–231 (1)).

In German, Austrian and Swiss corporate law, the right to information is limited at the outset to the **shareholder meeting** and namely it must be asserted at the meeting (sections 131 dAktG, 118 öAktG, Art. 697 (1) OR) and must substantively relate to the items on the agenda (Art. 697 (2) OR: on the exercise of shareholder rights). Consequently, limitations which are intended to ensure orderly conduct of the general meeting (see 2, above) are likewise applicable to the right to ask questions (cf. sections 131 Abs. (2) second sentence dAktG, 118 (4) öAktG).

Three of the legal systems discussed immediately above expressly address the refusal to provide information due to contrary **interests of the company**: Sections 131 (3) dAktG, 118 (3) öAktG, Art. 697 (2) second sentence 2 OR for the public limited company and similarly for the private limited company, section 51 a (2) dGmbHG, Art. 802 (3) OR. In the most general terms, this involves information the disclosure of which would or could be a significant (sometimes: a not insignificant) detriment to the company. Frequently this is specified to state that there must be reason to suspect that the shareholder intends to use the information for non-company purposes. The dAktG finally specifies an entire catalogue of reasons to refuse to provide information (section 131 (3)) which extends beyond the general detriment clause and singles out certain valuation approaches and methods as well as tax information. Based on Spanish law, information cannot be refused if it is demanded from one-quarter of the shareholders (by equity), Art. 196 (3), 197 (4) LSC.

The court may be consulted to rule on the justification of a refusal (sections 132 dAktG, 51 b dGmbHG, Art. 697 (4), 802 (4) OR). This is without prejudice to the ability to challenge a shareholder resolution adopted in this connection if the information that was refused was relevant to the resolution.

5. Analysis

The starting point of formal minority protection is the insight that shareholders must accept as the essence of the majority principle that they will be outvoted if they are in the minority. The task is seen as moderating the consequences for the minority as much as possible or to make them bearable. The most effective approach for this is to increase the required **majority threshold** to more than 50 % because this increases the prospects that minority shareholders may be able to prevent a decision contrary to their will using their share of the vote alone or in conjunction with others. The problem is that at the same time the advantages sought to be achieved through the majority principle are reduced, namely simplifying and accelerating the decision-making process and thereby the company's ability to act and react.

For this reason, all legal systems declare that qualified majorities are required for **serious decisions** and there is general agreement as to what subjects this includes, namely primarily all forms of amendments to the contract and articles of associa-

tion. However ways part starting with the question of how large a qualified majority should be established (primarily two-thirds or three-quarters or a majority of votes in combination with an absolute capital majority) as is the case with regard to whether such increased majority thresholds are mandatory or subject to discretion. To the extent they are subject to change, the decision of where they want to set the compromise between minority protection and ability to act is left to the shareholders; for lawmakers seeking a rational decision there is no single convincing solution.

The rules aimed at protecting **participatory interests** are likewise based on certain minority ratios which may be set lower here in any event, at 10 % or even only 5 % or even a lower absolute share of equity in exceptional cases. The same applies to the special form of active participation, namely initiating control and sanction processes. As individual rights, other participation rights such as rights to attend and speak, may or must be left independent of an ownership percentage. The same applies in the case of the right to information. Whether a right to file suit to enforce claims for damages on the part of the company and for its benefit should be classified as an individual right – based on the model of the American derivative suit – is an age-old topic of discussion in Europe. At this point, the only comment here on the subject is to note that regulation of the litigation costs and who should bear them are inseparable from the response to the factual question.[69]

The meaning of these participation and information rights should first of all be to grant the minority shareholder the ability or the opportunity to influence a decision in his interest. This is of course rather a theoretical issue where the majority blocks are firmly cemented. For this reason, we see the deeper meaning of these participation and information rights as **reconciling the minority shareholder** to the decision of the majority because the opinion-making process, which was also open to him, should convince him of the correctness, reasonableness or seriousness of the majority decision or at least of the legitimacy of the decision. This may be more of a psychological aspect. However it should nevertheless not be underestimated because it ultimately manifests a recognition or appreciation of the membership of the minority shareholder as well, which is essential.

III. Substantive minority protection

1. Voting right preclusion

a) Purpose. As long as the shareholders are pursuing parallel interests and differences of opinion involve only differing views of how the common interest may be pursued in the most promising manner, subjecting the will of the minority to that of the majority may be relatively easily justified by stating that the difference will be decided by the larger number or larger risk contribution. However the issue becomes really problematic if the majority follows **self-serving interests** at the cost of the minority. In such cases, the solution which presents itself as an instrument of minority protection is that the contrary special interest be eliminated in such cases, i. e. excluded from the decision-making process. The shareholder who is pursuing

[69] Likewise accurate, Enriques/Hertig/Kanda, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 175.

such an interest has his voting right suspended for purposes of the resolution regardless of what voting power he represents and which majority or minority he would join.

Of necessity, this is tied to a substantive evaluation of the will expressed and the interests it is pursuing.

b) Implementation. Most legal systems recognise the preclusion of voting rights in the case of a **conflict of interest** and this is expressly codified in statutes, however in any event with differing degrees of specificity or differing scopes. In the German and Austrian legal systems, the circumstances of granting a benefit or releasing an obligation, including discharge from a company position, as well as a decision on the conclusion of a legal transaction with the shareholder or the initiation or settlement of a legal dispute with him are emphasised in various combinations and to varying degrees of completeness (sections 136 (1) dAktG, 47 (4) dGmbHG, 125 öAktG, 39 (4) öGmbHG). The extent to which they are subject to expansion or generalisation is subject to dispute.[70] To the extent the latter is answered in the negative, the mere existence of a conflict of interest does not preclude and/or void voting, but rather the decision made on this basis must be reviewed as to whether its substance breaches the duty of loyalty[71] (see 3, below). With that, the manner in which both instruments of minority protection interrelate has been described.

Art. 2479-ter of the Italian CC contains a more general version of the exclusion of voting rights. The relevant circumstances in the case of the Swiss GmbH are drafted more narrowly in Art. 806 a OR: discharge of the manager or co-managers, acquisition of own equity interests by the company, release from non-competition agreements and other fiduciary duties. Spanish laws on private limited companies differentiate between the mere shareholder and the managing shareholder from the outset and only impose limitations on the latter related to release from non-competition agreements and the conclusion of service or work contracts (Art. 190 LSC). Limitations related to the grant of benefits and the release of obligations, including the approval of the transfer of his share by shareholder resolution, affect the former.[72]

This illustrates the fundamental difficulty which arises when evaluating conflicts of interest under the aspect of their inadmissibility. In certain constellations, the conflict relates to interests which the shareholder is permissibly following as an element or goal of his equity holding in the company, for example becoming a manager or member of the supervisory board and casting his vote for such purposes (expressly included in section 39 (5) öGmbHG). Compared to vested interests, these represent **membership-related interests** the pursuit of which must remain permissible with one's own vote. However, the classification of many specific cases is difficult, of which the Spanish catalogue referred to above lists a few. For example, based on prevailing opinion in Germany, the exclusion of voting rights does not apply to consent to the transfer of one's own shares – which is correct in our

[70] Roth/Altmeppen, GmbHG, § 47 marginal no. 55.

[71] Comparative law analysis as well by Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 56.

[72] Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain marginal no. 178.

opinion – and similarly not to the conclusion of an employment agreement with the managing shareholder – which is incorrect in our opinion.[73]

The legal consequence of the preclusion of voting is that the shareholder affected must abstain from casting his vote and if he does not do that his vote cannot be counted for purposes of determining the results of the ballot. In the event there are differences of opinion in this regard, every shareholder can challenge the incorrect counting or failure to count votes as a **defect in the resolution** to the extent it has an effect on the results of the decision[74] and/or may rely on the results of the decision-making process which have been the case had votes been counted correctly. The legal remedies to be discussed below are available for this purpose. The excluded votes are also not counted for purposes of determining the total number of votes from which the majority is to be determined.

2. Contesting majority resolutions

a) Purpose. It appears obvious that an incorrect tabulation of the votes, and thereby the inclusion of invalid votes, renders the resolution adopted in this manner invalid if this played a role in determining the majority. Similarly, the shareholders who are disadvantaged as a result may challenge this invalidity or may assert the correct voting results. However, the same is also generally the case for all rules the purpose of which is to protect the minority or individual shareholders. This is so at least in cases where their violation has an effect on decision-making or is otherwise of significance based on specific circumstances.

However, when looked at in detail there are significant differences both between different categories of resolutions and between the legal systems. Defects in resolutions may per se render the resolution void or merely provide grounds to challenge it using a specific procedure and subject to strictly-defined requirements. The legal consequences and their distinctions are found in the law generally, e. g. the treatment of the nullité in French law[75] and in part provided on an entity-specific basis. In such cases, the rules contain a sophisticated complaint mechanism and in others are only piecemeal. However, as far as may be seen, a **right of action** is always granted for purposes of determining or establishing the invalidity of the resolution or the correct contents of the resolution and this right is structured as an individual right on the part each shareholder.

If, in this manner, laws on defective resolutions represent the decisive and required guarantee of the varied regulations designed to protect minority rights, the definitive question is ultimately that of whether an outvoted minority may also successfully assert substantive challenges to a resolution that has been passed and in this manner impose substantive limits on majority rule. This is in fact the case, even if only in part and rudimentary.

b) Implementation. German and Austrian corporate laws have developed a special protective legal system which is based on the two pillars of **invalidity** and **contestability**. Certain serious defects, including for example defects related to rules

[73] Regarding both cases, see Roth/Altmeppen, GmbHG, § 47 marginal no. 65 et seq. with further citations.

[74] For Italy, see Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Italy marginal no. 128.

[75] See Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, pp. 180, 241.

of providing notice of meetings (sections 241 dAktG, 199 öAktG), render a resolution void. Others, and this includes most violations – including violations of individual rights – may provide a basis for contestability which may only be asserted by the shareholder affected and only within a short period of time by filing suit (sections 243 dAktG, 195 öAktG). However, substantive violations of law or provisions of the articles of association also provide grounds for a challenge. This system is underdeveloped in the GmbHG and the Austrian version recognises it under the term declaration of invalidity (section 41 öGmbHG). By contrast the German version contains no specific rule. It is however acknowledged in both legal systems that the elaborate rules set out in the AktG for the public limited company are applicable accordingly to the GmbH.[76]

This results in a distinction for purposes of enforcing minority protection such that serious violations of **participation guarantees** result in invalidity and in any event result in a defective resolution. By contrast, **procedural defects** merely provide grounds for a challenge and a nexus to the results of the resolution must be established. This is either understood to mean causality or more recently, in a subject-based analysis, is referred to as relevance.[77] **Substantive illegality**, to the extent this is the case, is always relevant; in this case, the next question is whether in addition – based on the keyword substantive review of resolutions – substantive assessments of interests in the conflict between the majority and the minority are also taken into account.

Swiss law on private limited companies refers to the law on public limited companies. Art. 706 (1) OR then provides in general that a violation of the law or company statutes represents grounds for a challenge followed in para. 2 by serious substantive encroachments in shareholder rights, including discrimination not justified by the object of the company or unequal treatment of shareholders compared to others as well as improper encroachments. This provides for a substantive assessment of the resolution on a two-fold basis from a standpoint of objectivity and/or justification.

In **French** corporate law, Art. L225-121 CCom declares a resolution invalid in the case of certain serious defects. The meeting may be annulled pursuant to para. 2 if the required information was not provided. Pursuant to Art. L223-27 (7), the meeting of a private limited company may be annulled if it has been convened irregularly except in the case of a full shareholders' meeting. Art. L225-104 (2) provides the same in the case of a public limited company. Specific remedies to have a decision declared invalid are spread throughout the laws, e. g. in Art. L223-31 (4) for resolutions of a single-member company. However, this is all overlaid by the rules on invalidity under the general rules of the Code Civil and the provisions of the CCom for all commercial enterprises (Art. L235-1 et seq.). These cases involve violations of mandatory law and, under certain circumstances, company statutes and also cover cases of immoral conduct or comparably improper conduct, whereby fraud and abuse of the power of the majority have particular importance in the case of shareholder resolutions. In practice proving this appears difficult – which is not

[76] For a discussion of Austrian law, see Thöni, Rechtsfolgen fehlerhafter Gesellschafterbeschlüsse, 1998; Eckert GeS 2004, 228.

[77] Zöllner, in: Baumbach/Hueck, GmbHG, § 47 Appendix marginal no. 126; Rowedder/Koppensteiner, GmbHG, § 47 marginal no. 134.

surprising of itself – however it offers the conceptual approach for a substantive weighing of interests.[78]

In **Italy**, a distinction is likewise drawn between contestability and invalidity. The latter is limited to particularly egregious violations of law as well as company statutes.[79] Otherwise, resolutions may be subject to challenge, namely based on the rules contained in corporate law (Art. 2377 CC) to which reference is made in the case of the private limited company.[80]

The details of national laws on defective resolutions are a separate topic that will not be addressed here any further except to the extent it specifically relates to the realisation of minority protection.

3. Substantive control of resolutions

a) Purpose. If the premise supporting majority decision first assumes that there is a general equality of interests within a corporate association and therefore specific decisions may well be left to the larger number – whereby the larger number may also be measured by equity or risk contributions – and second that the larger number also enjoys the presumption of correctness as to the correctness, usefulness and appropriateness of a decision in the case of a difference of opinion, then it is not a reach to realise protection for the outvoted minority by having compliance with this premise reviewed on a case-by-case basis. In this context, **review** would mean an external control by a court in the form of an action challenging the decision of the majority.

On the other hand, it is immediately clear from a functional standpoint that this form of control cannot go so far as to subject every shareholder resolution to a review on the merits because this would take review of majority decisions to the absurd. In addition, this raises the next question of the degree to which such an external review should be seen as better ensuring correctness compared to the majority of the shareholders. In any event, a narrower scope of review is needed. Finally, the problems of legal uncertainty, delay and potential for abuse associated with every external control (key word: abusive shareholder suit, [c] below) become ever more pointed along with the reach of such controls. With that in mind, one recognises at the same time however the distinction between a review of conflicts of interests, the purpose of which is to discover cases in which vested interests have been pursued at the expense of the minority in exceptional cases, and a more far-reaching review of the merits of the contents of the resolution.

b) Implementation. The right of every shareholder to be **treated equally** is generally recognised in the case of the public limited company and is often codified in national laws governing such companies (sections 53 a dAktG, 47 a öAktG) as expressly provided in Art. 42 of the Capital Directive, however the same applies in the case of the private limited company.[81] In principle, this provides that no shareholder may be disadvantaged compared to others without his consent. This thus renders the principle a component of minority protection[82] (see I 2 a, above).

[78] Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 184 et seq.

[79] Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Italy marginal no. 129.

[80] Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, marginal no. 128.

[81] Verse, Der Gleichbehandlungsgrundsatz im Recht der Kapitalgesellschaften.

[82] Roth/Altmeppen, GmbHG, § 13 marginal no. 62.

A shareholder's duty of loyalty is not codified in law in the same way, and as far as may be seen, is not recognised everywhere to the same general degree; and does not use the same terminology as is the long-established case in German law. This concept finds its counterpart as the duty of loyalty or fiduciary duty in Anglo-American law. A similar result seems to be achieved however in the Latin legal tradition, through heightened duties of consideration and ethical conduct in connection with the corporate relationship (cf. on French law, 2 above).[83]

aa) Duty of loyalty. The duty of loyalty is the counterpart of the requirement of equal treatment[84] or is even the associated overarching principle.[85] In Germany, the obligation is owed both to the company as well as the fellow shareholders – at least in the view which has since become established in Germany – and, in principle, is also the case for the public limited company even if reduced in intensity corresponding to the mostly less personalised characteristics of the company.[86] From a substantive standpoint, its main importance is in the areas of the pursuit of interests and conflicts of interests.[87] Even if the duty does not require altruism it limits the shareholder and thereby fellow shareholders and/or a majority of shareholders in the unbounded pursuit of its/their own interests without consideration of the so-called interests of the company, which is ultimately based on the community of interests, and thus the corresponding interests of all other shareholders.

If a majority resolution is approved in this manner by violating the principle of equal treatment or the duty of loyalty owed to the minority shareholders, then every shareholder may challenge the resolution. However, in this connection, the principle of equality plays a small role in practice because blatant unequal treatment without the corresponding basis in company statutes appears to be rather an exception. The duty of loyalty is suitable as a corrective approach for more subtle forms of discrimination. In Germany, the duty of loyalty is seen as the most important instrument, or as the foundation for further development, of **substantive control of resolutions** from a minority protection standpoint because the shareholder who has been disadvantaged and outvoted may obtain a substantive review of the resolution by means of a petition to avoid the resolution based on the issue of whether the substance of the resolution impermissibly curtails his interests.[88] This is also likely the case in other Continental European legal systems and is the case as well in the Anglo-American legal tradition.[89] The conceptual bridge between a breach of the duty of loyalty and a challenge to a resolution is thereby represented by the **vote cast** on the part of the person subject to the duty of loyalty. The vote should not have been

[83] For a discussion of French and English law, see Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 189. For a discussion of abuse of voting rights in Scandinavian law, see Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 47 and fn. 144.

[84] Emmerich, in: Scholz, GmbHG, § 13 marginal no. 52; Winter/Seibt, in: Scholz, GmbHG, § 14 marginal no. 41.

[85] Hüffer, AktG, § 53 a marginal no. 2.

[86] See BGHZ 103, 184; 129, 136.

[87] Roth, Treuhandmodell des Investmentrechts, p. 259 et seq.

[88] Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 17 and passim; Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 189 et seq. Wiedemann, Gesellschaftsrecht, Vol. 1, 1980, p. 409 previously saw a general clause as the solution for loyalty duties.

[89] Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 47.

permitted to have been cast in this manner and is therefore invalid. This then affects the resolution adopted if the objected-to votes were relevant for reaching majority support for the resolution.

Of course, the scope of this solution is difficult to define in general terms. A prime example of this, for which there are precedents in cases from both the U.S. and Germany,[90] is represented by so-called **starving out the minority** where the majority, who is able to protect its financial interests in another manner, stops dividends from being paid out for a longer period of time. If the individual shareholder is protected against a formal abandonment of the company's interest in profits (see I 2 a, p. 116 above), then the shareholders cannot be deprived of this right through the back door. However, German corporate law provides special rules for this purpose intended to ensure the shareholder a reasonable dividend both in relation to the net income for the year as well as to the common rate of return (sections 58 (2), 245 (1) AktG and in particular corporate group related equalisation measures for the benefit of external shareholders). A violation of these rules likewise represents grounds for a challenge.

A second characteristic example is the exploitation of company business opportunities (**corporate opportunities**) by (primarily: managing) majority shareholders for their own benefit and through competition with the company as well.[91]

However, on the whole when seeking to define the duty of loyalty more precisely, one must rely on case law history which does not readily lend itself to making generalities. Because the ground for a challenge is a breach of the duty of loyalty, the shareholder asserting the challenge must present the justification for such and fundamentally must prove this as well. This disadvantage in the assignment of roles before the court is made worse because the concept of a breach of the duty of loyalty is to a certain extent accompanied by a subjective analysis. This means that the corresponding subjective characteristics on the part of the person who owes the duty, such person's intent or motives, are also potentially part of the elements of the act or at least clarify it. This applies all the more in the case of fraud or the criminal law related offences of fraud or abuse of power of the majority (see, e. g. French law at 2, above). These types of self-serving or prejudicial motives may be present in relevant cases, however proving this is another matter altogether.

bb) Justification requirement. In light of this, it would amount to a quantum leap in the theoretical approach to substantive control of resolutions if one demands substantive justification for purposes of positively supporting the resolution. A special application for this – related to the **exclusion of subscription rights** on the part of existing shareholders in connection with a capital increase – may be derived from the law, namely from the norms set out in domestic corporate laws which in turn are based on the Capital Directive. Art. 29 (4) third sentence of the Directive provides that "a written report indicating the reasons for restriction or withdrawal of the right of pre-emption" must be presented to the general meeting (implemented for example in sections 186 (4) second sentence dAktG, 153 (4) second sentence öAktG). If one assumes that the explanation required for such purposes may not

[90] Dodge v. Ford Motor Co. 170 N.W. 668 (1919); OLG Nürnberg NZG 2008, 948; OLG Brandenburg ZIP 2009, 1955; for limited partnership BGHZ 132, 263. Additional citations in Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 33 fn. 49.

[91] Roth/Weller, Handels- und Gesellschaftsrecht, marginal no. 294 et seq.; Fleischer, NZG 2013, 361.

merely be empty phrasing, but rather must be substantively supported and correct, this must also be subject to external review in the case of a challenge to the resolution. In other words: The resolution needs a substantive justification ex ante and this must be reasserted and proved to be valid when the resolution is reviewed.[92] According to prevailing opinion in **Germany**, this is the case with regard to public limited companies[93] even if the CJEU has not held that the Capital Directive requires this but rather viewed this as merely a permissible tightening of the rules.[94] The same applies in the case of the private limited company.[95]

Swiss law – not bound by the Capital Directive – from the outset only permits the suspension of subscription rights on important grounds and directly subjects such an exclusion to the limitation that no one may be improperly benefitted or disadvantaged as a result (Art. 652 b (2) OR, applied to the private limited company via Art. 781).[96] As a result, by means of a challenge to the resolution, the outvoted minority may in any event have the question of whether there is an important ground and whether their subscription rights were excluded without a proper reason reviewed,[97] although the issue of the allocation of roles in the challenge is hereby not yet resolved. Based on general principles, the company and/or the majority supporting the resolution at the least should have to substantiate the important grounds.

On the whole, the decisive differences between the requirement of justification and the breach of the duty of loyalty include that substantive control is targeted directly at the contents of the resolution, not first via the roundabout way of looking at individual votes. Secondly, it allows for a broader evaluation of the correctness of the decision made whereas the duty of loyalty provides a rather coarse-mesh framework for evaluation. Finally the burden of substantiation and burden of proof lie with the company and/or the majority[98] and subjective characteristics, even the awareness or perceptibility of a deficit in justification, do not matter.

The determinative question is now the extent to which this control instrument is subject to being **cautiously expanded** absent a statutory basis to apply in cases other than the specific circumstances referred to above. Even before the Capital Directive, and independent of the express reporting requirement, German corporate law saw the basis for the more stringent requirements needed to exclude subscription rights in the fact that this represents an especially serious encroachment on membership rights.[99] Accordingly, this may only involve measures that have a similarly high degree of relevance for membership. **Structural changes** are primarily mentioned in

[92] Roth/Altmeppen, GmbHG, § 47 marginal no. 127.

[93] BGHZ 71, 40; 83, 319; Hüffer, AktG, § 186 marginal no. 25; for Austria, see Doralt/Nowotny/Kalss, AktG, § 153 marginal no. 114.

[94] CJEU Case C-42/95, *Siemens/Nold*, (1996) ECR I 6017 = NJW 1997, 721; for a critical view, see Kindler, ZHR 158 (1994), 339.

[95] Roth/Altmeppen, GmbHG, § 55 marginal no. 24; Lutter, in: Lutter/Hommelhoff, GmbHG, § 55 marginal no. 17; Zöllner, in: Baumbach/Hueck, GmbHG, § 55 marginal no. 20.

[96] For details see Zindel/Isler, in: Basler Komm, 2012, Art. 652 b marginal no. 11 et seqq.; Meier-Hayoz/Forstmoser, Schweizerisches Gesellschaftsrecht, § 16 N 232.

[97] Art 706 Abs 2 Z 2 OR; Zindel/Isler, in: Basler Komm, 2012, Art 652 b marginal no. 25.

[98] See generally, Roth/Altmeppen, GmbHG, § 47 marginal no. 129; specifically regarding section 186 dAktG, see Hüffer, in: MüKoAktG, § 243 marginal no. 140; Lutter, in: Kölner Komm, AktG, § 186 marginal no. 99; Hirte, Bezugsrechtsausschluss und Konzernbildung, p. 221.

[99] Hüffer, AktG, § 186 marginal no. 25; Zöllner, AG 2002, 585.

this context.[100] For example it is no coincidence that French law requires the consent of all shareholders in order to change the nationality of the company (Art. L223-30 (1) CCom).

If on the other hand German law subjects the most drastic structural change for shareholders in the minority, the so-called squeeze out, to the discretion of an exceptionally **high majority requirement** of 95 % (section 327 a AktG, Austria 90 %), this suggests that such majority need not provide a substantive justification for this step. However, this does not apply to the same degree to other structural changes for which a qualified majority of only 75 % is likewise required (in German and in Austrian law). One could take the position that in the case of a transformation, merger or creation of corporate groups, the minority shareholder who opposes these measures can demand a substantive justification as is similarly the case for the delisting of a listed public limited company[101] for which the resolution of the shareholders needs only a simple majority according to prevailing opinion.[102] However, this is rejected by the prevailing opinion[103] in Germany which appears to be the pioneer in developing this form of substantive control of resolutions, whereby it also plays a role that the applicable statutory rules often offer the shareholder the alternative of leaving the company in exchange for reasonable compensation or other financial payments. The topic of tension between minority protection in the company and in the form of withdrawing from the company has thus been broached, see 4, below.

On the other hand, there are serious – and therefore subject to a qualified majority requirement – decisions below the level of structural changes which potentially encroach more deeply on the membership interest of the individual shareholder than such changes, for example a capital increase in exchange for a contribution with the grant of subscription rights in which the minority shareholder cannot participate due to a lack of funds. If one takes this into consideration, the potential scope of substantive control of resolutions expands further and its boundaries become fuzzier. However, tight limits are essential for the reasons indicated at the outset.

cc) Evaluation of interests. The justification required within this scope is, as stated in most of the literature, to be provided in the **interests of the company**.[104] However, this is an oversimplification in two regards. First, the interest of "the company" is nothing other than the aggregated interest of all parties with a stake in the company (shareholders and stakeholders) and thus is primarily that of (all) shareholders so that the conflict between majority and minority is simply not solvable by these means. Second, an interest being pursued by the majority may also be legitimate, for example if the majority in a private limited company wants to convert it into a public limited company so that the shares may be traded in the capital markets and in so doing not only procure additional equity for the company but also potentially permits shares to be sold on favourable terms. Accordingly, the

[100] Previously, Wiedemann, ZGR 1980, 147, 157; Martens, GmbHR 1984, 265.

[101] On the latter, see Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 559 et seq.; for a contrary opinion, see BGH ZIP 2003, 387; Klöhn, NZG 2012, 1041.

[102] BGH ZIP 2003, 387; subject to dispute.

[103] Lutter, ZGR 1981, 171; Hüffer, in: FS Fleck, 1988, p. 717; Henze, in: FS Boujong, 1996, p. 242.

[104] Hüffer, AktG, § 186 marginal no. 25; Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 190.

concept of a justification requires a comprehensive weighing of the interests as part of which fundamental decisions for the benefit of the business being conducted, its existence and future, perhaps frequently tip the scales, but are not necessarily decisive.

In German law there is a line of cases for justifying the exclusion of subscription rights which focuses on business goals related to financing, investment and strategic orientation.[105] This may be the need to gain a large investor for restructuring or expansion purposes or to convert debt to equity, to place shares in the capital markets, to enter into co-operations with other enterprises, to acquire certain assets as part of an in-kind capital increase,[106] however by contrast not to defend against or reduce disruptive equity holdings.[107] An illustrative example from Swiss law: "Important grounds include, in particular, the take-over of enterprises …. or equity holdings as well as offering equity holdings to employees." (Art. 652 b (2,2) OR).

At the same time, limitations of the judicial reexamination become clear in the accentuation on company politics: To the extent **business decisions** are involved here, company management, which regularly employs the exclusion of subscription rights in the pursuit of its goals, and the majority of the shareholders, which approves it, must be given a certain degree of discretion.[108] This is also subject to generalisation as a ground rule of substantive resolution control.

The complexity of the evaluation thus required here, just as is the case with the fundamental concerns regarding an over-expanded juridification of business decisions, in turn shows that an external substantive control of resolutions, as essential as it is as the final mechanism of effective minority protection, must remain limited in scope.

c) Excursus: Abusive action for avoidance. Facing a suit for avoiding a resolution may represent a large burden to the relevant company because it will delay implementing the resolution until the process has concluded due to the associated legal uncertainty or if it does so, implementation may be associated with significant liability risks. In the most important cases of an amendment to the company's statutes or structural changes, implementing the resolution is not even possible for an indefinite period because the **registry court** will refuse entry until the pending legal proceedings have been concluded. This may be associated with significant delays which are detrimental to the company in most cases or even defeat subsequent implementation entirely. For these reasons, the company itself may be inclined to end the proceedings quickly and quietly by attempting to achieve a withdrawal of the claim or a settlement even in cases where the company believes the chances of success for plaintiff to be low. **Professional claimants** may in turn take advantage of this to obtain a financial benefit by filing illegitimate actions and placing pressure on the company. This "business model" presents itself especially in the case of listed public limited companies where it is easy for the potential plaintiff to acquire a few shares at low cost ahead of the general meeting thereby obtaining the right to file suit.

[105] Schockenhoff, Gesellschaftsinteresse und Gleichbehandlung beim Bezugsrechtsausschluss; Lutter, in: Kölner Komm, AktG, § 186 marginal no. 61; BGHZ 71, 40.

[106] See Hüffer, AktG, § 186 marginal no. 29 et seq., 34.

[107] See Hüffer, AktG, § 186 marginal no. 32; Lutter, in: Kölner Komm, AktG, § 186 marginal no. 71; Wiedemann, in: GroßkommAktG, § 186 marginal no. 161; BGHZ 33, 175.

[108] Hüffer, AktG, 186 marginal no. 36.

On the other hand, the company has the same or an even stronger incentive to shorten the process if it wants to eliminate a potentially legitimate suit for avoidance.

The potential for threat described here exists not only in the case of a substantive challenge to a resolution, but rather in the case of every challenge to a resolution for which there are enough opportunities to take advantage of procedural violations, or even potentially to induce them, within the thoroughly-regulated field of corporate law. However allowing substantive control of a resolution expands this spectrum and the associated legal uncertainty to a not insignificant degree.

A body of case law on the **abusive avoidance suit** has developed under German corporate law for purposes of preventing this tactic and protecting the company. According to these cases, a challenge is rendered invalid when the plaintiff is pursuing unrelated goals by means of the challenge, namely he wants to allow his right to sue to be "bought"[109] for personal financial gain regardless of whether the suit as such had merit. Apart from collateral liability to pay damages to the company, the legal consequence is that the suit is unfounded due to its abusive character and the objection to the resolution as such will not be subject to further review even if its justification could quickly and easily be determined and confirmed. This illustrates the dilemma that legitimate challenges whose success, for the sake of legitimacy, would be in the best interests of the company or at least that of the minority may be fended off with an accusation of abuse of rights.[110]

If one recognises that the discovery of existing defects in a resolution is principally a legitimate concern of minority protection regardless of the motive of the challenger, but also that the company should be protected against unfounded or wanton delays, the solution should more likely be sought on the path last taken by German lawmakers. For special cases, namely in section 246 a AktG for increases and decreases in capital as well as inter-company affiliation agreements, the German legislature introduced an **approval procedure** for purposes of advance entry in the registry in which the higher instance court suspends the blocking effect of the challenge suit following a cursory review and at the same time immunises it against a later positive assessment of the challenge to the extent the challenge appears to be obviously unfounded during the initial review or the disadvantages "to the company and its shareholders" so clearly outweigh the seriousness of the legal violation that a weighing of the interests commands approval. In effect, this practically introduced an expedited process in order to keep the delays associated with the challenge to a resolution as short as possible; at the same time the potential for abuse of the challenge suit is significantly reduced.

4. Withdrawal and exclusion of the minority

a) Purpose. The right of the minority shareholder to **separate himself** from the company and thereby from the superior strength of the majority is, as has been said,

[109] BGHZ 107, 296; BGH AG 2007, 625; KG ZIP 2011, 123; Hüffer, AktG, § 245 marginal no. 22 speaks of a "current wave of abuse"; contrary view in Baums/Drinhausen/Keinath, ZIP 2011, 2329; most recently Bayer/Fiebelkorn, ZIP 2012, 2181; Bayer/Hoffmann, ZIP 2013, 1193; Keinath, ZIP 2013, 1205.

[110] Critical for this reason, Roth/Altmeppen, GmbHG, § 47 marginal no. 143; Slabschi, Die sog. rechtsmissbräuchliche Anfechtungsklage; previously Mestmäcker, DB 1961, 951; Bokelmann, Rechtsmissbrauch des Anfechtungsrechts durch den Aktionär?; Roth, ZGR-Sonderheft 12, 1994, pp. 167, 181. See also, Seibert/Böttcher, ZIP 2012, 12, 14.

the ultima ratio and as such is indispensable in many constellations. However on the other hand it frequently represents a less than satisfactory radical solution for the affected shareholder. The termination of membership can in principle be effected as a transfer of the shareholding and a withdrawal from the company. The problem with the first option is that it is prototypically only possible in the case of the listed public limited company. Otherwise, this method runs into limitations on grounds of legal structure (shares subject to restrictions on transfer) or the lack of a market. On the other hand, the dissolution or termination of the membership would be, in any event based on an important reason, nothing other than the application of a principle which applies to on-going legal relationships in general. However, withdrawal from the company in exchange for reasonable **compensation** is not readily acceptable to the company because it received the capital contribution on an indefinite basis and it is entitled to rely on retaining the contribution as part of its corporate assets and, last but not least, because the legal hurdles imposed by capital commitment could preclude the payment of compensation from corporate assets (see previous discussion in Ch. 2). For this reason, the principle referred to above has only limited applicability in corporate law.

To the extent withdrawal is even made possible, it is as a matter of law not subject to the free will of the shareholder but rather is tied to the existence of **important grounds** which may trigger a judicial review and potentially a legal settlement. For this reason, withdrawal is included as substantive minority protection. In the case of a transfer of shares subject to a restriction on transfer, the same applies at least where the restriction on transfer may (only) be overcome on important grounds.

Apart from the fact that it may likewise face the same barriers faced by the withdrawal in light of the capital commitment, the **exclusion** of unwanted shareholders on the other hand should generally be tied to important grounds for purposes of protecting such shareholders. If however a legal system permits groundless exclusion to be placed at the will of the majority (even if subject to reasonable compensation) in the company statutes, this represents a problem in and of itself in the tension between private autonomy and minority protection.

b) Implementation. In principle, shares are freely transferable as a matter of law so that, as a means of dissolving his ties to the company, a **sale** becomes a problem of the available market and the price which may be obtained there. For the typical small shareholder in a listed public limited company, a sale to a segment of the **capital market** is normally possible at any time so that he must merely come to terms with the development of the price on the market – which will frequently not disappoint him less than the decisions of the majority of the shareholders in the public limited company with whom he is dissatisfied.

However, one must not be deceived by this picture of the listed public limited company; all across Europe, the vast majority of public limited companies are not traded on an exchange or other liquid segment of the market. And these companies have also likely taken advantage of the option also open to public limited companies to subject their shares (registered shares) to restrictions on transfer, i. e. to place limits on transferability (cf. sections 68 (2) dAktG, 62 (2) 2 öAktG).

This latter, **limited transferability** subject to a requirement of consent, is the distinguishing characteristic of the private limited company. The transfer requires

the consent of the company or, which practically has the same meaning, that of the (majority) of the other (or all) shareholders, and this consent requirement may be included in the articles of association under some legal systems (sections 15 (5) dGmbHG, 77 öGmbHG). This is done in the vast majority of person-driven private limited companies. Elsewhere, the law provides this as the standard, which is the case in most of the Latin countries (Art. L223-14 (1) CCom, 107.2 b Spanish LSC, mandatory law in both countries;[111] Art. 229 (2) Portuguese CSC[112]) with the exception of Italy[113] and in Switzerland (Art. 786 (1) OR).

However, on balance the minority shareholder is placed in an even better position in the last-named countries because consent may only be refused under the condition that the shareholder desiring to sell is offered another purchaser on the same or reasonable conditions (Art. L223-14 (3) CCom; 107.2 e LSC) or the law reserves for him a right of withdrawal in such cases (Art. 786 (3) OR, in abridged form Art. 229 (1) Portuguese CSC[114]). The öGmbHG contains a similar provision (section 77)[115] related to restrictions on transfer in the articles of association. German law does not contain an analogous provision.

If a **right of withdrawal** is granted in the cases described above where a sale is impossible, this represents an application of withdrawal on important grounds. In some legal systems, such a right of withdrawal results as a less drastic remedy than the prescribed dissolution of the company through judicial decision. The latter is the case under section 61 dGmbHG; however where a minority shareholder can demonstrate that remaining part of the company may no longer be reasonably expected from him (due to the decisions and/or company policy of the majority), this represents the less disruptive measure compared to dissolution of the company. The right to withdraw from the German GmbH on important grounds is recognised for this reason. It is exercised via a private declaration of withdrawal, however this in turn only if a less drastic solution is not available.[116] A sale of the shares presents itself as a primary alternative so that viewed from this starting point an interrelationship is again established between an ability to sell the shares and a right of withdrawal.[117]

French law recognises the **dissolution of the company** based on important grounds (des justes motifs) as a general remedy under corporate law which, however, in keeping with the seriousness of the consequences, is only granted in exceptional cases and not readily in the case of unacceptability on the part of minority.[118] The Swiss OR expressly searches for means of avoiding dissolution through less drastic remedies (Art. 821 (1) third sentence). Art. 2473 Codice civile

[111] For France, Art. L 223-14 (7) CCom, for Spain see Löber/Lozano/Steinmetz, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Spain marginal no. 142.

[112] According to Stieb, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Portugal marginal no. 80 with fn. 123.

[113] Fasciani, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report Italy marginal no. 111.

[114] According to Stieb, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, marginal no. 81.

[115] Fasciani makes a similar report in the case of Italy, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, marginal no. 111.

[116] Roth/Altmeppen, GmbHG, § 60 marginal no. 107 et seqq.; Ulmer, GmbHG, Anh § 34 marginal no. 46; Hülsmann, GmbHR 2003, 198.

[117] Ulmer, GmbHG, Anhang § 34 marginal no. 55.

[118] Arzt-Mergemeier, Der gesellschaftsrechtliche Minderheitenschutz, p. 216; cf. also Karst, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, country report France marginal no. 150.

enables withdrawal to a large extent, however makes this optional in some instances.[119]

If based on the foregoing, a right of withdrawal is to be recognised in the case of a private limited company, the payment of **compensation** presents the main hurdle because this is subject to the rules of capital commitment without exception. Accordingly, if someone else cannot purchase the shares for consideration they may only be purchased by the company from its non-committed assets. This is more likely to be feasible in the case of the German GmbH because the statutory capital commitment is limited in the manner described (Ch. 2 V 1).[120] However, even where capital commitment levels are higher, as provided under Austrian laws on private and public limited companies, payment of compensation should still be possible to the extent distributable assets are on hand.

Nevertheless, rights of withdrawal are fundamentally not provided in most countries in the case of the **public limited company**. Withdrawal appears to be incompatible with the essence of the corporate form.[121] Exceptions are provided only in the case of structural changes such as transformations, mergers, also certain consolidations, by which a reluctant and/or so-called "outside" shareholder minority may withdraw in exchange for compensation (sections 305 (1) dAktG, 29 dUmwG). In most cases, the settlement or consideration, as applicable, is also not paid from the assets of the company but rather from persons acquiring the shares. A special right to tender on the part of shareholders desiring to withdraw is granted in the case of take-over offers by Art. 16 of the EC Directive of 2004 on this topic; they may demand that a bidder who has reached the 90 % threshold purchase their remaining shares. In this case, compensation likewise does not come from company assets. German jurisprudence has likewise recognised a right of withdrawal on the part of minority shareholders in the case of delisting, whereby the consideration may only be paid by the public limited company as part of a permissible redemption (Ch. 2 V 5) and otherwise from the majority shareholder.[122]

By contrast, **Italy and Spain** have determinedly introduced the withdrawal right (Art. 2437 et seq., Art. 346 et seq. LSC) for the public limited company as a minority protection mechanism if the shareholder has been outvoted on far-reaching resolutions (Art. 2437, 2437 quinquies Codice civ., Art. 346, 348 a LSC). In doing so, Italy makes further distinction based on the fungibility of the shares on the capital market and attempts to create equilibrium with capital protection in this manner so that the shares are first offered to the other shareholders, otherwise only non-committed funds or funds made available via a reduction in capital may be used.[123]

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[119] See Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, pp. 60, 72.

[120] Roth/Altmeppen, GmbHG, § 60 marginal no. 119.

[121] Cf. Baums, Ausschluss von Minderheitsaktionären; Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 523 et seq. advocates for additional withdrawal rights as a minority protection mechanism.

[122] BGH ZIP 2003, 387 with comments from Streit; BVerfG ZIP 2012, 1402; Klöhn, NZG 2012, 1041; see also section 29 (1) dUmwG regarding delisting following a merger.

[123] Italy protects minority shareholders in addition by means of a consolidated group related withdrawal right, Art. 2497 quater Codice civ., see Stein, in: FS Hommelhoff, 2012, pp. 1149, 1161. Pursuant to Art. 500 LSC, the Spanish public limited company may issue shares with a redemption obligation (redeemable shares) on a limited scale the redemption of which may not be charged against committed assets, Art. 501.

The **exclusion of a minority shareholder** against his will is initially confronted with the same financial question as the withdrawal; for the shareholder may only be forced out for reasonable compensation and this cannot be paid out of committed corporate assets. However, the cases covered by the statutes involve acquisition rights on the part of the majority shareholder to some extent who then must pay the compensation from his own assets and precisely these cases are problematic for the minority shareholder in a more serious aspect, namely that no important ground is required beyond certain qualified statutory requirements.

In German law, the situations covered by the statutes are first the corporate **squeeze-out**, which in section 327 a AktG permits a primary shareholder with a 95 % interest, and in section 62 (5) UmwG in the case of a merger, permits the controlling public limited company from an equity interest of 90 % onward, to demand the transfer of the shares from the remaining shareholders for reasonable compensation; and second, the redemption of shares in a GmbH under section 34 GmbH, whereby the shares as such are cancelled and the company owes the compensation. In addition, exclusion on important grounds is generally recognised, which based on prevailing opinion requires a ruling from a court. Execution largely mirrors that applicable to a redemption.[124] The important ground here is the mirror image of what is required for a withdrawal. Under the European Take-Over Directive (Art. 15), the successful bidder may have a purchase right as to the remaining shares if he has acquired a 90 % majority – in principle the counterpart of the previously-discussed right to tender on the part of the remaining shareholders. The price of the successful take-over offer is decisive for setting compensation the broad acceptance of which is thus sufficient for the (generally non-rebuttable) presumption of its reasonableness.[125]

These squeeze-out rules represent the most extreme form of a negation of the minority's membership interests. In this case, the size of the majority ownership interest is made the yardstick for determining the need to protect the minority, substantive considerations play no role and this is explained by the effort to strengthen business punch and initiative by concentrating power.[126] Germany has restricted this right to the public limited company. By contrast, Austria has extended it to cover the private limited company, and has reduced the required majority to 90 % (section 1 (1) GesAusG).[127]

The **redemption** of shares in a private limited company is designed to be a private autonomous means of strengthening majority power as a matter of law. It must be provided for in the company's statutes or have been introduced as part of an amendment to the statutes, whereby the latter – if the redemption may be executed against the will of the affected shareholder by means of a so-called compulsory redemption – requires unanimous approval.[128] Private contractual submission of the individual may go so far such that even his compensation may be reduced or even

[124] Roth/Altmeppen, GmbHG, § 60 marginal no. 77 et seq.; § 34 marginal no. 1.

[125] See Hüffer, AktG, § 327 a marginal no. 1 a.

[126] German Reg.-Begr. (official statement) from 2000, BT-Drucks. 14/7034; Hüffer, AktG, § 327 a marginal no. 1; more refined view in Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 417, there under p. 441 et seq. also with regard to dissolution by means of transfer with a three-quarters majority.

[127] GesellschafterausschlussG von 2006, see Koppensteiner, GeS 2006, 143.

[128] Roth/Altmeppen, GmbHG, § 34 marginal no. 9.

ruled out completely in extreme cases.[129] Redemption is generally executed by means of a majority resolution (section 46 no. 4 dGmbHG). However according to prevailing opinion it requires substantive reasons which must be set out in the articles of association and are then subject to review on a case-by-case basis.[130] The substantive grounds may be less serious than the important grounds required in the case of a withdrawal or squeeze-out, however the redemption authorisation may relate to an important ground of this type and then defeats (competes with based on contrary opinion) the suit for exclusion on important grounds. Art. 36 et seq. Capital Directive regulates the redemption of shares.[131]

5. Analysis

Two approaches must be distinguished in advance for purposes of the substantive review of majority resolutions: the review of whether votes were cast for the majority based on **improper motives** and the review of whether the will of the majority may be objected to **substantively**. The first variation primarily involves conflicts of interest where vested interests are being pursued within the majority which conflict with so-called company or business interests. In exceptional cases, for example in family-owned companies, the majority may even be driven by the mere desire to thwart the legitimate interests of the minority.[132] These are constellations which typically fall within the scope of the duty of loyalty (as a sub-category thereof) and/or abuse of voting rights the most important forms of which however may and should be addressed by means of the exclusion of voting rights.[133]

However, these constellations are ultimately comparatively easy to resolve. The conflict may be established to the extent the **interests** being pursued may be identified and its legitimacy may be established by means of an analysis of the competing interests. Remedies are appropriate to the extent this analysis shows that personal interests are being impermissibly pursued, i. e. the resolution may be challenged as a matter of law. Neither the argument of judicial overreach nor of legal uncertainty may prevent this. At most, it may be doubtful whether – which may be apparent in relation to the purpose of the duty of loyalty – a subjective disapproval of the shareholder's motives is relevant; or, starting from the perspective of the exclusion of voting rights, an objective analysis of the deviating interests is sufficient.

The question of the **substantive justification** for majority resolutions beyond cases of conflicts of interests or abuse of voting rights described above brings one into uncertain territory. It seems clear that a smaller list of resolution subjects needs to be made which more or less include the key words structural decisions and core membership areas (dividends, exclusion) and which refers to additional matters

[129] Roth/Altmeppen, GmbHG, § 34 marginal no. 52.

[130] Westermann, in: Scholz, GmbHG, § 34 marginal no. 13 et seq.

[131] See Lutter/Bayer/Schmidt, EuropUR, § 8 marginal no. 33, § 20 marginal no. 223 et seq.

[132] See Fleischer, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 26 and fn. 12.

[133] Roth/Altmeppen, GmbHG, § 47 marginal nos. 43 et seq., 55 et seq. That this is not practiced in German law with the same emphasis may also be a reason why foreign observers attribute limited efficiency to controlling conflicts of interests here, see Enriques/Hertig/Kanda, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 174.

taken from the respective statutory rules (graduated majority requirements).[134] The dilemma between protecting the minority from arbitrary action, or also merely unreasonableness, and protecting entrepreneurial freedom and efficiency in decision-making on the part of the majority inherent in every form of legal review also remains present in this area.

If one recalls that the exclusion of subscription rights was the starting point of this legal development and for such purposes the statutory requirement of justification is argumentatively the standard, then this perhaps permits a third solution to be arrived at for the fundamental principle as well. In the case of exclusion of subscription rights, what is involved is the right of the shareholders, and therefore the minority, to justification, namely a **substantive explanation** the substance of which may be subjected to review. The minority shareholder should at least be informed and understand why he has been outvoted. If the advocates of an exclusion of subscription rights in a given case are well-advised, they will endeavour to provide an acceptable justification in advance of the resolution which will withstand a later legal review and additionally has the chance of convincing the reluctant minority of the correctness of the intended measure or at least of the pointlessness of their challenge.

This link in assessment between ex ante justification and ex post review is subject to generalisation. The possibility of the latter should provide an incentive for a substantive justification in advance of the resolution and vice versa the production or lack of such a justification should render the subsequent challenge of the resolution more difficult or make it easier respectively. The latter effect will practically be forced to be part of an **expedited approval procedure** in which the earlier-provided justification serves as a fundamental basis for the cursory review. In addition, one could create the proposed connection by means of a sensible rule on **procedural costs** according to which the challenger bears a higher share of the costs if the resolution was sufficiently justified and vice versa is largely relieved of costs in cases where the majority has overrun him.

The **withdrawal** of a minority shareholder from the company in exchange for compensation in full[135] is a possibility which in light of reasonableness is frequently considered as an alternative compared to a restriction of majority rights and/or legal review of majority decisions.[136] What is correct in this approach is that the withdrawal of the minority shareholder is intended to be largely made available as ultima ratio where he cannot be substantively protected from the decision of the majority. In any event this should be in the form of the elimination of barriers to sales and otherwise potentially by means of acquisition and compensation paid by the majority. By contrast, compensation from corporate assets must always comply with the elementary principle of corporate law that the shareholder's equity holding is intended to be indefinite and his contribution may not be repaid. Capital maintenance within the statutorily prescribed limits is given priority for this reason. A so-called open-end principle[137] as is possible in the case of other, liquid assets such as certain investment funds is fundamentally not compatible with capital protection as prescribed by corporate law.

[134] Details in Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 365; see also Roth/Altmeppen, GmbHG, § 47 marginal no. 129.

[135] BVerfG ZIP 2000, 1670.

[136] See Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 461 et seq., also p. 511 et seq. on the American appraisal right.

[137] See Roth, Treuhandmodell des Investmentrechts, p. 335 et seq.

Chapter 5. The External Control of Corporations

I. Purposes of control and instruments of control

As described above,[1] in the case of the small corporation, the general meeting is primarily responsible for the internal control of the management body. In the large corporation, this responsibility lies with special supervisory bodies or individual members of the management body. First and foremost, this internal control aims at the safeguarding the shareholders' interests. It corresponds to the role of the members of the management body as mandataries of the shareholders.[2]

Naturally, internal control is only able to realise the second protective concern of corporate law – protecting third parties (i. e. creditors and others) (Art. 50(2)(g) TFEU) – to a limited extent because there are of course no third parties in the company's organisational structure. A certain degree of third party protection is best ensured by the obligations of the members of the management body, particularly in the field of capital raising and capital preservation, as well as in times of company crisis, which are mandatory and no matter of debate for the shareholders. Moreover, additional external boards of control are needed which can ensure the necessary protection of creditors and others, if necessary, even against the will of the shareholders; capital market law is not meant here, even if this field nowadays performs some regulative functions of corporate law.[3] The current discussion rather is limited to the control mechanisms typical to corporate law which are equally important for all corporations: annual audit, compulsory form and disclosure.

II. Annual audit

The annual financial statements and management reports of corporations must be examined by an auditor according to national law based on art. 51 of the Accounting Directive (see section 316 (1) HGB, section 268 öUGB, Art. 727 OR, art. L232-1 CCom, art. 2409-bis CC, Art. 2477 subsections. 2 and 3 CC). Further regulations can be found in the Fourth, Seventh and Eighth Directives. The annual audit serves to protect shareholders, but primarily to protect creditors and the public. With this, it realises mainly the second protective purpose of Art. 50(2)(g) TFEU, the **protection of third parties**. The annual audit fulfils three functions: Control, information and certification functions.[4] A part of the **control function** is to inspect whether the legal requirements relevant for the annual financial statements and complementary provisions of the articles of association or of the

[1] See Ch. 3, p. 74 et seq.

[2] See Ch. 3, III, above, p. 77 et seq., regarding the mandate theory as one of the guiding principles of organisational structure.

[3] Raiser/Veil, Recht der Kapitalgesellschaften, § 12 marginal no. 4 refer here to the prohibition of insider trading as an example and the significance of compliance requirements for corporate structure.

[4] See additionally Ebenroth/Boujong/Joost/Strohn, HGB § 316 marginal no. 3 et seq.; Habersack/Schürnbrand, in: Staub, HGB, before § 316, marginal no. 1 et seq.

statutes have been observed. The annual audit confirms the reliability and credibility of the information contained in the annual financial statements and in the management report. The reliability of information also includes its accuracy. The **information function** of the annual audit vis-à-vis the company's legal representatives, an optional supervisory board and the shareholders, is fulfilled mainly by the audit report. Finally, the annual audit has a **certification function** vis-à-vis the addressees of the annual financial statements where it receives either an unqualified audit certificate, a qualified audit certificate, or no audit certificate after the final result of the audit. However, the auditor may only satisfy these functions if provided with a reliable annual financial statement. This appears to be questionable in view of the "abridged balance sheet" on the basis of Art. 1 a (3) Accounting Directive[5], which in 2012 was approved for "micro-undertakings". In a meeting of the rapporteurs and shadow rapporteurs on 5 September 2012 concerning the amendment to the Fourth and Seventh Directives, at least all political groups of the European Parliament agreed on a compromise to implement country-oriented financial reporting for companies. In this context, an agreement was also reached to abandon the compulsory audit for medium-size companies previously under discussion. A new financial statements directive was adopted on 29 June 2013 with several provisions in this regard (arts. 14, 36).[6]

The **accounting** must be included in the annual audit (section 317 (1) first sentence HGB). The detailed contents of the annual audit are provided in Art. 51 a of the Accounting Directive. Appointment and removal of the auditors are also regulated in detail (arts. 37, 38 CD 2006/43 on statutory audits of annual accounts), whereby the core aspect is to find a qualified and independent person for the position of auditor.

From an organisational standpoint, the question is whether the **auditor** is to be viewed as a **corporate body** or an independent expert performing a public function.[7] In some legal systems, the auditor has the position of a corporate body. For example, in Italian law this is indicated by Art. 2409-bis CC, which regulates the annual audit in the paragraph on "Management and control" of the company and gives the public limited company the choice between whether the annual audit is to be carried out by the "auditor council" (collegio sindacale)[8], a corporate body, or by an external auditing company. Earlier jurisprudence from the German Federal Court of Justice reflected this view as well: The auditor was to be seen as a corporate body because he is integrated into the company's organisational structure and independent of management board, supervisory board and general meeting in fulfilling a function that was originally intended for the supervisory board, but mostly requires too much expertise for its members. Such a classification of the auditor as a corporate body can convincingly explain the appointment of the auditor being organised in the way similar to how board

[5] In the version set out in the so-called "Micro-entity Directive", Directive 2012/6/EU dated 14 March 2012 amending Council Directive 78/660/EEC on the annual accounts of certain types of companies as regards micro-entities OJ EU. L 81 dated 21 March 2012, pp. 3–6.

[6] Directive 2013/34/EU.

[7] For detailed treatment, see Habersack/Schürnbrand, in: Staub, HGB, preceding § 316 marginal no. 16 et seq.

[8] *Supra*, Ch. 3, at IV 5 a aa, p. 89 et seq.

members in corporate law are appointed (cf. art. 37 CD 2006/43 on statutory audits of annual accounts). This also applies with a view to the classical support function of the auditor in relation to the supervisory board (section 111 (2) third sentence dAktG). Such a classification of the auditor as a corporate body cannot be disputed with the argument that, according to section 319 (1) first sentence dHGB, apart from natural persons, auditing companies can also be appointed as an auditor. This is because, according to common principles of the law of associations, legal entities may also be considered agents of a company.[9] Against this backdrop, in a leading decision from 1954, the German Federal Court of Justice had considered the auditor as obliged to provide a warning in crisis situations because of the special allegiance resulting from his position as agent.[10] Later on, this was confirmed by the lawmaker with the introduction of an "obligation to address problems" in section 323 (1) third sentence dHGB.

In 1980, the German Federal Court of Justice, withdrew a bit from this position in that it then described the auditor as having a position "*like* a corporate body".[11] The Federal Court of Justice kept to that line in a judgement of 10 December 2009, according to which the auditor has no comprehensive position as a representative of the company's interests ("Sachwalter"). For the Court, the crucial points here were that the annual financial statements of the company's management must be audited solely considering their accounting (Art. 51, 51 a Accounting Directive; sections 316 (1), 317 (1) dHGB), and that the auditor has no further support functions, even in a voluntary audit. It might be true that the annual audit protects, inter alia, the principal's interests. But it is also claimed to be of significance for the shareholders, as well as for creditors, employees, customers and suppliers of the company. In this regard, the auditor had a **public function**, as it would be in the public interest that the accounting keeps to the principles of proper bookkeeping and provides a true and fair view of the company's net asset position, financial position and results of operations. Therefore, the judges see the auditor as an **impartial and uninvolved third party**.[12] More recent decisions of Higher Courts have completely turned away from the concept of the auditor's position as a corporate body; instead the auditor is seen as an independent expert or outside supervisory authority with a public function.[13] The independence of the auditor from instructions of the company or other company bodies (Art. 22 CD 2006/43 on statutory audits of annual accounts) speaks in favour of this classification.

[9] Schürnbrand, Organschaft im Recht der privaten Verbände, p. 217; Habersack/Schürnbrand, in: Staub, HGB, preceding § 316. marginal no.17; see the profound comparative analysis in Pescatore, L'amministratore persona giuridica, 2012.

[10] BGHZ 16, 17, 25 = NJW 1955, 499.

[11] BGHZ 76, 338, 342 = NJW 1980, 1689: "wie ein Gesellschaftsorgan" (establishing that, unless otherwise stated in the articles, the statutory auditor shall be appointed by the general meeting of the shareholders unanimously).

[12] BGHZ 183, 323 = NJW 2010, 1808 pt. 29.

[13] OLG Düsseldorf NZG 2006, 758, 759; in the literature Habersack/Schürnbrand, in: Staub, HGB, preceding § 316, marginal no. 17.

III. Compulsory form

1. Purposes of form requirements

The purpose of most formal requirements in the field of private law[14] is, inter alia, to protect the declaring person from binding himself hastily in important or risky transactions (**warning function**). Prominent examples of this warning function in German law are in particular the written form requirement for issuing a declaration of suretyship (section 766 BGB), a promise to fulfil an obligation or of an acknowledgement of a debt (sections 780, 781 BGB), the notarial authentication of contracts on the transfer of current assets (section 311 b (3) BGB) and the promise of donation (section 518 BGB). Since merchants usually are more versed in business and therefore less worthy of protection than non-merchants, the law abstains from formal requirements with a warning function if the mentioned transactions are a commercial transaction (acte de commerce) on the part of the debtor (section 350 dHGB). In the case of the **notarial authentication**, the warning function of formal requirements is flanked by the notary's duty to advise. However, the advisory and instruction function of formal requirements must be distinguished from the warning function; e. g. simple written form requirements do in fact have a warning function, but never an instruction function for lack of notarial advice. This applies, for example, to the mere written form requirement for the formation of a private limited company under French law (Art. 1835 CC).[15]

Furthermore, formal requirements occasionally are intended to clearly separate the conclusion of a contract from mere preliminary negotiations, to record and clarify the subject matter of the contract and to facilitate the evidence of its subject matter. In this respect, they have a **clarifying and evidentiary function**. This may exist in favour of the contracting parties, but also in favour of third parties. For instance, with regard to the information on the company's share capital and its disclosure under Art. 2 (a-c) Disclosure Directive, in this way third parties are supposed to receive the opportunity to inform themselves on the volume of the company's capitalisation.

Finally, formal requirements can also have the purpose of ensuring supervision by the authorities. In this respect, they have a **control function**. For example, the documentation of the written general agreement between bank and customer under section 34 (2) WpHG [German Securities Trading Act] is intended to provide the competent authorities an opportunity to control compliance with the guidelines of the MiFID. In addition, some formal requirements have the function of impeding the conclusion of the transactions in question: this applies, for instance, to the necessity of a notarial authentication for **any obligation to transfer company shares** under section 15 (4) GmbHG. The function of this provision is in particular to impede the negotiability of GmbH shares and their speculative trading.[16]

The mentioned purposes of the form are indeed mere legislative objectives and not criteria for the application of formal requirements in the individual case. Therefore this formal requirement must be followed even if in the individual case the purpose of the formal requirement has already been achieved otherwise. Never-

[14] Regarding the following, see Einsele, in: MüKoBGB, § 125 marginal no. 8 et seq.
[15] See 3 a., below (p. 160 et seq.).
[16] See 3 b., below (p. 162 et seq.).

theless, the purpose of the form is important for numerous questions: It has effects on the scope of formal requirements, on the question of to which extent a transaction/a declaration of intent requires compliance with a form; on the curability of transactions that were first concluded without a valid form; and also on the question of under which conditions an informally concluded transaction may be regarded as valid. For legal policy, it is important to be sure about the purpose of form for the respective transaction because this is the only way to decide on the level of compulsory form (mere written form, notarial certification, notarial authentication).

2. The functions of the civil law notary in corporate law

a) General principles. In Continental Europe, the office of notary and corporate law have been connected for a long time. This applies more so to some sections of corporate law than to others. In organisational law for corporations, including the transformation, merger and splitting of companies, the notary's competences are particularly extensive – among other things because of protection of creditors and others, which is particularly important here. In partnership law, notarial duties are basically restricted to certifications and therefore rather limited. Creditor protection by the notary is unnecessary here because creditors are protected by the direct and personal liability of the shareholders. However, the commitment of great sections of public limited company law to the hands of the notary has proven to be useful. In this context, alleviating the burden on the judiciary is just one advantage among many of the notarial activity. However, the legal policy discussion in Germany in the run-up to the reform of private limited company law by the so-called "MoMiG"[17] in 2008 proved that notarial competences in corporate law are nonetheless no matter of course. Partly, the utility of notarial activity was questioned here from an economic standpoint[18] and a (at least partly) notary-free corporate law was demanded. The stone of contention was and is mainly the statutorily-provided consultation of the notary for major transactions even if they are attended to by experienced law firms, and the authentication process as such, which is sometimes experienced as difficult, especially in this sector. However, on this occasion the German lawmaker also clearly disapproved of the visions of a largely notary-free corporate law. More than ever it is true that the real importance of the notary in corporate law lies in the comprehensive, highly qualified and cost-effective provision of small and medium-sized companies with advice to and assistance in the organisation of corporate law issues.[19]

b) Historical development of notary functions in corporate law. The historical origins of the office of notary probably lie in the Northern Italian (Lombard) city states of the High Middle Ages.[20] At that time, the **Italian city states** engaged specially appointed scribes to certify transactions, a part of their voluntary jurisdiction. It probably was in the 12th century that the status of the "notarius" was raised

[17] Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen vom 23.10.2008, BGBl. I, p. 2326; providing an overview Kindler, NJW 2008, 3249 et seq.

[18] E.g. by Eidenmüller, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, pp. 165, 167.

[19] Generally on the role of the notary in corporate law, see Priester, in: Hauschild/Kallrath/Wachter (eds.), Notarhandbuch Gesellschafts- und Unternehmensrecht, § 1, p. 1 et seq.

[20] On this issue and the following, see Murray/Stürner, The Civil Law Notary, p. 10 et seq.

from a mere scribe to an independent legal adviser. Form books[21] and manuals were written even then.[22] Also the **French notaryship** was strongly influenced by Italy, and was regulated by law for the first time in 1304, when Philipp IV, called the Fair, issued the "Ordonnance sur les tabellions et notaires".[23] In **Germany**, the office of notary was firmly established at the latest at the beginning of the 16th century (Reichsnotariatsordnung of 1512).[24]

With the introduction of **public limited companies**, the office of notary received its first competences in corporate law.[25] The requirement of a notarial authentication of the statutes of a public limited company has been an integral part of German commercial law since the General German Commercial Code (ADHGB) of 1861. There had already been corresponding specific regulations in the Prussian Public limited company Act of 1843, as well as in the drafts of a code of commercial law for the Kingdom of Württemberg of 1838/40 and of a code of commercial law for the Prussian states of 1857. Precursors of these codifications might be the French Code de Commerce of 1807 and its two major offshoots, the Spanish Codigo del Commercio of 1829 and the Dutch Wetboek van Kophandel of 1838. On the requirement of a judicial or notarial authentication of the statutes, following the example of the Dutch legislation, the explanatory report to the Prussian Public limited company Act of 1843 explains that "on the one hand, this is necessary so that the legitimation of the representatives is certain, however, on the other hand, it seems appropriate that an expert be consulted for preparing such articles of association."[26] Later, under in the ADHGB, amendments to the statutes were also subjected to notarial authentication (Art. 214).[27] Another milestone in the development of an external legal control of corporations was then set with the **public limited company law reform of 1884**. According to the then created Art. 238 a ADHGB, every single decision of the general meeting needed a judicial or notarial authentication. With that, the public limited company law reform had a double ratio legis, namely of providing reliable evidence of the existence and the subject matter of the decision (**evidentiary function**) and also – here, at an early stage, the legislative request of an external control of corporations emerges – of ensuring the **substantive correctness** of the decisions. According to the explanatory statement, the goal was "to rule out any uncertainty regarding the form of a decision made by the general meeting"; in addition the presence of a judge or notary shall contribute to "the thorough observance of law and statute when making decisions".[28]

In 1891, the first draft of a law on private limited-liability companies (Gesellschaft mit beschränkter Haftung [GmbH]) had not yet provided for notarial participation in the foundation of the company. The authors of the draft thought that, considering that

[21] Cf. the Liber Tabellorum of Irenaeus published at the start of the 12th century; see also Bärmann, DNotZ 1979, 3 for additional detail.

[22] Rolandinus, Summa artis notariae (1215–1297).

[23] For further detail, see Murray/Stürner, The Civil Law Notary, p. 15 et seq.

[24] See Murray/Stürner, The Civil Law Notary, p. 11 et seq.

[25] Priester, in: Hauschild/Kallrath/Wachter (eds.), Notarhandbuch Gesellschafts- und Unternehmensrecht, § 1 marginal no. 4 et seq. (also regarding the following); on the history of corporate law in continental Europe in general, see above, p. 12 et seq.

[26] Quoted based on Priester, in: Hauschild/Kallrath/Wachter (eds.), Notarhandbuch Gesellschafts- und Unternehmensrecht, § 1 marginal no. 5.

[27] Copy of the ADHGB in the BGBl. des Norddeutschen Bundes 1869, 404.

[28] Cf. the printout of the explanatory statement of the corporate law reform of 1884 in Schubert/Hommelhoff, 100 Jahre modernes Aktienrecht, ZGR-Sonderheft 4, 1985, p. 505 f et seq.

the mechanics of the foundation process should be simpler than for public limited companies, there was no such need.[29] However, in the end this liberal position was not adopted by the GmbH law. On the contrary, section 2 (1) first sentence GmbHG required notarial authentication of the articles of association from the outset. Furthermore, as in public limited company law, section 53 (2) first sentence GmbHG extends the authentication requirement to amendments to the articles. Other important authentication requirements were stipulated from the start for a transfer of shares and for the underlying obligatory part of the acquisition transaction (section 15 (3) and (4) of the GmbHG). Just like in English law,[30] share transfers involve a two-step process: In the first step the buyer and the seller conclude a sales contract where they agree on the terms of the transaction (price etc.). In the second step the transfer is executed.

c) Notary and commercial register. Further, a central competence of the notary in corporate law results from national regulations, according to which **registrations in the commercial register** must be made **in a publicly certified form** (section 12 dHGB; section 11 öUGB; Art. 16, 18 HRegV (CH); Art. R310-3 CCom;[31] Art. 2330, 2436, 2443, 2480, 2481 CC). The notarial certification assures the identity of the registering persons, as well as time and place of the signing. In this respect, notarial participation brings a considerable advance in legal certainty compared with the situation **in Anglo-American legal systems**, which are characterised by serious **control deficits**.[32] There, online registration without any external legal control is possible for anybody – even for criminals.[33] Therefore, Anglo-American registers have only a very limited or no disclosure function at all. Cases of "identity fraud" or "identity theft" are not unusual. This is why, for instance, Companies House warns about "identity fraud" on its website. The economic damage caused by false registrations in Companies House is described as substantial. In general, between 50 and 100 cases of "corporate identity fraud"[34] are estimated per month. Therefore, it is at least a reduction of the problem to classify notarial participation simply as a cause of "transaction costs that reduce welfare".[35]

With the introduction of the **electronic commercial register** based on Directive 2003/58/EC[36], the relevance of the notary as a gateway to the commercial register has once again been significantly increased in the legal systems of the Latin Notary's Office: The data for the electronic registration must be prepared by the notary in order to be able to be directly imported to the registry software.[37]

In this respect, the importance of the notary for the external control of corporations must not be underestimated, especially because his role in cooperation with

[29] Entwurf eines Gesetzes betreffend die Gesellschaft mit beschränkter Haftung nebst Begründung und Anlagen, amtliche Ausgabe 1891, p. 47.

[30] Gower & Davies, Principles of Modern Company Law, 9th ed., 2012, p. 982.

[31] For additional information on corporate law disclosure in France, see Sonnenberger/Dammann, Französisches Handels- und Wirtschaftsrecht, III 116 et seq.

[32] Regarding the following, cf. Priester, in: Hauschild/Kallrath/Wachter, Notarhandbuch Gesellschafts- und Unternehmensrecht, § 4 marginal no. 82.

[33] Cf., e. g. http://www.companieshouse.gov.uk/infoAndGuide/companyRegistration.shtml; see above, p. 11 et seq.

[34] Bock, ZIP 2011, p. 2449.

[35] Eidenmüller, in: Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, pp. 163–171.

[36] See Lutter/Bayer/J. Schmidt, EuropUR, § 19 marginal no. 5.

[37] Priester, in: Hauschild/Kallrath/Wachter, Notarhandbuch Gesellschafts- und Unternehmensrecht, § 1 marginal no. 29.

the commercial register is not only to make a formal preliminary check and to help technically with the registration. In this phase of company formation, the notaries have a **substantive control function**, and at the same time relieve the registry authorities, because they act as a filter for them and largely spare them the time-consuming task of dealing with the shareholders and managers involved. The notary has this substantive control function especially for the preparation of articles of association. He monitors the observance of normative regulations, a prerequisite for the company's entitlement to registration (e. g. under section 9 (1) first sentence dGmbHG). Thus, the involvement of a notary is important for the **substantive guarantee of correctness of legal acts under corporate law**.[38] The Italian legislation goes so far as to entrust the notary with the sole substantive examination of the legality of corporate formation: The registry court only examines the "regolarità formale della documentazione" (Art. 2330 (3) CC).[39] If a legal examination in two stages (by notary and court) occurs – as it is the case in Germany – the court is still significantly relieved by the preceding examination performed by the notary. In practice, it represents a very large difference whether the text of a contract is prepared by lay people and attorneys without any special knowledge in corporate law, or if it has been critically examined by an expert.

Another of the notary's tasks in the run-up to the registration in the commercial register is not exactly a part of the external control: to **advise** the **persons involved** on the requirements for the foundation of a company under corporate law, for instance when it comes to raising capital. A diligent notary pays attention to compliance with formalities under Art. 7–11 Capital Directive. And finally, the notary eases the burden on the registry authorities and acts as a filter for them in so far as he ensures that the submitted enclosures are as correct and complete as possible.

d) Notarial acts as an exercise of official authority. Notarial functions have a **double purpose**: They equally serve the **preventive administration of justice** and the **impartial support** of the persons involved in an authentic instrument.[40] To start with the preventive administration of justice, in the Latin Notary's Office of today, the notary is more than just a keeper of the minutes of the declarations of intention made by the persons involved. In truth, for the notary the authentication results in a series of duties of preventive administration of justice (under German law, cf. section 17 BeurkG). According to that, the notary first of all must **clarify the facts** on which the authentication is to be based. So the maxim "da mihi factum, dabo tibi ius" applies not only to the civil court but also to the notary. Based on the facts he has determined, the notary must find out what the will of the persons involved is and formulate it as precisely as possible in legal terms. Here it is also the notary's responsibility to propose a proper choice of the legal options that come into question. In corporate law, this applies for instance to the decision on the form of the company that corresponds most to the founders' interests. In this context, another central point

[38] BGHZ 105, 324, 338 – Supermarkt.

[39] See additionally, Cian/Trabucchi, Commentario breve al Codice Civile, Art. 2330 comment. I 2; Bertolotti, in: Cagnasso/Panzani (eds.), Trattato delle nuove s.p.a., 2013, vol. 1, La s.p.a. Profili comparatistici. La costituzione, p. 647 et seq.

[40] Regarding the following, see especially Priester, in: Hauschild/Kallrath/Wachter, Notarhandbuch Gesellschafts- und Unternehmensrecht, § 1 marginal no. 8 et seq.; regarding current developments, most recently Huttenlocher/Wohlrab, EuZW 2012, 779 et seq.

of notarial work is instructing the persons involved on the legal implications of the authenticated transaction. With this **"instruction function"**, notarial authentication fulfils a central purpose of the form (above 1., p. 154 et seq.). For instance, when founding a company, the persons involved must be instructed on the consequences of a breach of capital raising rules and on liability risks in the foundation phase. When purchasing own shares, there are often problems with the maintenance of capital which the notary has to point out. In the case of a transfer of shares, liability risks for the buyer (section 16 (2) dGmbHG) and the liability of legal predecessors (section 22 (1) dGmbHG) must be addressed. According to the German law on notarial authentication, the notary must also protect persons involved who are "inexperienced or unsophisticated" from being legally disadvantaged (section 17 (1) second sentence BeurkG). Here it becomes clear that the notary has a task in the preventive administration of justice that involves the **"protection of the weaker party"**. In corporate law, this can be of importance if employees – who are less experienced in business – are to purchase company shares.

The second purpose of notarial work – the **impartial support of the persons involved** – finds expression in the legal requirement according to which the notary does not represent a party, but rather acts as an impartial adviser to the participants (section 14 (1) second sentence BNotO). In contrast to the lawyer's role as an agent for his client, the notary accordingly works with the approval of the persons involved, namely with the object of finding a proper legal solution for the *interests of all persons involved*. The impartial support of the persons involved has at the same time a preventive character in so far as the notary to an extent takes action as part of a "mediation".[41]

In light of this professional – and largely statutory – notary task it is not convincing that the European Court of Justice classifies notarial work as not directly connected specifically with the **exercise of official authority** in terms of Art. 51 (1) TFEU.[42] In taking this position, the CJEU interprets the concept of official authority in European law in a manner diametrically opposed to the view of the German Federal Constitutional Court.[43] For purposes of national law, the latter takes the view that the notary has been assigned to perform original state functions which are provided for by the sovereign power according to the applicable legal system. Exactly this point is negated by the CJEU, because the notary cannot take action independently of the will of the parties. Thereby the CJEU misjudges, among other things, that in civil proceedings courts also regularly take action not ex officio, but merely on application by a party.[44] There is also the fact that, particularly in **EU company law**, the notary and the government agency maintaining the registry are deemed on a par in a central part – under the regulation of control of company formations and amendments to

[41] Priester, in: Hauschild/Kallrath/Wachter, Notarhandbuch Gesellschafts- und Unternehmensrecht, § 1 marginal no. 13.

[42] Case C-54/08, *Kommisssion/Deutschland* [*Notarberuf ohne Staatsangehörigkeitserfordernis]* (2011) = NJW 2011, 2941 = EuZW 2011, 468 with comments by Fuchs = EWiR 2011, 703 with brief comments by Vollmer; for a critical view, see Huttenlocher/Wohlrab, EuZW 2012, 779 et seq.

[43] BVerfG DNotZ 2009, 702; NJW 2012, p. 2640 et seq.

[44] Grziwotz, EWiR 2012, 479 et seq. regarding KG ZIP 2012, 1514 according to which the acts of the German notary are official in nature and accordingly do not fall within the scope of the free movement of services.

the articles of association in Art. 11 of the Disclosure Directive. Both must protect the **interests of third parties**[45] and therefore ensure "**sovereign control**".[46]

3. Small corporation

a) Formation, capital raising, amendments to company statutes. According to most of the legal systems included in this study, the small corporation (private limited company) requires an **official document for its formation** (section 2 (1) first sentence dGmbHG; section 4 (3) öGmbHG; Art. 777 (1) OR; Art. 2463 (2) CC). Only French law makes do with written articles of association (Art. 1835 CC); however, notarial authentication takes its place. Of course, in France the statutes of a private limited company also require authentication if immovable property is contributed to the company.[47] Otherwise, according to Art. L210-7 (1) CCom, in France the registry clerk is responsible for reviewing formation.[48]

The French system clearly shows the **weaknesses of a procedure without a notary**. In the course of the implementation of the Disclosure Directive, the French lawmaker consciously refused obligatory notarial examination in advance.[49] Instead, a three-component regime was introduced that is intended to ensure the legality of the preparation of and amendments to the articles of association.[50] First of all, a **registration request (demande d'immatriculation)** is needed, which requires the fulfilment of all "formalities" of the founding (Art. L210-1 CCom[51]). If, after the formation, obligatory information is missing in the statutes or if there are breaches of "formalities", all persons affected can apply for an **action aux fins de régularisation**, so that the company is forced to conform to the laws with the threat of a penalty payment (Art. 1839 CC[52]). The third component is a **liability requirement**,

[45] Recital no. 2 to the Disclosure Directive; with regard to the third-party protective function of the Disclosure Directive, see also Habersack/Verse, Europäisches Gesellschaftsrecht, § 5 marginal no. 2.

[46] Grundmann, Europäisches Gesellschaftsrecht, marginal no. 200.

[47] See additionally, Frank/Wachter, RIW 2002, 11, 12.

[48] The following is provided for all commercial companies: "Il est procédé à l'immatriculation de la société après vérification par le greffier du tribunal compétent de la régularité de sa constitution dans les conditions prévues par les dispositions législatives et réglementaires relatives au registre du commerce et des sociétés"; additionally Didier, Le registre du commerce et des sociétés nell' ordinamento francese, in: Bocchini (ed.), Il registro europeo delle imprese = European companies registry, Vol. 1: Registro delle imprese e mercato interno, il registro delle imprese nell'ordinamento francese, inglese e tedesco, rappresentanza commerciale e registro delle imprese, atti traslativi di azienda e pubblicità, Padova: CEDAM, 2003, p. 27 et seq.; regarding the legal situation in France prior to the CCom 2000, see Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 171 et seq.

[49] Houin, Rev. trim. dr. com. 22 (1969), 999, 1007; see also Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 172.

[50] Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 172 et seq.

[51] Article R210-1 CCom: "(1) Les sociétés commerciales sont immatriculées au registre du commerce et des sociétés dans les conditions définies par le livre Ier. (2) La demande d'immatriculation est présentée après accomplissement des formalités de constitution de la société."

[52] Article 1839 CC (modifié par LOI n°2009–526 du 12 mai 2009 – art. 10): "(1) Si les statuts ne contiennent pas toutes les énonciations exigées par la législation ou si une formalité prescrite par celle-ci a été omise ou irrégulièrement accomplie, tout intéressé est recevable à demander en justice que soit ordonnée, sous astreinte, la régularisation de la constitution. Le ministère public peut agir aux mêmes fins. (2) Les mêmes règles sont applicables en cas de modification des statuts.

which the founder and first board members are subject to if there is missing information or formalities have been disregarded (Art. 1840 (1) CC[53]; Art. L210-8 CCom). However, there is at no time a substantive examination by a notary or the registry clerk (greffier).[54]

By contrast, the main **purpose** of notarial authentication of corporate formations and of amendments to the statutes is **to document the bases of the registered corporation** in the interest of legal certainty and the transaction.[55] Here, the formal requirement fulfils a double protective function. It aims both to protect the persons involved and to protect third parties by ensuring legal clarity, complying with the foundation requirements and instructing the parties. The criticism of the notary's authentication monopoly as a foundation obstacle and cost factor[56] is not convincing: Only the notary is able to ensure comprehensive protection of the founders against liability risks, of co- and minority shareholders against overreaching, of creditors against insufficient capital raising, and finally of the public against dubious company formations.

It is the **founding member** of a private limited company who is affected by rather hidden risks of differential and contingent liability and piercing the corporate veil, as well as in connection with the foundation of shell companies, 'hidden' contributions in kind and for other foundation defects. The notary points these out in the course of the foundation (cf. also under 2 d)). Public interest is affected in a special way by mandatory capital preservation rules. By virtue of his impartialness and legal knowledge, the notary is able to safeguard these interests.[57] The **warning function** of the authentication must be highlighted, especially with regard to the founders of the company.[58] Notarial authentication makes the founders realise the importance of their declaration of intention and includes a notarial instruction of the persons involved on the legal implications of formation.[59] The notary ensures the same

(3) L'action aux fins de régularisation prévue à l'alinéa premier se prescrit par trois ans à compter de l'immatriculation de la société ou de la publication de l'acte modifiant les statuts."

[53] Article 1840 (créé par Loi 78–9 1978-01-04 JORF 5 janvier 1978 rectificatif JORF 15 janvier, 12 mai 1978 en vigueur le 1er juillet 1978): "(1) Les fondateurs, ainsi que les premiers membres des organes de gestion, de direction ou d'administration sont solidairement responsables du préjudice causé soit par le défaut d'une mention obligatoire dans les statuts, soit par l'omission ou l'accomplissement irrégulier d'une formalité prescrite pour la constitution de la société. (2) En cas de modification des statuts, les dispositions de l'alinéa précédent sont applicables aux membres des organes de gestion, de direction ou d'administration alors en fonction. (3) L'action se prescrira par dix ans à compter du jour où l'une ou l'autre, selon le cas, des formalités visées à l'alinéa 3 de l'article 1839 aura été accomplie."; similar Art. L210-8 CCom.

[54] Just shortly after the implementation of the Disclosure Directive, talk was of a mere "coup de chapeau" in the face of European lawmakers: Hémard/Terré/Mabilat, Rev. soc. 88 (1970), 197, 202; Sonnenberger, ZfRV 1974, 244, 253; Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 176.

[55] Cf. e. g. for German law, Roth/Altmeppen, GmbHG, § 2 marginal no. 22 et seq. (also regarding the following).

[56] But trending in this direction, Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 163 et seq.

[57] On shareholder liability in the (small) German corporation see Meister et al., The German Limited Liability Company, 7th ed., 2010, no. 54 et seq; cf. also Fitz/Roth, JBl 2004, 205.

[58] Cf. also previously RGZ 54, 418, 419; RGZ 66, 116, 121; RGZ 149, 38, 39.

[59] To that effect, also BGH DB 1988, 223 = NJW-RR 1988, 288 on formal requirements for a pre-contract for the formation of a GmbH; see also Kindler, Grundkurs Handels- und Gesellschaftsrecht, § 14 marginal no. 45 et seq.

external control when making amendments to the statutes: section 53 (2) first sentence GmbHG; section 49 (1) second sentence öGmbHG; Art. 780 OR; Art. 2480 second sentence CC). In this context, the compulsory form also pursues the targets of legal clarity and instruction of the persons involved, as well as – as a precaution – of guaranteeing substantive correctness with participation of the notary.[60]

European corporate law also ensures a minimum degree of **formation control**.[61] According to Art. 11 of the Disclosure Directive, the instrument of incorporation and the statutes must be officially authenticated if the law of the applicable Member State does not provide for a preventive, administrative or judicial control. This also applies to amendments to these legal acts. Formation control by the notary or another public agency is intended to prevent a priori an invalidity of the corporation. This means that in states where – like in **France** – a private agreement is sufficient for company formation (Art. 1835 CC), substantive examination of the legal acts prepared by the founders, carried out by the government agency maintaining the registry, is mandatory. On the other hand, the **Italian model** of examining company formation solely by the notary is also permitted (Art. 2330 (3) CC). Finally, the two-stage formation control in the course of the notarial authentication *and* – subsequently – by the government agency maintaining the registry, as it is typical of German law, is completely unobjectionable (section 2 (1) dGmbHG; section 23 (1) dAktG; section 9 c dGmbHG; section 38 dAktG). By contrast, the **SPE project** follows an excessively liberal policy in that it permits conformity to be reviewed by a notary, a judicial body, another competent authority and/or by **self-certification** (Art. 9 (4)[62]). And it is even added that an "unnecessary" substantive review of the documents must not be carried out. In saying that, the SPE statute even falls behind Art. 11 of the Disclosure Directive, where the notarial formation control is not mandatory. But the authors of the SPE Regulation misjudge the following:[63] Only a notarial legal examination ahead of the register procedure can guarantee a sufficient degree of correctness of the legal acts constituting the company. The text of the articles of association is established beyond doubt as a result of the notarial authentication (clarification and preservation of evidence). The raising of capital is supervised in a reliable and competent way. There are hardly any reported cases of notarial liability for negligence related to company formation.

b) Transfer of shares. Under German law, special authentication requirements for small corporations are regulated in section 15 (3) and (4) dGmbHG. According

[60] BGHZ 105, 304, 338; Roth/Altmeppen, GmbHG, § 53 marginal no. 21.

[61] Regarding the following, see e. g. Lutter/Bayer/Schmidt, EuropUR, § 19 marginal no. 81 et seq. (p. 448 et seq.); Habersack/Verse, EuropäischesGesellschaftsrecht, § 5 marginal no. 38 et seq.; comparative legal overview Einmahl, AG 1969, 210 f.; comprehensive treatment in Schwanna, Die Gründung von Gesellschaften in Deutschland, Frankreich und Großbritannien – Gemeineuropäische Prinzipien des Gesellschaftsrechts, 2002.

[62] In the compromise version proposed by Hungary (Council Doc. 10611/11 = 11786/11): "The compliance of the documents and particulars of an SPE with this Regulation, the articles of association and national law shall be subject to control that shall be carried out in accordance with the applicable national law; in particular by a notary, a judicial body, another competent authority and/or by self-certification, including by an authorised signatory. However, unnecessary substantive controls of the documents and particulars shall be avoided."; on the issue of the SPE Project *supra*, Ch. 1, III 4, p. 23 et seq.

[63] On the following issue, see Wicke, in: Süß/Wachter, Hdb. des internationalen GmbH-Rechts, § 8 marginal no. 19; Wicke, GmbHR 2011, 566, 569.

to these provisions, the transfer of shares of a private limited company is just as **subject to compulsory notarial authentication** as the mere commitment to their transfer. Also under Austrian law, the transfer of shares by transactions inter vivos requires the form of a notarial deed (section 76 (2) öGmbHG). In this respect, Italian law makes do with a notarial certification (Art. 2470 (2) CC), while French and Swiss law even content themselves with a private agreement (France: Art. L 221–14 (1) in conjunction with Art. L223-17 CCom; Art. R221-9 in conjunction with Art. R223-13 CCom; Switzerland: Art. 785 (1) OR[64]). Where applicable, the authentication requirement – according to the historic German lawmakers – shall "give the guarantee that the shares do not become an object of trading of the new companies'".[65] That "doubts and uncertainties on the matter of transaction cannot arise" was merely a subordinate ratio legis.[66] All in all, this makes clear the lawmakers intention: to design the private limited company with the help of the authentication requirement as a **closed company**, where a change of members is indeed not ruled out, but shall be made formally complicated.[67] In this way, the authentication requirement at the same time realises a certain protection for the small corporation as a legal form ('Typenschutz').[68]

c) Control deficits. Control deficits exist firstly where the reviewed legal systems and legislative initiatives foresee no **preventive notarial examination of the formation and the statutes**. This applies to France, where a mere commercial register control examination was introduced (art. L210-7 CCom), and even more to the planned SPE statute (art. 9 [4]),[69] according to which even a self-certification of the shareholders, in accordance with national law, is to be sufficient and is not to be examined by no authority whatsoever. In this regard, the astonishing statement of the English Companies House (above, p. 11) serves as a cautionary example. Due to his legal knowledge and the close contact with the parties in the run-up to and in the course of the authentication, the notary would be most qualified to guarantee correctness with regard to fundamental corporate acts.

Secondly, control deficits exist because of certain gaps in the system of authentications of transactions in the small corporation. First of all, this applies to the **redemption** of shares in a private limited company, for which a notarial authentication is not mandatory (cf. section 34 dGmbHG). This is surprising, because the redemption of shares is an actus contrarius to the formation and transfer of shares and should be subject to an external control, not only because of the potential loss of rights for the person involved.[70] Furthermore, control deficits result in the case of the **splitting and consolidation of shares.** These measures are within the competence of

[64] Regarding Swiss law and its effects on international legal transactions, cf. Weller, Der Konzern 2008, 253 et seq.

[65] Explanation in Schubert/Hommelhoff, 100 Jahre modernes Aktienrecht, p. 37.

[66] Explanation in Schubert/Hommelhoff, 100 Jahre modernes Aktienrecht, p. 38.

[67] Previously providing a comparative legal analysis Hallstein, RabelsZ 1938/39, 341, 378 et seq.; German jurisprudence still emphasizes this formal requirement on the issue of section 15 (3) dGmbHG: BGH NJW 1996, 3338, 3339.

[68] Apt, Großfeld/Bernd, RIW 1996, 623, 629; comprehensive treatment, see Kindler, Geschäftsanteilsabtretungen im Ausland, p. 12 et seq.

[69] Cf. the Hungarian proposal dated 20 June 2011 (Council Doc. 11786/11); cf. Bayer/J. Schmidt, BB 2012, 3.

[70] Priester, in: Hauschild/Kallrath/Wachter/Priester (eds.), Notarhandbuch Gesellschafts- und Unternehmensrecht, § 1 marginal no. 24.

the general meeting of the shareholders (section 46 no. 4 dGmbHG) which already is an indication of their fundamental nature. In view of the effect on the legal situation of the individual shareholder the involvement of a notary would be worth considering here as well. It is ultimately not consistent if national laws require authentication by a notary in the case of the formation of a company or an amendment to its statutes but not in the case of the **dissolution of the company**.[71]

4. Large corporation

a) Formation, raising of capital, amendments to company statutes. The notary's mandatory competence related to the formation of a public limited company has long historic roots in Germany, Austria, Switzerland and Italy (section 23 (1) dAktG; section 16 (1) öAktG; Art. 629 OR; Art. 2328 (2) CC). This applies similarly to closely associated measures such as amending company statutes including alterations of share capital. This results in part from requirements based on the corresponding form (Art. 647 OR) and in part from the requirement of notarial authentication of resolutions of the general meeting (section 130 (1) dAktG; section 111 (1) öAktG; Art. 2371 (2) and Art. 2375 CC) in conjunction with the competence of the general meeting to amend company statutes including capital measures. Substantively, the competence of the notary is justified by the same values presented in connection with the small corporation under 3 a), above.

b) General meeting. The requirement to have resolutions of the general meeting recorded by a notary (section 130 (1) dAktG; section 111 (1) öAktG; Art. 2371 (2) and Art. 2375 CC) serves a two-fold purpose: First, the authentication requirement serves the purpose of providing legally certain documentation of the decision made by the general meeting. In doing so, it performs the classic **evidentiary function**[72] and this for purposes of protecting (future) shareholders, company creditors and the public. The minutes of the general meeting represent a factual report by the notary of what occurred at the general meeting, in particular with regard to resolutions which were adopted.

Second, the notarial minutes ensure from the outset that statutory procedural requirements for the adoption of resolutions at the general meeting are complied with and thus aims to **guarantee substantive correctness**.[73] This conforms to the essential function of the notary to participate in the pursuit of preventive justice (see 2 d, above, p. 158 et seq.). In this case, the notary also does more than take minutes.[74] As an independent organ of the administration of justice, he must also assess the propriety of the conduct of the meeting and if he discovers any defects, must attempt to have them corrected.[75] In the words of the historical lawmakers, the notary thus acts here as "recorder and stage manager".[76] Issues regarding the correctness of the resolutions

[71] Cf. MüKoGmbHG/Berner § 60 marginal no. 101.
[72] BGHZ 127, 107, 113 = NJW 1994, 3094, 3095; see above, p. 154, 156.
[73] Kubis, in: MüKoAktG, § 130 marginal no. 1.
[74] Priester, in: Hauschild/Kallrath/Wachter (eds.), Notarhandbuch Gesellschafts- und Unternehmensrecht, § 1 marginal no. 15.
[75] Hüffer, AktG, § 130 marginal no. 12; OLG München DNotZ 2011, 142 with comments by Priester.
[76] Citations in Priester, in: FS 50 Jahre Deutsches Anwaltsinstitut, 2003, p. 571 („Protokollant und Inspizient").

and the associated process must be reviewed by the notary including a summary review of legality.[77] Furthermore, the notary is subject to comprehensive duties to provide comment and to intervene in order to avoid faulty resolutions.[78]

The duty to submit the notarial minutes to the commercial register in addition to the formal requirements in the legal systems reviewed in this study (e. g. section 130 (5) dAktG) additionally serve a disclosure function with respect to a right of access based on Art. 3 (4) Disclosure Directive (e. g. implemented through section 9 (1) dHGB).

5. Analysis

A distinction must be made with regard to the question of the extent to which external **control** of companies may be realised **through compulsory legal form**: To the extent the legal systems reviewed here limit themselves to requiring legal acts on the part of a corporation to be made by private agreement (e. g. Art. 1835 CC), there can be no talk of a real external control. This is even though the form of a private agreement satisfies the classical functions of protecting against haste and serving as a warning. With regard to the evidentiary function however, serious doubts as to the suitability of a mere written form requirement are appropriate. By its nature, the requirement of a mere written contract does not guarantee the **advisory function** associated with notarial form. The notarial requirement for corporate acts appropriately protects the interests of third parties and the public in addition to those of these individual interests. Viewed on the whole, the involvement of a **notary** in the core corporate acts is associated with a series of **advantages**:

First, the notary makes a very significant contribution to **easing the burden on the authority maintaining the registry**. This is the case first and foremost, from a formal standpoint because the notary prepares the data to be reported and filed. In addition, the notary also ensures the **substantive correctness of the notarial authentications performed and entries in the registry** in all cases. This in turn results in a significant reduction in judicial control responsibilities in advance of entries in the registry. National lawmakers have already reacted to this with the elimination of a review of certified documents by the authorities maintaining the registries. For example, this is the case in Italy (Art. 2330 (3) CC)[79] as well as regarding reductions in commercial register controls under section 9 c (2) dGmbHG resulting from the German Handelsrechtsreformgesetz [Commercial Law Reform Act] dated 22 June 1998. The notary, as an independent public official, replaces a part of the otherwise necessary external state control of companies by ensuring compliance with compulsory legal forms.

External control of companies by notaries also has an additional beneficial effect in the area of contentious jurisdiction. The notary's independent position, and the notary's precise recording and formulation of the legal intent of the participants, likely result in having many **disputes avoided** from the outset and in this manner never reaching a court.

In addition to this control and filter function, the notary also has an important **communication function** at the interface between the shareholders and management on the one side and the authority maintaining the registry on the other. The

[77] Kubis, in: MüKoAktG, § 130 marginal no. 31.
[78] OLG Düsseldorf DNotZ 2003, 775, 778.
[79] For a more detailed treatment, see 2 c., above, p. 157 et seq.

notary does not merely submit the required notices and documents to the registry, but rather also clarifies any objections on the part of the registry or if needed staves them off. His legal knowledge and familiarity with the practices of the authority maintaining the registry within his country enable him to do so.

Based on his broad legal education, the civil law notary is additionally able to optimise draft instruments prepared by specialised attorneys. This applies for example in the case of inheritance law; its importance to corporate structuring is obvious. Equally important are the fields of real property law and matrimonial law which may also have close connections to corporate law depending on the circumstances of the particular case.

Finally, the fact that the notary is able to offer small and medium-sized enterprises (SME's) competent and comparably affordable legal advice particularly in the field of corporate law must be viewed positively.

Overall, there is much in favour of not only maintaining the existing form requirements in the field of corporate law, but also of open-mindedly considering their expansion. This results in the desire for a series of legal policy enactments (V., below, p. 176).

IV. Disclosure

1. Main principles of commercial disclosure in the European Union

a) Entry in the commercial registry and publication as the primary means of disclosure. Within the European Union, commercial disclosure is extensively regulated by section 2 of the Disclosure Directive (Art. 2–7).[80] In addition to secondary disclosure instruments such as the right to copies and minimum information on business correspondence, the Disclosure Directive requires the Member States to establish registries, whereby under Art. 3 (1) of the Disclosure Directive they have the discretion to decide to organise a central register for the respective country or whether to opt for a decentralised organisation. The primary disclosure instruments[81] are the obligation to provide a submission to the registry and to publish in the respective official gazette or a "similarly effective form of publication." According to Art. 3 (1) Disclosure Directive, the Member States open a "file" for every company at the registry in which all documents and particulars required to be disclosed must be filed or must be entered into the registry. Following Amending Directive 2003/58/EC, this filing or entry, as applicable, is required to be in electronic form since 1 January 2007. According to Art. 3 (5) Disclosure Directive, documents and particulars subject to a disclosure obligation must be published in an official gazette designed by the

[80] Cf. primarily Lutter/Bayer/Schmidt, EuropUR, § 19 marginal no. 12 et seq. (p. 421 et seq.); comparative legal analysis Bocchini (ed.), Il registro europeo delle imprese = European companies registry, Vol. 1: Registro delle imprese e mercato interno, il registro delle imprese nell'ordinamento francese, inglese e tedesco, rappresentanza commerciale e registro delle imprese, atti traslativi di azienda e pubblicità, Padova: CEDAM, 2003.

[81] Cf. with regard to the distinction between primary and secondary disclosure instruments, primarily in Habersack/Verse, Europäisches Gesellschaftsrecht, § 5 marginal no. 11; more detailed treatment in Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 63 et seq.

respective Member State. Reproductions in part or even a reference to the filing of the documents is sufficient for such purposes.

b) Specific items required to be disclosed. Items included as part of corporate reporting are the documents and particulars specifically described in Art. 2 Disclosure Directive. In addition to this catalogue, other items are subject to disclosure based on other EU Directives in the field of company law. To list a few in particular: Art. 2(f) of the Capital Directive, Art. 47 Accounts Directive, Art. 38 Consolidated Accounts Directive, Art. 4 et seq. Transparency Directive.[82] The following must be disclosed pursuant to Art. 2 Disclosure Directive: the instrument of incorporation or the statutes, as applicable, members of corporate bodies, subscribed capital, accounting documents, a transfer of registered office, dissolution/declaration of invalidity/liquidation. The Member States may determine additional items to be disclosed in their respective domestic laws.

c) Effects of disclosure. The effects of disclosure are primarily derived from Art. 3 (6) and (7) of the Disclosure Directive, whereby a distinction is made between negative and positive effects: the principle of negative disclosure (negative Registerpublizität) based on non-disclosure of legally relevant facts under Art. 3 (6), (7) subsection (3) Disclosure Directive permits third parties as well as the company to rely on the true legal situation. Art. 3 (6) subsections 1 and 2 Disclosure Directive ensures the principle of positive disclosure (positive Registerpublizität) based on disclosure of legally relevant facts in that the public may generally rely on the appearance of a certain legal situation given by incorrectly published information. In this context, the Member States' obligation codified in Art. 3 (7) subsection (1) Disclosure Directive to take the necessary measures to avoid any discrepancy between what is disclosed and what appears in the register or file in advance is of particular importance. More than ever, one will need to see in this provision the preventive **obligation** on the part of the Member States to ensure – in the interests of third parties – that the **contents of the registry are conform to the actual circumstances** and do not rely blindly on the information that companies deliver (see above, p. 11). As described under III. above (p. 154 et seq.), a required form for corporate acts with special relevance for third parties is a suitable instrument for this purpose.

d) Sanctions. Pursuant to Art. 7 Disclosure Directive, the Member States threaten to impose appropriate penalties at least in cases where accounting documents are not disclosed as well as in cases where compulsory particulars on commercial documents or on a company's website are lacking. This is in addition to the general duty of cooperation under Art. 4 (3) second sentence TEU. According to this provision, the Member States are to take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. According to Art. 288 TFEU, these "acts of the institutions of the Union" also include directives adopted by the EU. In this regard, it should be noted that the threat of penalties for purposes of enforcing disclosure obligations subject to regulation by the Member States is

[82] Additional specific details in Lutter/Bayer/Schmidt, EuropUR, § 19 marginal no. 28.

largely without effect (e. g. under section 14 dHGB in German law).[83] Instead, more consideration should be given to codifying private law-based liability in cases where commercial law disclosure obligations are ignored. For example, **personal liability** on the part of the party refusing to make disclosure would be conceivable in this regard (cf. Art. 16 (2) SE Regulation and in national law, e. g. section 11 (2) dGmbHG; Art. L210-6 (2) CCom; Art. 2331 (2) CC) (see above, p. 48). These forms of liability would likely provide more of an incentive to comply with disclosure obligations than the largely ineffective fine regulations contained in domestic law.

2. Commercial law disclosure, protection of bona fide rights and protection of the public (based on the example of the acquisition of shares in a German GmbH from a transferor who is not the true owner)

a) General principles of the good faith acquisition of shares in a GmbH. Pursuant to section 16 (3) first sentence dGmbHG, newly codified in 2008,[84] in case of a transfer of shares by means of a legal transaction inter vivos the transferee may validly acquire such share from a transferor without title who has been registered on the **shareholder list** as the owner of such shares if the list has been "received" by the commercial register. The purpose of these rules is to create greater legal certainty in the circulation of shares and in particular to reduce the costs of review (and thus transaction costs) in the case of business and share purchases.[85]

As to disclosure, section 40 dGmbHG distinguishes the list to be submitted by company managers from the list to be submitted by the transactional notary based on the preparer of the respective list. Consequently, in the latter cases the obligation of the notary replaces that of company managers. The 2008 lawmaker saw a greater risk in the former cases. In particular in the case of a transfer of shares there is, in the eyes of the lawmaker, a *higher risk* that company managers – whether due to incompetence or fraud – create a **false legal instrument** as is the cases of succession or splitting and consolidation of shares.[86] In this context, the *shareholder list* as a *legal instrument* is presumed to accurately display a certain legal status similar to the land register in real property law (section 892 BGB) and the inheritance certificate in inheritance law (section 2365 BGB). As was the case under prior law, the shareholder list must be submitted to the commercial register upon formation of the company and upon every change in the composition of the shareholders or the size of their shareholdings (sections 8 (1) no. 3, 40 dGmbHG). However, the MoMiG[87] increased the significance of the list in several ways: **(1)** As against the company, only shareholders who are included in the shareholder list accepted by the commercial register are deemed to be shareholders (section 16 (1) dGmbHG). The shareholder list is since 2008 the *sole proof of entitlement* for the exercise of

[83] Regarding the notoriously inefficient "compulsory process" under section 14 HGB Wachter, MDR 2004, 611, 612 text accompanying fn. 15; Leible/Hoffmann, RIW 2005, 544, 545 et seq.; Kindler, in: MüKoBGB, Internationales Gesellschaftsrecht, vol. 11, marginal no. 994; see additionally, Koch, in: Staub, HGB, § 13 d marginal no. 59 et seq.

[84] Following the "MoMiG" see fn. 17, above.

[85] Whether this will be successful is another issue; for a critical view, see, e. g. Rodewald, GmbHR 2009, 196 et seq.

[86] BT-Dr. 16/6140 p. 44 right column, where one is satisfied with the manager's filing duty in such cases rather than threatening liability under section 40 (3) GmbHG.

[87] See fn. 17.

shareholder rights and that is – other than was earlier the case on submission (section 16 (1) GmbHG (prior version)) – not only in cases of acquisition via legal transaction, but rather in the case of any change in shareholder make-up or shareholdings. **(2)** In addition, registration of the shareholder list triggers *liability* on the part of the transferee for any then-outstanding contribution obligations (section 16 (2) dGmbHG). **(3)** In addition, assigning numbers to the shares (section 8 (1) no. 3, section 40 (1) first sentence dGmbHG) enables the shareholder list to precisely *individualise the shares*. As a result, doubts as to the identity of the transferring shareholder, as was occasionally earlier the case upon the sale of a nominal amount applicable simultaneously to several shares, are excluded. **(4)** The most important function of the shareholder list in the situation described above is that of a reference legal instrument for the good faith purchase of shares introduced by the MoMiG.[88]

Before the 2008 corporate law reform[89], the good faith purchase of shares in a GmbH from a transferor who is not the true owner was not possible. Accordingly, the transferee had to review the effectiveness of all transfers and other changes in ownership back to the formation of the respective company but could nevertheless not achieve complete certainty due to the risk of hidden intermediate transfers. As discussed, the point of reference for a good faith purchase since the reform is the shareholder list which has been now cast as the definitive legal instrument: pursuant to section 16 (3) first sentence dGmbHG, a share or a right thereto may be validly acquired from a transferor without title if the transferor is registered as the owner of the share on the shareholder list received by the commercial register. The good faith effect only relates to the transferor's shareholder status and not to the existence or encumbrance-free status of the relevant shares. Accordingly, just as before the reform, the potential transferee must fully investigate whether the to-be-acquired share was ever effectively created and whether it still exists. If, for example, the capital measure intended to create the share was ineffective (cf. section 55 dGmbHG), a good faith purchase is not possible. If the requirements for a good faith purchase in section 16 (3) first sentence dGmbHG are satisfied, the acquisition from a transferor without title likewise fails if one of the following exclusionary grounds is present: **(1)** With respect to the relevant share, the shareholder list has been incorrect for less than three years and the inaccuracy is not attributable to the rightful shareholder. **(2)** The transferee is aware of the transferor's lack of title or is unaware of this due to gross negligence. **(3)** An objection has been attached to the shareholder list related to the share.

b) The true shareholder's loss of rights and its constitutional boundaries. Compared to the situation previously, the MoMiG[90] provides share acquisitions a far greater degree of legal certainty. However, at the same time, the true shareholder is threatened with a final loss of this right to the good faith buyer. From the perspective of constitutional **protections of property** (Art. 14 GG),[91] this is only acceptable if the shareholder list possesses such a **high degree of legal certainty** that

[88] See fn. 17.
[89] See fn. 17.
[90] See fn. 17.
[91] Regarding constitutional protection of share ownership, see most recently BVerfG NZG 2012, 826 subsection C I 1 a – Delisting.

such a good faith purchase is only possible in rare exceptional cases.[92] It has been long-recognised that the prior owner's loss of rights by means of a good faith purchase must not violate Art. 14 GG.[93]

c) Transparency of shareholding structures as a policy goal of the drafters of the 2008 corporate law reform. Some excerpts from the explanatory statement accompanying the government's draft of the MoMiG[94] are informative for purposes of understanding the new provisions related to the disclosure of transfers of shares. For example, the introduction states that in addition to the goal of combating abuse, the new rule also is in line with the general desire of creating transparency in shareholding structures for the GmbH and to prevent money laundering.[95] Immediately thereafter, reference is made to the tightening measures contained in section 40 dGmbHG as part of the Handelsrechtsreformgesetz [Commercial Register Reform Act] of 22 June 1998,[96] however at the same time it is made clear that gaps remain in particular with regard to foreign notarial authentications;[97] because in the same paragraph in the explanatory statement introducing the transparency aspect, the gap referred to by the lawmaker in the case of foreign authentications results from **deficits in transparency**. These deficits cannot be denied and they relate to the fact that foreign authentications of share transfers are frequently not reported to the commercial register in or to the treasury. Since April 2013 public attention has focussed on the latter aspect.[98] As to the legal consequence of recording the shareholder list in the commercial register, the explanatory statement is not clear. What is involved is the issue of its constitutive effect for the acquisition of title.[99]

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[92] Position taken at the outset of the discussion based on the MoMiG draft 2006 by Ziemons, BB 2006, Special 7/2006, pp. 9, 12: "The seizure of property rights by enabling a good faith purchase provided by statute in the interests of simplifying transfers, is only then compatible with fundamental guarantees of property if precautions are taken to ensure that it remains an absolute exception"; Preuß, ZGR 2008, 676, 699; also of this opinion Harbarth, ZIP 2008, 58, 61 et seq.; Mayer, DNotZ 2008, 403, 430 et seq.; Bednarz, BB 2008, 1854, 1855 with fn. 25; Apfelbaum, BB 2008, 2470, 2476 et seq.; Reichert/Weller, in: Goette/Habersack (eds.), Das MoMiG in Wissenschaft und Praxis, pp. 79, 103.

[93] Hager, Verkehrsschutz durch redlichen Erwerb, § 4 pr., p. 46: "The good faith purchase must be subsumed in the systematic of Art. 14 GG."; following Peters, Der Entzug des Eigentums an beweglichen Sachen durch gutgläubigen Erwerb, § 3 II 3 c, p. 26: "The interference with the previous owner may be measured under Art. 14 GG."

[94] See fn. 17.

[95] BT-Dr 16/6140 p. 37 right column with explicit reference to Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

[96] BGBl. I, p. 1474.

[97] BT-Dr. 16/6140 p. 37 right column, top: "However, gaps remain, e. g. with regard to foreign authentications which are now being closed."

[98] April 2013 marks the beginning of one of the biggest financial leaks in history. The International Consortium of Investigative Journalists (ICIJ) has released the first stories from a global collaborative project into the world of offshore money. The Tax Justice Network, an advocacy group claims that a third of the world's wealth is tied up in the secret area of offshore; for details see http://www.icij.org/offshore.

[99] On this topic, the materials state (BT-Dr. 16/6140 p. 37 right column below): "The provision – section 16 (1) GmbHG, comment of the author – does not mean that the filing and inclusion of the list in the commercial register would be a prerequisite for the effectiveness of share purchase. The effectiveness of the transfer – apart from the new situation to be dealt with concerning the good faith purchase – remains independent of entry in the shareholder list. Without filing and receiving

As envisaged by the drafters of the MoMiG[100], submission of the list by the notary first serves the **interests of the new shareholder**. Because of section 40 (2) first sentence dGmbHG, the new shareholder needs only "in rare cases" enforce his right to have the company submit the list.[101] In the case of the assignment of shares via legal transaction inter vivos this right lapses if for no other reason than the fact that the manager is not even authorised to submit the list. In this case, the notary acts "in the place of" the managers (§ 40 (2) first sentence dGmbHG).

The government's explanatory statement makes an additional comment regarding the legal effect of including the list in the commercial register in relation to a good faith acquisition under section 16 (3) dGmbHG. This act not only establishes the **legitimacy** of the shareholders included on the list as against the company but also **protects third party expectations**. In this regard, the drafters of the legislation see a parallel to a good faith purchase in real estate law.[102] The comment is made regarding section 40 GmbHG that due to the possibility of the good faith purchase tied to the shareholder list, its degree of correctness should be increased.[103] This is precisely the goal of, inter alia, the increased **involvement of the notary in updating the list of shareholders**. The lawmakers primarily view the submission of the list as a "follow-on formality" subsequent to a notarially recorded transfer of shares.[104] Remarkably, the explanatory statement to the MoMiG[105] emphasizes at this point the duty of the notary to eliminate all doubts as to the correctness of the list.[106] The involvement of the notary should therefore increase the shareholder list's guarantee of correctness.[107]

There are two aspects of the new rule which in the eyes of the lawmakers help to increase the guarantee of correctness (Richtigkeitsgewähr): the **involvement of the notary in the event of changes in the composition of shareholders** (e. g. under section 15 (3) dGmbHG) *and* the subsequently prepared attestation thereof (§ 40 (2) second sentence dGmbHG).[108]

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of the list by the commercial register, the new shareholder remains however unable to exercise his membership rights because he only receives shareholder status vis-à-vis the company upon receiving of the updated list by the commercial register. From a doctrinal standpoint, the shareholder list is being made to approximate the register for registered shares of the public company (Aktienregister) with regard to which problems have not arisen related to relative legal status."

[100] See fn. 17.

[101] BT-Dr. 16/6140 p. 38, left column: "In future, in the standard transfer of shares via legal transaction, the submission of the updated shareholder list will be taken care of by the notary along with the authentication (section 40 (2) first sentence GmbHG)."

[102] BT-Dr. 16/6140 p. 38, right column: "The provision is based in part on section 892 BGB."

[103] BT-Dr. 16/6140 p. 43, right column.

[104] BT-Dr. 16/6140 p. 44, left column.

[105] See fn. 17.

[106] BT-Dr. 16/6140 p. 44, right column: "If the notary has doubts as to whether the change he has been involved in is effective (…) he may only then submit the corresponding list to the commercial register once the doubts have been eliminated." The notary is otherwise already obligated to undertake this review of legal conformance and effectiveness under section 4 BeurkG: König/Bormann, DNotZ 2008, 652, 668; see additionally Mayer, DNotZ 2008, 403, 409 et seq.

[107] Lange, GmbH-Rundschau 2012, 986, 987 citing BT-Dr. 16/6140, p. 44 and additional authors from the literature.

[108] BT-Dr. 16/6140 p. 44, right column: "The *attestation* on the part of the notary provided under section 40 (2) second sentence, which is based on the attestation already common under section 54, increases the guarantee of correctness on the change *in conjunction with* his involvement, …" (emphasis by the author); see also Kort, GmbHR 2008, 169, 172 at fn. 25; Mayer, DNotZ 2008,

Accordingly, **notarial authentication** and the **attestation** thereof have not been introduced in the interests of the new shareholder, but rather to **protect the true shareholder** who is subject to a potential loss of rights. Authentication and the attestation thereof are intended to prevent the loss of rights on the part of the true shareholder in favour of a good faith transferee to the extent possible in the case of a disposition by a transferor who is not the true owner; this is because the list cannot be "received" by the commercial register without notarial attestation under section 40 (2) second sentence dGmbHG. As a result, both the legitimacy effect of the list (section 16 (1) first sentence dGmbHG) and its suitability as a certification of legal status (section 16 (3) first sentence dGmbHG) depend upon notarial attestation. Consequently, based on the notarial attestation, the transfer of shares has effects not only on the good faith purchase as between the parties to the transfer agreement but also for unrelated third parties. Therefore, in the case of a transfer of shares, legal certainty and protection of the public call for a notarial authentication which serves as the basis for the notarial attestation as the "follow-on formality" under section 40 (2) second sentence GmbHG.[109]

Accordingly, the requirement for **notarial attestation protects** not only the ease and security of transactions but rather – vice versa – the **property rights (Art. 14 GG)** of the true owner; because the lawmaker trusts that the notarial attestation, including the notarially-determined shareholder list, will only be inaccurate in rare cases. The notary then becomes the guardian of a shareholder's property rights.[110]

d) Quasi-constitutive effect of the notarial attestation for the acquisition of shares. According to section 16 (1) first sentence dGmbHG, introduced in 2008, in the case of a change in the composition of the shareholders, only that person indicated as the owner of a share in the shareholder list received by the commercial register is deemed to be a shareholder in relation to the company. Therefore, only the list establishes the legitimacy of the transferee vis-à-vis the company. Of course, in the case of a transfer of shares, the legitimizing effect arises only with and at the point in time of the acceptance of the notarially-established shareholder list by the commercial register. Inclusion in this list makes the transferee a shareholder.[111] By

403, 411 ("It – notarial attestation – comment of the author – increases together with the expansion in the notary's competence related to the shareholder list, the guarantee of correctness in relation to shareholder composition.").

[109] König/Bormann, DNotZ 2008, 652, 670.

[110] Along these lines (however more reserved in the formulation) Mayer, DNotZ 2008, 403, 431 et seq.

[111] On point, Preuß, ZGR 2008, 676, 686 et seq. (emphasis by the author): "The receipt by the commercial register of the signed shareholder list triggers the legitimizing function vis-à-vis the company. Sending a copy of the amended list to the company merely serves an informational function. This solution is close to the direct effect of acquisition vis-à-vis the company. Because the notary is obliged to immediately submit the shareholder list to the commercial register pursuant to section 40 (2) GmbHG following the effectiveness of the changes and section 16 (1) second sentence GmbHG provides that a legal act previously undertaken by the buyer in relation to the share is deemed to be effective from the outset if the list is immediately received by the commercial register following the performance of the act, this de facto results in the transferee being "deemed" to be a competent shareholder in relation to the company following the conclusion of the purchase transaction as determined by the notary. In the case of the notary's filing obligation, the new rule contained in the government draft thus results in a conceptual change."

its nature – and therein lies a "conceptual change"[112] – the acquisition is accordingly only perfect upon the receipt of the list including notarial attestation (section 40 (2) second sentence dGmbHG) by the commercial register. From a doctrinal standpoint, this places such an acquisition in proximity to the acquisition of immovables, especially real property law, which requires disclosure in the land register in addition to an agreement between owner and acquirer in order to be complete (section 873 BGB). The mere assertion in the explanatory statement accompanying the MoMiG that the entry of the transferee in the list and its subsequent acceptance by the commercial register were not intended to be prerequisites for the effectiveness of a share acquisition[113] does not change this; because the legislative materials are only one of many interpretive materials and they must accordingly yield if objective, teleological and systematic factors point to another interpretation of the law and such is compatible with the text of the statute.[114]

In this case, the text of section 16 (1) first sentence dGmbHG ("deemed … to be the owner of the share") suggests a fiction, namely the fiction of shareholder status. This fiction would be superfluous if the transferee – as indicated by the government explanatory statement – were already the shareholder upon entering into the transfer agreement. If the lawmakers had merely been concerned with a limitation on the exercise of the *already-transferred* rights, as stated later in the explanatory statement,[115] it would have been more obvious to borrow the text from section 20 (7) dAktG: "Rights related to shares the acquisition of which has not yet been entered in the shareholder list filed with the commercial register may not be exercised until that point in time". And also the *fiction of the effectiveness* of legal acts carried out by a transferee who has not yet been entered into the shareholder list – filed with the commercial register – (section 16 (1) second sentence dGmbHG) *makes sense only if the person acting is not a shareholder*. In the case of a transfer of shares, such person becomes a shareholder only upon submission of the shareholder list including notarial attestation. Accordingly, this has a quasi-constitutive effect for the share acquisition.

e) Increasing the role of the notary for reasons of protecting property rights and public safety and order. The new section 40 (2) GmbHG assigns a "key role" to the notary in the case of an transfer of shares:[116]

aa) On the one hand, the notary's involvement in a transfer of shares and the subsequent disclosure of the transaction to the commercial register serves the purposes of legal certainty and protection of third parties.[117] More precisely: It is exactly the involvement of the notary that is intended to **assist in preventing the loss of property-rights (Art. 14 GG)** on the part of the **true shareholder.** Such a loss is effectively a kind of expropriation, not justified by any legal appearance attributable to the true owner.[118] The purpose of the public-law duty on the part

[112] See prior fn.

[113] BT-Dr. 16/6140 p. 37 right column; accord, e. g. Reichert/Weller, in: Goette/Habersack (eds.), Das MoMiG in Wissenschaft und Praxis, pp. 79, 81 et seq.

[114] Cf. only Canaris, Handelsrecht, § 5 marginal no. 52, p. 68.

[115] BT-Dr. 16/6140 p. 37, right column.

[116] So verbatim in Kort, GmbHR 2008, 169, 171.

[117] König/Bormann, DNotZ 2008, 652, 670.

[118] Cf. again above, p. 169 et seq., and Ziemons, BB 2006, Special 7/2006, pp. 9, 12; accord Preuß, ZGR 2008, 676, 699; similarly Harbarth, ZIP 2008, 58, 61 et seq.; Mayer, DNotZ 2008, 403, 430 et seq.;

of the notary to prepare and submit the up-to-date shareholder list is intended to counter this.[119]

In the case of an transfer of shares, the lawmakers were realistic enough not to rely on satisfaction of the manager's duties to determine and submit the shareholder list under section 40 (1) GmbHG: This is because managers are often close to the majority shareholder and are subject to the temptation to follow his wishes even when they are inconsistent with the law. Accordingly, managers frequently not only lack legal **expertise** but also the required degree of **neutrality** which may be presumed in the case of the notary.[120] Constitutional concerns are also made clear in the comments of the Federal Council of 6 July 2007 which militate against the loss of rights based on bona fide effects triggered by a list that is prepared by managers (section 40 (1) GmbHG). The risk of abuse is so high in this constellation that talk can no longer be of a constitutionally reasonable determinant of the contents and limits of property rights.[121] In fact, upon submission by the manager (section 40 (1) GmbHG), not even a plausibility check performed by the register court can verifiably ensure that the shareholder list has been signed by the authorised persons.[122]

bb) Furthermore, an equally important additional **public interest objective** of the notary's duty to prepare and submit the shareholder list for filing becomes clear from the explanatory statement to the MoMiG: What is involved is "**creating transparency** regarding shareholder structures within the GmbH and **preventing money laundering**."[123] Although this statement is found in the justification for the acquisition of shareholder status vis-à-vis the company (section 16 (1) dGmbHG), it however necessarily includes disclosure under section 40 dGmbHG because section 16 (1) dGmbHG refers to this provision. By means of the regulations referred to

Bednarz, BB 2008, 1854, 1855 with fn. 25; Apfelbaum, BB 2008, 2470, 2476 et seq.; Reichert/Weller, in: Goette/Habersack (eds.), Das MoMiG in Wissenschaft und Praxis, pp. 79, 103.

[119] Regarding the public law nature of the duties of the notary under section 40 (2) GmbHG: Greitemann/Bergjan, in: Birk (ed.), Transaktionen – Vermögen – Pro Bono, FS zum zehnjährigen Bestehen von P+P Pöllath+Partner, 2008, p. 271, 281; Vossius, DB 2007, 2299, 2304. Cf. also Bohrer, DStR 2007, 995, 1000; see similar Saenger/Scheuch, BB 2008, 65, 67, who however refer to the freedom of choice of law and want to allow the parties to transfer the shares on the grounds of a foreign authentication.

[120] Wicke, GmbHG, 2nd ed., 2011, § 16 marginal no. 28.

[121] BR-Dr. 354/07, p. 14 = BT-Dr. 16/6140, p. 66 right column: "In point of fact – outside of the cases described in section 40 (2) GmbHG, comment of the author – anyone can submit a shareholder list to the commercial register with any contents desired and without any review of his identity. This type of rule cannot serve as the basis for the possible loss of significant assets. Also the mere passage of time – the draft legislation provides for a three-year window during which a good faith purchase is generally not possible – does not represent a reasonable point of reference. In point of fact, a circumstance must be created here as well which justifies accepting significant losses to the detriment of the true owner."; see above, p. 169 et seq.

[122] Preuß, ZGR 2008, 676, 700.

[123] Quoting BT-Dr. 16/6140 p. 37 right column; see also Reichert/Weller, in: Goette/Habersack (eds.), Das MoMiG in Wissenschaft und Praxis, pp. 79, 85: "… the idea of disclosing shareholdings also (…) serves (…) since MoMiG the public interest in transparent corporate structures (anti-money laundering,…)." Other approach previously in Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, p. 166 who do not want to use the control options contained in corporate law for purposes unrelated to corporate law. However, it remains unclear what interest worthy of protection the shareholders are supposed to have in a fast, "efficient" formation (and/or transfer of interests) if the company is used as a tortious tool. The CJEU condemns any attempt of the shareholders, "by means of the formation of (a) company, to evade their obligations towards private or public creditors"; judgment of 9 March 1999, case C-212/97 ("Centros"), pt. 38.

above, German lawmakers want to, inter alia, "conform to" Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of **money laundering** and **terrorist financing**.[124]

Precisely these statements are extremely interesting for purposes of evaluating the disclosure of shareholder status as an instrument of external control if the **notary** also falls subject to the **Money Laundering Directive** to the extent he participates, by assisting in the planning or execution of transactions for their client concerning the buying and selling of business entities or the organisation of contributions necessary for the creation, operation, or management of companies, or the creation, operation or management of companies or similar structures (Art. 2(3)(b) subsections i, iv as well as v of the Directive). Company shares are assets within the meaning of the Directive as is illustrated by the broad legal definition in Art. 3 no. 3 ("assets of every kind, whether corporeal or incorporeal"). Art. 13 of the Directive applies to cases in which there is a high risk of money laundering and terrorist financing. In such cases, the Member States are to ensure under Art. 13 (6) of the Directive that institutions and persons covered by the Directive pay special attention to any money laundering or terrorist financing threat that may arise from products or transactions that might favour anonymity, and take measures, if needed, to prevent their use for money laundering or terrorist financing purposes. Art. 13 (6) of the Directive is even quoted in the explanatory statement to MoMiG in relation to sections 16 and 40 dGmbHG[125] and is thereby part of the ratio of the rules on the transfer of shares.

On the whole, in relation to the role of the notary in safeguarding the interests of the public by establishing transparent shareholdings, this means: **(1)** The lawmaker views the notary as a person subject to the Money Laundering Directive within the meaning of Art. 13 (6) in conjunction with Art. 2 of the Directive in connection with a change in shareholders or a change in their shareholdings (sections 15 (3), 40 (2) dGmbHG). This does not apply to the managers (section 40 (1) GmbHG) because the manager may not be subsumed under Art. 2 of the Directive. **(2)** The lawmaker classifies, inter alia, the **transfer of shares as a "transaction, which could favour anonymity**". **(3)** The lawmaker views the **involvement of the notary in the disclosure of the shareholding** (section 40 (2) GmbHG) as a measure necessary to prevent money laundering and terrorist financing. Contrary to what the text of the Directive may suggest, German national law does not assign the necessity test to the notary but rather establishes for the notary an obligation which in any event consists of a duty to be involved in disclosing the current shareholding structure to the commercial register. This is not objectionable from a European law standpoint as Art. 5 of the Directive expressly empowers the Member States to enact stricter regulations than provided for in the Directive; the Directive merely codifies a minimum standard.

cc) In summary, it must be noted that the increased role of the notary in the transfer of shares accomplished by the MoMiG[126] serves a two-fold goal: **guaranteeing the correctness of the shareholder list** (and thereby constitutionally-required property rights of the true owner); **transparency in the shareholding structures** in the public interest as well as preventing money laundering and terrorist financing.

[124] Again in turn verbatim BT-Dr. 16/6140 p. 37 right column; see generally on this Directive Donath/Mehle, NJW 2009, 650 et seq.

[125] Cf. BT-Dr. 16/6140 p. 37, right column (para. 1).

[126] See fn. 17.

3. Analysis

The EU has created a nearly complete system for commercial law disclosure at the centre of which is the Disclosure Directive. Deficits in control are found primarily on the sanction side (Art. 7 Disclosure Directive). Instead of largely ineffective fines (or in addition thereto), the introduction of general liability on the part of the person acting should be considered in cases where disclosure obligations are not satisfied. Art. 16 (2) SE Regulation could serve as an example for such purposes.[127] At the Member State level, disclosing the identity of shareholders based on German GmbH law provides a good example of an efficient external control on smaller corporations. However, the shareholder list is used as a means of disclosure in this regard and requires substantive guarantees of correctness for reasons of protecting the property interests of the true owner and for superior grounds of public security. The civil law notary is likely in the best position to provide this.

V. The expansion of external controls as a desideratum in terms of legal policy

Experience ultimately shows that effective external control of corporations can be achieved neither by means of self-obligation ("corporate governance code") nor by means of a sanction-free statutory list of duties. Instead, a moderate tightening of external control appears to be indicated. In the case of the control instruments reviewed here, this means first of all that the permissible waiver of the central accounting requirements in the case of "micro-entities" provided for in the so-called Micro-entity Directive[128] is the wrong path. The abbreviated accounting prepared on this basis (Art. 1 a (3) Accounting Directive as set out in the Micro-entity Directive) is not a suitable basis for the **annual audit** of small corporations which nevertheless remains mandatory. A further **expansion of compulsory form requirements in corporate law** should also be considered. This applies in the case of some specific transactions involving small corporations, such as the redemption of shares in a private limited company, the splitting and consolidation of shares and the winding-up of the company. Finally, the introduction of general liability on the part of the persons acting should be considered for purposes of **increasing the effectiveness of corporate disclosure obligations**.

[127] Art. 16 (2) SE Regulation provides: "If acts have been performed in an SE's name before its registration in accordance with Article 12 and the SE does not assume the obligations arising out of such acts after its registration, the natural persons, companies, firms or other legal entities which performed those acts shall be jointly and severally liable therefor, without limit, in the absence of agreement to the contrary."

[128] See above, p. 152.

Chapter 6. The Future of European Company Law

I. At the outset

Our starting point was the antithesis between two theoretical models of corporate law: the freedom of contract theory taken from the Anglo-American legal tradition and the Continental European tradition of state regulatory policy. As part of a socioeconomic analysis, which is attributed much more explanatory value today than the assumption of value- and target-oriented legislation, it seems appropriate to establish a connection between the actual structure of corporations and the distribution of power which defines it. In doing so, one sees that in the U.S. and in Great Britain, the widely-held public limited company plays a larger role, whilst the person-based private limited company and closely-held corporation which have been the focus of our study are much more in the fore in Continental Europe. For this reason, distinction between **dispersed and concentrated ownership** appears as a common theme throughout the international standard work, The Anatomy of Corporate Law.[1] However, this presents the first paradox: the idea that a corporate law based on freedom of contract would be a better fit for the person-based company with a small group of shareholders,[2] is contrasted by the fact that liberal legal systems often feel obliged to follow the opposing legal principle. We attempted to demonstrate that this is neither a self-deception on the part of unenlightened minds nor a relic of outdated legal traditions.

We also showed that the contractual theory is tailored to fit a system of corporate law which primarily is reduced to the legal relationships between the **shareholders**, and transfers the interests of other third parties and/or affected persons to other areas of the law. This presents the second paradox: that on the one hand, in the view of the Anglo-American tradition protection of minority interests as between the shareholders cannot be left to private autonomy because it, to the extent dispositive, simply does not function in cases where large majority blocks are dominant. In the view of the Anglo-American tradition, the same applies to shareholder protection within (mandatory) capital market law. This may be explained by a lack of equality of arms, however also marks the degree to which the protection of interests by the state is all the more indispensable in favour of minority shareholders. The latter is beyond any doubt within Continental laws, even if they create better prerequisites for reconciling interests from a private autonomous perspective by involving an impartial trusted third party in the person of the notary. On the other hand, the proponents of the contract theory like to apply their theory of private autonomous legal protection precisely in the area of **creditor** protection even though creditors are outside of corporate circle and their protection, to the extent labelled as such under laws governing insolvencies or the like, is of course mandatory.

[1] Davies/Enriques/Hertig/Hopt/Kraakman, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 305 et seq. expressly following on the ground-breaking work from Berle/Means, The Modern Corporation and Private Property, 1932.

[2] Davies/Enriques/Hertig/Hopt/Kraakman, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 305 likewise concur.

European legal developments since 1999 – both the decision of the CJEU in the Centros matter and the efforts at legislative reforms such as the EPC – have led primarily to the fact that Continental legal systems are experiencing **pressure to reform** and that many countries have bowed to such pressure. France, Spain, Belgium, the Netherlands, Germany have already been mentioned. This willingness to make reforms, which has been primarily driven by competition from the English Limited, may be subject to a contrary interpretation: It might show that national lawmakers are capable of learning, that traditional structures are not resistant to modernisation, however were in need of reform in some instances and required an outside impulse in order to break open antiquated relics. Accordingly, the remaining core of Continental European law should be viewed with scepticism in this regard. Or: It is the expression of a hectic form of activism which reacts to perceived threats without careful evaluation. These innovations have in part not been accepted in practice, which tends to be conservative, as is reported from Spain and Portugal and regarding the Austrian URG.[3] However this is not the case where a mere cost reduction is involved, such as with the German *Unternehmergesellschaft*. Whether disillusionment will make itself felt on the part of the shareholders or the public, as has occurred in the case of the Limited, remains to be seen.

For this reason, both the results of the reforms and the remaining core must be subject to analysis which may be critical but which must be unbiased, in the course of which it will be seen that much is worthy of retention and is exemplary for the future of Europe. For example, the GmbH had already been conceived as an alternative to the Limited Company in 1892[4] and generally Continental European corporate law embodies a regulatory policy tradition which need not fear the competition of ideas and principles with Anglo-American corporate law, but rather should hold its own in the struggle for influence on the future development of European law. This is the case not only for the legitimacy of national law from a subsidiarity standpoint but also for the substantive design of European Community law. It is true that many European initiatives for simplification and deregulation have not been successful in past years, as the Commission admits in its **Action Plan 2012**,[5] and if it wants to limit itself as expressed to the editorial standardisation of laws created to date in the short term merely in order to create more consistency and clarity, a watchful eye should be kept on the process to ensure that losses in substance do not creep in.

Traditionally, supra-national EU company forms are much less an expression of regulatory innovation than adaptations of tried and true categories taken from national laws[6] and as such, the Continental European company forms should claim their exemplary function. Innovation is desirable, however in Community law convincing innovation results from a critical analysis of national experiments and experience from which cautious reform steps appropriate to the material and the European integration process may be derived.

[3] In contrast to both other cases, the latter is not available for selection, may however apparently be ignored due to insufficient sanctions. Its existence is not also thanks to modern deregulation but rather just the opposite – efforts to create efficient governmental legal protection.

[4] Fleischer, ZHR 174 (2010), 385, 411.

[5] COM (2012) 740/2 dated 12.12.2012.

[6] Fleischer, ZHR 174 (2010), 409.

II. Conclusions from the individual chapters of the book

1. Capital structure (*supra*, Chapter 2)

The attempts at deregulation in the Capital Directive are symptomatic of the efforts to push back Continental European notions of protection of capital in European law. However, these efforts did not progress very far in the amendment Directive 2006 and capital preservation has likewise not had to capitulate in face of the SPE project. This is all for a good reason: Its central theme, today and in the future, is that the founders, even under the umbrella of liability privilege,[7] cannot be allowed to transfer the entire entrepreneurial risk to creditors leaving them to protect themselves on their own, but rather that shareholders themselves must bear a meaningful **share of risk**. This is the justification for requiring the founders to put in a fixed amount of capital and it is still very reasonable for lawmakers to require a significant **minimum threshold** in this regard. All additional details follow from this thought. With regard to the amount of minimum capitalisation, the assessment of entrepreneurial risk may very well vary from country to country, however the low amounts in some countries (less than EUR 10,000 for a GmbH) remain nothing more than mere cosmetics for which stimulating company formations no longer provides a convincing argument.

The **fixed capital** requirement, associated with the hope that founders will see a significant level of contribution on their part as reasonable, becomes all the more important the lower the statutory minimum capitalisation threshold is set; this function should be supported through effective disclosure of the fixed capital.

The consequence of the prescribed capital structure is, on the one hand, a set of rules for **raising capital** which ensure that the promised equity investment either effectively flows into the company's liable capital or may be realised through personal liability on the part of the shareholders and, on the other, the prevention of capital outflows from the accumulated company assets which would again reduce liable assets. In this regard, the accent of the modern view may very well be on **capital preservation** because it needs to take into consideration the dynamic observation of the financial situation and because experience has shown that, precisely in a crisis, the temptation arises to withdraw the last valuable assets for one's own benefit or to take too large a business risk in order to attempt to turn things around after all. Instead, there need to be incentives and sanctions which promote the early recognition of potential crises and lead to a sensible restructuring or careful liquidation. In this regard, it is much less important whether one selects from among both of the threshold values found in national law, the lower figure (subscribed capital plus committed reserves) or the higher figure (subscribed capital plus reserves which have not been reversed) for purposes of the capital commitment but it is instead much more important to derive performance indicators based on capital and liquidity which are suited to function as a reaction threshold and to tie them to promising

[7] The term "privilege" expresses benefit derived from developments in the law when compared to what had been taken as matter of fact in the past and one example remains limitations on liability regardless of their substantive justification (Ch. 2 I). Linguistic euphemisms for such cases may be in fashion but are gratuitous. On the "right" to a limitation on liability in European corporate law, cf. Schön, in: FS Hommelhoff, 2012, p. 1037.

reaction guidelines. At their core, their purpose is the priority of creditor interests in a crisis and they prescribe priorities for company management and therefore find themselves at the intersection of responsibility for capital and responsibility for management.

Similarly, these rules stand at the intersection of corporate law and **insolvency law** and terminology is not important in this regard. This classification likewise is unlikely to make a difference for international private law connections.

By contrast, hypertrophies may be determined in legal systems such as Germany's (keyword: constructive contributions in kind, cash pool) especially in the area of raising capital which national law is most recently attempting to counter and which must also be reduced to their sensible core for the development of European law. If raising capital is not secure, the principle of fixed capital is of course mere window dressing; what is needed and what is also sufficient in principle is a control of values which ensures proper capital inflows and liability guarantees. This is especially essential in order to permit contributions in kind and deferred capital contributions and relies on the two pillars of parallel precaution and examination (ex ante) and the correction of violations when subsequently discovered, at the latest when the company is insolvent.

2. Organisational structure (*supra*, Chapter 3)

In the realm of organisational structure (*supra*, Chapter 3), the primary legislative task consists of ensuring balance between the **influence** of the different corporate constituencies (various shareholder groups, employees, creditors and other external parties) and the required **independence** of these constituencies from each other. Within the majority of the legal systems examined in this study, even in the case of the small corporation, this independence is also ensured against influence on the part of the shareholders to the extent the powers and obligations of the executive bodies take into consideration the interests of third parties. For example, for this reason the representative authority of the management body is unlimited and cannot be restricted.[8] There are furthermore accounting obligations and obligations to file an insolvency petition independent of contrary provisions in company statutes or other influences at the shareholder level. The same applies in the case of the obligations of members of the management body in connection with capital preservation and disclosure in the commercial register. The shareholders only have freedom to contract with regard to the obligations of the management body which do not protect third parties.

As discussed in Chapter 2 of this book, a company's *capital structure* – statutory minimum capitalisation requirements, securing raising of capital, capital preservation mechanisms – is aimed at protecting the company's **creditors**. By contrast, the company's *organisational structure* – primarily the division of powers between the shareholders and the executive bodies – is likewise designed with another important protective purpose in mind also derived from Art. 50 (2)(g) TFEU: safeguarding the interests of the **shareholders** in relation to the management body. An overall assessment of rules on the division of powers as between the shareholders and the management body reveals a clear hierarchy in the case of the small corporation: The

[8] In this regard, the basis for national regulations is Art. 10 Disclosure Directive; see also Bachmann et al. (eds.), Rechtsregeln für die geschlossene Kapitalgesellschaft, pp. 82–85, 110 subsection C.4. in favour of retaining this principle.

shareholders are the "masters of the company".[9] This hierarchy is based on the classic mandate theory. The law counters deficits in protections for creditors and the public originally associated with this theory with a series of mandatory obligations on the part of company management with which not even the general meeting of the shareholders can interfere. On the whole, this represents a balanced system for allocating powers. Of course, there is a need for further discussion of whether the sacrifices in personnel competence on the part of the shareholders associated with the expansion of protection against discrimination found in EU law are actually desired.

The primary competence of the management body which has been provided for in the interest of professionalism of decision-making in the case of large, dualistically-organised corporations has likewise proven itself: It counterbalances the lack of expertise found at the general meeting generally seen in the case of a large body of shareholders. However, those legal systems which solely provide for the **dualistic** model for large corporations (Germany, Austria) should consider the introduction of an optional, **monistic** organisational structure based on the Italian or French examples.

In the case of **liability** on the part of members of a corporation's **management body**, the group of potential parties to whom such members are liable appears to be uniform. Amongst the legal systems reviewed in the present study, the liability standards are broadest in the Latin countries which have a form of "all around liability" found in corporate law applicable to members of a management who breach their obligations. At first glance, provisions regarding liability on the part of members of a management body appear to be restrained in the case of German and Austrian corporate law. In general, this liability only applies in relation to the company itself. Liability in relation to individual shareholders is only provided in exceptional circumstances (e. g. in the case of violations of capital commitment), whereby protections found in tort law may apply on a supplemental basis. General liability on the part of company management in relation to third parties, in particular company creditors, is unknown in German and Austrian law. However, in this regard German decisional law has developed a comprehensive arsenal of actions giving rise to liability which are based on general principles of private law (promissory estoppel, culpa in contrahendo, tort). Viewed on the whole, the differences which have been found do not appear to be so serious such that European harmonisation in the realm of liability on the part of members of a corporate management body is needed. There is also agreement in principle on important issues such as liability privileges in the case of genuine entrepreneurial decisions ("business judgment rule").

3. Minority protection (*supra*, Chapter 4)

Where **representation** of the minority on the board of directors or the supervisory board on the one hand, and **withdrawal** for valuable consideration on the other[10] are discussed as the focal points of Anglo-American minority protection, it needs to be stated that within this legal tradition the former issue very quickly leads

[9] In this regard, Continental European company law is likewise thoroughly "shareholder centric"; cf. Davies/Enriques/Hertig/Hopt/Kraakman, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 308 et seq, who attribute this feature to Japanese and British law.

[10] On the former issue, see e. g. Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 90 et seq. and on the latter Hofmann, Minderheitsschutz im Gesellschaftsrecht, p. 461 et seq.

to the issue of the independence of members of these boards which is equally well-known in the context of Continental European rights, while the latter disappoints the hope for a solution within the company and raises the question of with which assets the compensation is to be provided or may be lawfully performed.

The **independence** of board members is actually a core issue not only of minority protection but also of the control function in general. However, with regard to this independence, the thought that a certain degree of dependence on the persons who appointed them is inevitable on the part of the person appointed has likely arrived everywhere – in any event in the case of limited terms with the possibility of being reappointed – and cannot be reliably removed by operation of law.[11] Thus the issue has come full circle. In the case of protection of minority interests, this means: Except in cases where the minority is able to appoint its own representative to the supervisory board or board of directors, the installation of so-called independent board members does not solve the problem.

However, in the event such representation of minority interests on the boards is to be provided for, this only works above a relatively high minority ratio (one-third in Austria) and it appears to be more promising to require **qualified majorities** in the case of serious decisions, whereby the German and Austrian experience do not militate against setting a so-called blocking minority at one-quarter and to provide for additional restrictions.

Otherwise, Continental European minority protection is based on the two pillars formal and substantive protective measures. The former – **information and participation** rights – may not be able to protect the minority shareholders from being outvoted, however they may not be ignored. Such shareholders are able to come to their own opinion, in the best-case convince others or allow themselves to be convinced. If these shareholders' rights are violated, this is relevant to the resolution adopted: it is defective and may be challenged in court.

The foregoing notwithstanding, the lynchpin is substantive minority protection. It enables a court to be called upon to perform a substantive review of the majority resolution. However the difficulty lies in properly limiting the scope of such judicial review. There are primarily two starting points of which the second is the more problematic. The first is likely universally recognised in principle:[12] The majority must be prevented from obtaining personal benefits at the cost of the company or minority respectively. This therefore involves **conflicts of interest** and, in such cases, the general legal remedy is the duty of loyalty which is violated through such instances of "helping oneself" and may trigger the corresponding sanctions. The key issue therefore becomes the efficiency of sanction mechanisms. In our opinion, the most promising path for this is to start one step earlier and to avoid the conflict as such through a voting exclusion.

A more far-reaching substantive control of resolutions which demands and reviews a **substantive justification** for the majority resolution in areas of particular sensitivity to the minority is known only in Germany, and even there only on a selective basis. This collides with the entrepreneurial discretion of the majority, with

[11] S. Davies et al., in: Kraakman et al. (eds.), The Anatomy of Corporate Law, pp. 310, 313, who however overlook that there is also a circle of persons in a widely-held AG who may determine the (pre) selection, see previously Roth, Das Treuhandmodell, p. 315.

[12] On this topic, see Enriques/Hertig/Kanda, in: Kraakman et al. (eds.), The Anatomy of Corporate Law, p. 153 et seq.

the shareholders' collective ability to act and thus requires clear limits which are lacking to date. The exclusion of the pre-emptive right with its statutory requirement for justification – which may also be found in the Capital Directive – expresses the basic idea that the will of the majority must be substantively justified in advance of the decision. The sword of Damocles in the form of a post-decision legal review may be necessary in this respect but may be made tolerable through appropriate procedural rules.

4. External controls (*supra*, Chapter 5)

The second protective concern of corporate law – protecting creditors and others (Art. 50(2)(g) TFEU) – is definitively addressed by external controls which may even act against the will of the shareholders if needed. At the fore are the mechanisms of the annual audit, compulsory form and disclosure which are of equal importance to all corporations.

All of the legal systems included in this study require corporate annual financial statements and management reports to be reviewed by an **auditor**. This audit serves to protect shareholders, however primarily to protect creditors and the public. The annual audit fulfils three functions: The control, information and certification functions. However, the auditor may only satisfy these functions if provided with a meaningful annual financial statement. This appears doubtful in light of the "abridged accounting" now permitted under Art. 1 a (3) Accounts Directive[13] in the case of "micro-undertakings". A non-uniform picture emerges in regard to the issue of whether the auditor is to be viewed as an agent of the company or an independent expert performing a public function.[14] The statutorily-emphasized independence of the auditor from instructions of the company or other company bodies speaks in favour of the latter.

A distinction must be made with regard to the question of the extent to which external control of companies may be realised through **compulsory legal form**: To the extent the legal systems reviewed here limit themselves to requiring legal acts on the part of a corporation to be made by **written private agreement**, there can be no talk of a real external control. This is despite the fact that a written agreement satisfies the classical functions of protecting against hastiness and serving as a warning. However, serious doubts as to the suitability of a mere written form requirement are appropriate in the case of the evidentiary function. By its nature, the requirement of a mere written contract does not guarantee the advisory function associated with notarial authentication. The **notarial requirement** for corporate acts appropriately protects the interests of third parties and the public in addition to those of these individual interests. Viewed on the whole, the involvement of a notary in the core corporate acts is associated with a series of advantages: relief for agencies maintaining registries, a higher degree of certainty in the substantive correctness of the recordings and registrations undertaken and avoidance of conflict through professional preparation of contracts. Overall, there is much in favour of not only maintaining the existing

[13] In the version set out in the so-called "Micro-entity Directive", Directive 2012/6/EU dated 14 March 2012 amending Council Directive 78/660/EEC on the annual accounts of certain types of companies as regards micro-entities ABlEU. L 81 dated 21 March 2012, pp. 3–6; art. 36 Directive 2013/34/EU.

[14] For detailed treatment, see Habersack/Schürnbrand, in: Staub, HGB, preceding § 316 marginal no. 16 et seq.

form requirements in the field of corporate law, but also of open-mindedly considering their expansion. This results in a series of legal policy suggestions (III, below).

The EU has created a nearly complete system for commercial law **disclosure** at the centre of which is the Disclosure Guideline. Deficits in control are found primarily on the sanction side (Art. 7 Disclosure Directive). Instead of largely ineffective fines (or in addition), the introduction of general liability on the part of the person acting should be considered in cases where disclosure obligations are not satisfied. Art. 16 (2) SE Regulation could serve as an example for such purposes. At the Member State level, disclosing the identity of shareholders based on German and Austrian GmbH law provides a good example for an efficient external control on smaller corporations.

III. Conclusions for European legal policy in the area of corporate law

At present, the EU Commission's legal policy programme includes in particular – in addition to the further improvement of corporate governance – promoting mobility of enterprises, creating additional EU legal entities such as the EPC, creating European laws on corporate groups and creating a European Model Company Act (EMCA).[15] While the decision in the "VALE" matter may have temporarily halted the expansion of mobility, amongst others due to the likely lack of EU competence for a Directive applicable to an isolated, cross-border conversion without the transfer of the place of management,[16] caution remains advisable in the case of substantive corporate law. In central areas of corporate law, the comparative legal analysis undertaken in the present work shows an impressive state of development in Continental European legal systems concerning **protection of minorities and third parties**. Any additional European standardisation cannot be allowed to qualitatively lag behind this state of development. This applies in equal degrees to legal harmonisation of the laws of the Member States and to the supra-national entity forms of EU company law.

Within the topic of **capital structure**, the founders cannot be allowed to transfer the entire entrepreneurial risk to the creditors under the umbrella of liability privilege and leave them to fend for themselves, but rather the shareholders themselves should also undertake a reasonable degree of risk. At its core, the SE share capital requirement of EUR 120,000 (Art. 4 (2) SE Regulation) moves in this direction and capital raising in the case of the planned SPE under the heading of preventative creditor protection[17] follows this trend.

On the topic of organisational structure, the report of the "Reflection Group" of 5 April 2011 includes the assessment that the legislative **distinction between large and small corporations** – i. e. between public limited companies and private limited companies – is outdated because in reality there are public limited companies with a small number of shareholders and – vice versa – private limited companies with a large number of shareholders.[18] Accordingly, making legislative distinctions be-

[15] *Supra,* Ch. 1, III 3, p. 21 et seq.; Lutter/Bayer/Schmidt, EuropUR, § 18 marginal no. 100.

[16] Kindler, EuZW 2012, 888 (referring to ECJ, case C-378/10 *VALE*); with great commitment in favour of mobility-enhancing EU legislation: Schön, ZGR 2013, 333.

[17] Bayer/Lutter/Schmidt, EuropUR, § 43 marginal no. 74.

[18] Reflection Group, p. 8 et seq. (Report of the Reflection Group On the Future of EU Company Law, 5.4.2011, accessible at http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en. pdf).

tween listed and non-listed companies would be more appropriate to the times.[19] However, as a generality this opinion cannot be joined regarding the organisational structure of small corporations. In practice, most small corporations remain characterised by a person-driven structure and low levels of capitalisation. National laws even provide for a limit on the number of shareholders in some instances. Accordingly, the regulatory distinction between "large" and "small" corporations corresponds to a necessary, and at least legitimate, statutory classification based on circumstances in the real world. In this regard as well, the increase in freedom of design endorsed by the Reflection Group ("flexibility")[20] in the case of large corporations – meaning a harmonisation of both forms – is not a value as such: The stronger the influence of the shareholders on company management, the weaker is the protection of third parties.[21] In the case of the small corporation, freedom of design internally is – this should have become clear from the discussion above – sufficiently assured.[22] This is clearly expressed in national corporate law and should remain so. In this respect, the report of the "Reflection Group" is not clear. The report states simply that freedom of design in relation to organisational structure should be further expanded for all entity forms.[23]

Where the protection of **minority shareholders** is concerned, efforts should be made at the European level to demand qualified majority in the case of serious decisions, whereby the so-called blocking minority can be set at one-quarter without trouble. The planned SPE statute is hardly satisfactory in this regard: Art. 28 (1) in the version proposed by the Hungarian Council presidency[24] includes a markedly abbreviated list of mandatory powers of the general meeting and the requirement of a two-thirds majority in the case of important decisions under Art. 28 (2) lags behind the three-quarters threshold contained in many legal systems.

The foregoing notwithstanding, the lynchpin is substantive minority protection. It enables a court to be called upon to perform a substantive review of the majority resolution. However the difficulty lies in properly limiting the scope of such judicial review. In this situation, the conflict situation as such should be avoided at the outset through a voting exclusion. The planned SPE statute is silent on this issue.

Experience ultimately shows that effective **external control** of corporations can be achieved neither by means of self-obligation ("corporate governance codes") nor by means of a sanction-free statutory list of duties. Instead, a moderate tightening of

[19] Reflection Group (fn. 18), p. 9.

[20] Reflection Group (fn. 18), p. 12: "EU harmonisation should respect the national corporate governance systems of the Member States and *should strive to further the trend towards increased flexibility and freedom of choice in respect of company forms and the internal distribution of powers*." (emphasis not in the original).

[21] See Fischer-Zernin, Der Rechtsangleichungserfolg der Ersten gesellschaftsrechtlichen Richtlinie der EWG, p. 14 with fn. 11, cited previously.

[22] Other assessment contained in Hopt, EuZW 2012, 481, 482 (with the demand for more freedom in design for *all* non-listed companies): "The watershed is the recourse to the capital market, then investor and creditor protection must be ensured. By contrast, in the case of the SME freedom of contract, flexibility, initiative and manoeuvring space for founders must have priority."

[23] Reflection Group (fn. 18), p. 12: "Thus, there is reason to expect that governance structures will be subject to even more diversity in the future with more options and flexibility within the individual Member States as they introduce and adjust to options available in each other's laws."

[24] Docs. 8084/11, 9713/11 and 10611/11; see the extensive discussion of the 3rd Hungarian proposal for a compromise in Lutter/Bayer/Schmidt, EuropUR, § 43 (with citations to now very comprehensive literature on the topic of the SPE); for an overview in a nutshell see above, p. 23 et seq.

external control appears to be indicated. In the case of the control instruments reviewed here, this means initially that the permissible waiver of the central accounting requirements in the case of "micro-entities" provided for in the so-called Micro-entity Directive[25] is the wrong path. The abbreviated accounting prepared on this basis (Art. 1 a (3) Accounting Directive as set out in the Micro-entity Directive) is not a suitable basis for the **annual audit** of small corporations which nevertheless remains mandatory. A further **expansion of compulsory form requirements in corporate law** should also be considered. This applies in the case of specific transactions in small corporations, such as the redemption of shares in a private limited company, the splitting and consolidation of shares and the wind-up of the company. Finally, the introduction of general liability on the part of the persons acting should be considered for purposes of **increasing the effectiveness of corporate disclosure obligations**.

That is the quintessence of our review of congenial Continental European corporate laws, their **"spirit"** as a synonym for the French word "esprit" or the German word "Geist" both in the sense of an intellectual basis and a driving force. During the past ten or twenty years, this spirit was no longer the driving force in discussions about reforming corporate law whether at the level of comparative legal studies or at the level of European institutions. Nonetheless, anyone who has spent their career in the legal field observing the development of the law knows the regularity of the swinging pendulum. For example, the financial sector has had to learn the painful lesson that deregulation is not a goal in and of itself over the course of the last several years and if English business sense is still fighting some of the consequences in this area, this no longer need appear exemplary. Of course, legal policy still finds it difficult to transfer these lessons to other realms like corporate law, such as recognising the universally valid core in the requirements for capital structure which are without argument state of the art in the case of banks.

Why is it so difficult for the spirit of Continental European corporate law to make itself heard as the first violin in a concert of 27? One aspect has been emphasised over and over in this regard for purposes of explaining insufficient exchange of ideas, insufficient mutual coordination and insufficient unity: the lack of a **common language**. Concepts and models may be easily conveyed and clearly explained in English. English is the language of the accompanying socio-economic theories. Of necessity, English is also a language through which Continental Europeans express what they have in common and we hope to make a contribution to this conversation by publishing our book in an English-language version.

[25] See above, fn. 13.

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