Chapter 4: Law of Companies

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I. Introduction

I. Introduction

The European company law, as well as the law of mergers and acquisitions, is not part of what is known as the primary EC law, which can be found directly in the EC Treaty. Even the basic provisions have not been integrated into the EC Treaty itself, but must be studied by analyzing a number of regulations, directives, recommendations and opinions within the framework of Art. 249 ECT. In this respect, the company law is entirely different from the EC antitrust law. While the law of antitrust seemed to be constituent for the basic purposes of the former European Economic Community, as founded in 1957 by the Treaty of Rome, the law of companies was seen as a part of the private law of the Member States, which at the time it was felt was only necessary to be approximated step by step in the future (see Art. 94 ECT). And indeed, there is a general difference between the two fields of regulations: the antitrust law contains provisions that have a direct impact on competitive actions and market structures, while the company law mainly regulates the internal organization of business enterprises.[1] This is why the EC Treaty, by trying to establish a common European market, has focused on the basic provisions of

[1] Indirectly, however, the company law also influences market conditions. This is why the antitrust law – including the law of capital markets - and the law of company have to be interpreted by common principles.

competition, leaving the company law and related matters to the approximation procedures of the future.

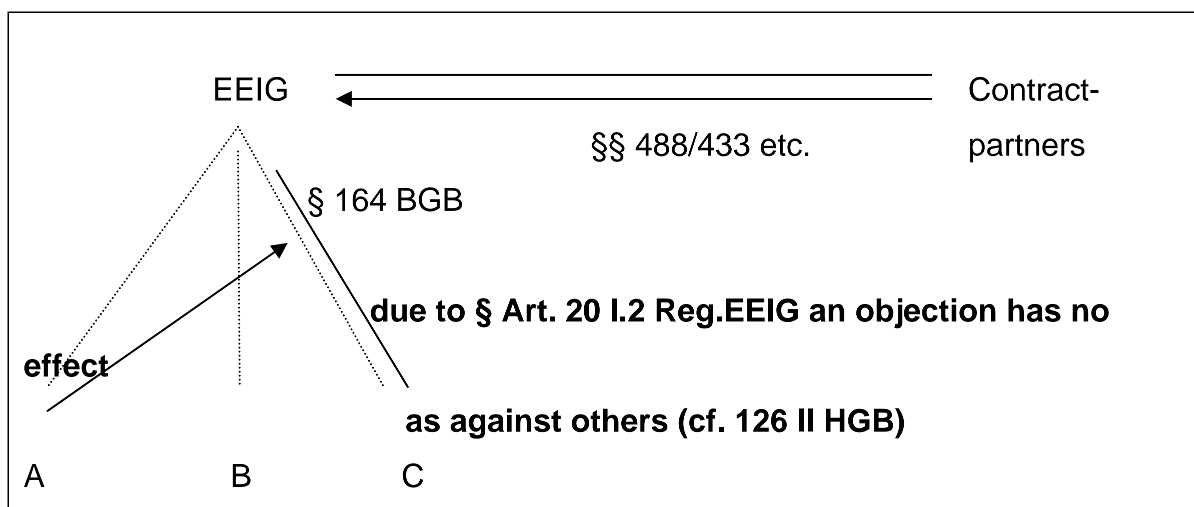
Until now, only three such supranational forms have been regulated: the European Economic Interest Group (EEIG), the Societas Europeae (SE) and the European Cooperative Societies and on Mutual Membership Associations (ECSMMA). While the EEIG is already nearly 29 years old, the SE regulation dates back to 2001 and was implemented by the German legislature in 2004. The ECSMMA is also quite young, but due to time constraints, cannot be analyzed here. As the name indicates, it is a legal form of mutual societies that are admitted for special purposes only.

II. Supranational Law

1. European Economic Interest Group. The EEIG regulation was already issued in 1985, but its Art. 43 (2) ruled that it would not be in force in the Member States before July 1st 1989.[2] At the same time, a supplementary national executive order dated April 14th 1988 came into force in Germany.[3] This lapse of more than three years makes clear, that, at least ten years ago, one did not see any time pressure to bring a supranational legal form of association into existence. It is however to be considered that in the course of the development of the internal Community market the actual legal importance of cross-border legal forms will increase. The EEIG is quite similar to the German general mercantile partnership (OHG), since it also possesses quasi-legal personality and imposes personal liability onto the partners for debts of the association in the same way as Art. 24 (1) of the directive on EEIG.

If a security for a loan is provided, similar problems to those concerning the GmbH and OHG arise; namely whether the security passes to the partner who pays off creditors and suchlike first, so that he can claim satisfaction from the party furnishing security, notwithstanding the fact that he himself who provided equity capital is actually some kind of lender of securities for a loan.

The managers of the association have the aforementioned sole power of management and representation, Art. 20 (1), which have to be set up in contrast to the joint power of management and representation (see above chapter 2 II a). This too is in accordance with the law of the German OHG (see §§ 115 I, 125 I HGB).



[2] Regulation no. 2137/85, ABl. L 199/1

[3] BGBl. 1989 I, 514; cf. Miller-Gugenberger, NJW 1989, 1449.

The EEIG must at least have 2 partners from different Member States of the Community, because otherwise no necessity would exist as to choose a supranational legal form (Art. 4 (2) a). Nevertheless, managers of the EEIG can either be partners or third parties (Art. 19 (1)), i.e. the principle of external organ control (Fremdorganschaft) is in effect, notwithstanding the fact that the partners are personal liable. This is not only considerably different from the German law, but could also be of importance for the law of limited partnership as far as systematic aspects are in question. As stated, one willingly relies on the theory of internal organ control (Selbstorganschaft) in order to prevent the limited partner from being able to ultimately decide. As the EEIG was integrated into the German company law, very likely this opinion cannot be upheld anymore without making restrictions. However, personal liability in the EEIG is also virtually not possible without limitations, as will be shown in the following:

Art. 3 (1) states that only enterprises can be partners of an EEIG[4] and that only ancillary commercial purposes can be pursued which themselves serve the commercial purposes of the respective partners. No doubt, these so-called ancillary purposes are meant to oppose the "flight" from national company law. Only on the ground of supranational ancillary purposes a supranational legal form shall be usable. On the other hand, the EEIG can undoubtedly pursue own profit interest and principally, it can even pull profits of its partners toward itself (cf., Art. 21 (1); Miller/Gugenberger, loc.cit. p. 1454).

From the previously mentioned it has become clear that the EEIG is a suitable legal form for organization of an international coalition of enterprises. It can even act as a legal form for an international holding company with the sole purpose of managing the partnership interests of the international joined associations. It is therefore not exaggerated to designate the regulation on EEIG as the primary European legislation on international joint associations.[5] Furthermore, the deed of partnership of an EEIG can also provide for the right to give instructions to the management of the enterprises participating, as far as their national laws do not prohibit this.[6] Art. 3 II lit.a EEIG, however, prohibits instructions which serve the purpose to practise a leading management, like a mother company can do against their dominated daughter enterprises.

2. European Corporation.

a. Setting up and monistic model of management. A further and practically much more important legislation to the supranational legal form concerns the European public limited company, the so-called Societas Europeae (SE). Proposals concerning the SE that even go back to the 50s[7], have not managed to gain a binding effect for a long time. The main reason for this was long seen in the fact that no suitable solution for how to deal with the codetermination in Germany, that has virtually no real equivalent in any other Member State, could be found. Binding rules have been in effect since 2001. But as in their core they aim at big enterprises, only a few fundamentals shall be represented here.

It is dealt with the EU-regulation on The legal form of the Societas Europeae (SE) and the directive on Codetermination passed by the European Parliament (VO) (EC), no. 2157/2001, 8.10.2001 on The Statute of the European association (SE), ABL. no. L 294/1 with EC directive no. 2001/86, 8.10.2001 on The complement of the Statute of the

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[4] Even individually owned enterprises as natural persons, Art. 4 (1) EEIG.

[5] Cf., Habersack loc.cit..

[6] Compare for Germany, e.g. § 76 I AktG.

[7] However, the last proposal is dated May 1991, ABl. C 176/1.

European association with regard to codetermination of employees, ABl. No.L 294/22). The period of time for transposition of the directive on questions of codetermination in respect of the board of supervisors has been terminated by 8.10.2004[8], and in December of this year the German legislator has enacted the necessary statutes, so that from then on the firstSE could launch its activities. At least in Europe, international groups of affiliated businesses and cooperations will no longer have to deal with differences in legal form in the Member States. Instead of this, it will be possible to act with only one legal form throughout Europe. Consequently, a multitude of constellations of groups of affiliated businesses which sole purpose was to compensate differences in national legal forms will become obsolete. Furthermore, both choice of location and movement of registered seat will be unburdened from questions of national legal form. Managerial decisions concerning groups will be simplified in the long term. Literature prognosticates an annual reduction of costs of 30 billion US$ (*Monti*, WM 1997, 607), whereas some oppose a practical necessity *(Rasner*, ZGR 1992, 314, 316 f.). Apart from costs there may also be advantages in flexibility and improvements of management responsibility, which cannot or which can hardly be exactly quantified. The appraisal of single and overall economic efficiency of codetermination in the board of supervisors appertains to the same area of questions. Last but not least, one can better calculate the legal position in respect of the so-called D&O-insurance.

Art. 2 VO provides for five different incorporational procedures, whereby in any case an across border element is required:

- Merger of 2 public limited companies (AG/ Plc.) of different nationality;
- Holding company (SE) (suitable also for GmbH's);
- Subsidiary-SE by acquisition of interests in a subsidiary (all legal persons, not natural persons);
- Shift of form (only AG with subsidiary abroad);
- Subsidiary-SE of an SE (suitable also for GmbH's).

Although for the GmbH it is impossible to merger and to shift legal form, it can still make use of the legal possibilities provided for groups of affiliated businesses (holding company or subsidiary). The construction of a holding which is open to GmbH's, commercially represents some kind of merger contribution (fusionierende Einbringung) which is commercially similar to the merger but at present unknown to the German law. The partners of the associations of founders contribute a minimum of 50% of their shares to the SE and receive shares of the SE according to a proportional exchange rate. Correspondingly, the SE becomes a 50%-plus partner of the founding associations.

Once an SE is set up one can move its seat to any other Member State without being forced to give up its legal form at the border. Art. 8 VO states that the transfer of seat "neither leads to the winding-up of the SE nor to the setting up of a new legal person." As long as Germany applies the theory of registered seat one can – qualified majority assumed[9] – at least set up an SE and move its seat.

Art. 4 (2) VO prescribes a minimum nominal authorized capital of 120.000. - € According to Art. 5 VO national provisions are to be taken into account in respect of the rise of capital and capital-maintenance. In Germany therefore, the strict rules on non-cash

[8] To it cf., Ch. Teichmann, ZGR 2002, 383 ff.

[9] Art. 8 (6) VO refers to Art 59, according to which a majority of at least 2/3 has to vote for it.

capital contribution, special auditing and post-formation acquisition of capital goods (see above chap. 3 I 2b) are unchangingly applicable.

b. Codetermination. In spite of the fact that according to Art. 38 VO one can choose between the monistic and the dualistic model, a bypass of codetermination is barred to the extent to which it is provided by national laws. According to Art. 43 pp., the monistic model contains a board of managers and a general meeting (Hauptversammlung). The general meeting selects the board with simple majority of the voting rights, which are calculated according to the par value of the shares. The board has to have a minimum number of managing directors and can provide for non-managing directors who can operate as advisors and supervisors.

The dualistic model is very similar to the German public limited company (Aktiengesellschaft/ AG). A further board, the supervisory board (Aufsichtsrat) is implemented between the general meeting (Hauptversammlung) and the executive board (Vorstand). Nevertheless, the previous-later-principle is in effect, i.e. one can avoid the separation into supervisory board and executive board in Germany, as long as it is provided for workers' codetermination, which is practically only possible by the introduction of a division into internal and external board.[10]

As this area of regulations was left to the directive, one is referred to the legislation of transposition issued up to 2004. The flight from German codetermination to foreign top-management of groups, however, is barred by providing, that a bargaining commission has to be instituted, the task of which is to find out an adequate model of codetermination. If the bargaining procedure does not lead to a result being accepted of both sides, a legal model of codetermination has to be adopted. The general idea of these provisions is, that the legal regulations shall be binding, which have been in force before the switch to a SE for most of the employees.

c. Protection of minority-participation and rights to withdrawal. Serious impacts on the existing majority ratio and quick asset ratio can go along with the setting up of an SE; after the procedure, the majority ratios of the former associa-tions of founders are added. Above all, in cases where threshold of majority is scarcely exceeded (25% blocking minority for changes of articles of association etc.; 50% plus 1 share for absolute majority; relative majorities) such shifts considerably alter the feasibility of the respective shareholders to take influence. On account of Art. 25 (3) VO with § 29 I 1 UmwG options on appropriate payment in full settlement for leaving shareholders (rights to withdrawal) are to be opened when a German AG is participating. The pressure on liquidity mainly depends on the extent to which such rights will be exercised.

Because of these difficulties, a differentiated protection of minority-participation[11] is provided for the SE. Statements on the merger with participation of a German AG are sufficient for the general view. According to Art. 23 each general meeting of the merging associations has to consent to the merger. As the VO does not contain any majority rules, the reference of Art. 18 VO leads to the German national law and its ¾ majority requirement in the general meeting, §§ 65, 73 UmwG.

Thus up to 25% of the shareholders can be outvoted and make use of their right to withdrawal as a consequence. Their decisions will depend on the amount of pay-ment in full settlement for which, unlike to German law, § 34 UmwG, a compulsory judicial

[10] Cf. Teichmann, loc.cit pp. 446.

[11] Strictly speaking, it is not the question of protection of specific groups of SE-shareholders, but whether minority shareholders of other legal entities could be forced to enter the SE (so-called SE-entry-protection), cf. Kalss, ZGR 2003, 593, 601.

procedure of examination is not demanded. Art 25 (3) VO states that national law with its possibilities of re-examination is only applicable if the majority of the voting to merger explicitly approves its application. In cases of approval, the German courts will, similar to § 305 V AktG, base their review of the exchange ratio or the payment in full settlement essentially on the market value. The protection of minority shareholders is not continuation-orientated but market-orientated. Nevertheless, this market and value orientation of European company law is subject to approval of the majority voting.

Do the partners holding the majority of the votings not agree on the possibility of judicial examination, two different risks occur: First, the majority can fail, as some proponents of the merger could refuse to vote in order to - e.g. in a second voting – accomplish possibilities of judicial examination. Secondly, in cases of given majority the danger of an uncontrolled inappropriate fixing of the exchange ratio of shares arises. Nonetheless, the protection of minority shareholders of the SE is far behind German law.

Although the setting up of a holding, which is also possible for GmbH's, is according to Art. 32 (6) subject to the approving voting of the participating associations, there is neither a qualified majority nor are there rules on the withdrawal of partners holding a minority of capital and on their judicially examinable payment in full settlement. This is criticized with good reason in literature.[12] Not only the participation of the associations of founders in the SE-holding is concerned, but also the exchange of shares of the associations of founders and the SE. In German law, exchange deals of this kind are connected with the contractual group (Vertragskonzern) and the incorporation (Eingliederung) and are evidently subject to judicial review (see §§ 305 V, 320b II 2 AktG).

d. Liability for faults in management. Finally, the SE management's responsibility for faults is of central importance, as hereon it essentially depends whether available management competence can develop and whether good managers work for the SE, for they see possibilities of personal growth. For this Art. 9 (1) VO regulates that the Member States pass regulations (i) or that the national law concerning public limited companies is in effect (ii). The German draft following the discussion of the Ministry of Justice is now present [13] and makes § 93 AktG applicable on the monistic model, too. With this, it seems that Art. 53 VO is fulfilled, as one is referred to the law of the Member States concerning public limited companies in cases of responsibility for executive organs of the SE. The reference however is systematically rather inconsistent, as in the monistic organisation there are two different management levels: The board (Verwaltungsrat) and the Chief Executive Officers (CEO's). The provisions concerning the responsibility of the board of management of public limited companies are ana-logously applicable (§§ 24 VIII, 43 draft).

The parallel to § 93 AktG cannot be completely drawn in respect of the boards, as they can only conduct business deals in as far as powers have not been transferred to the CEO. Otherwise the boards can only act as observers. For this purpose, it is more useful to refer to both the responsibility of the supervisory board according to § 116 AktG and to the criterion developed hereto in deviation from essential parts of § 93 AktG. Particularly, one cannot generally assume an economical scope of dis-cretion or latitude of interpretation (business judgement rule), because what is at issue here is not business management, but to review the legitimacy of actions of the CEO and the board of management respectively.[14]

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[12] Kalss, ZGR 2003, 593, 602.
[13] Printed in AG 2003, 204 pp.
[14] Cf. – even further differentiated – Merkt, ZGR 2002, 650, 671 p.

The facts that the CEO only partly decides on the ground of fully transferred competences and that he is rather subject to instructions, have only insufficiently been considered. In the later case, it seems to be more to the heart of the matter to apply the standards of care that have to be followed by a managing director of a GmbH who is bound by instructions.[15]

The reference written down in the draft to § 93 AktG predetermines that the legal regime of liability concerning groups in the sense of § 317 AktG is wanted, which also entitles shareholders to claims in its paragraph 2 sentence 2. Compensation entitlements according to § 93 AktG can only be claimed by the association and - after seizure – by its creditors, but not by shareholders. Opposing the transfer to the SE, literature says that the regime of liability goes along with the model of organisation in countries with monistic law concerning shares and prevalent external liability. Art. 51 VO with its reference to the law concerning shares is only to be understood as a least possible regulation.[16] One can still add that the setting up of an SE does not represent elementary law concerning shares, but rather includes law concerning merger or groups. In Germany, external liability has long been valid law in these fields of law,[17] for why in this respect one cannot assent to the suggested reference to § 93 AktG in the draft.

III. European and German Law

We now come to the European directives on the company law and the m&a activities. Most of it has allready been respected, in this book, when the relevant subjects of the German law have been analysed which, time after time, has transformed the european provisions. The following can be very short comments on what the european sources of law are, and how the German transformation has taken place. Some more detailed information is collected to the actual problems of international take over bids (IV.).

1. The Directive on Stock Capital. The directive on stock capital ((DSC) was first enacted on the 13th of December 1976[18] It has been transformed by a German act to supplement the act of commercial corporations (AktG)of the 13th of December 1978[19]. A changing directive has been regulated, in Nov. 1992 (J.Off. L 347/64). Its provisions referred to the non-cash stock capital of the AktG, the augmentation of stock capital and the acquisition of own stock capital by stock corporations. Perhaps most important[20] are the provisions on acquiring own stock capital through affiliated enterprises which are dominated by the company the shares of which are acquired (§ 71d AktG). We will focus on this part of the Stock Capital Directive because buying own shares is an often favoured method of defending against hostile take overs (see allready above ch.3 IV.1a).

If a company buys own shares, of course, the same shares cannot be bought by a potential hostile overtaker. This is, however, only one extrem market constellation. Normally the company simply reduces the sharholders capital because the former shareholder gets back the market value of his share, when he receives the purchasing price of his sold share. This is why the credit security function of the shareholders capital is reduced to the same extent.

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[15] Comparator. notices, ZGR 2002, 650, 672.
[16] See loc.cit p. 674.
[17] Compare § 317 I S.2 AktG.
[18] 77/91 EWG, J.Off. L 26/1 of 31st Jan. 1977.
[19] Federal Legislative Publication 1978 I, 1959.
[20] At least in the context of mergers and acquisitions.

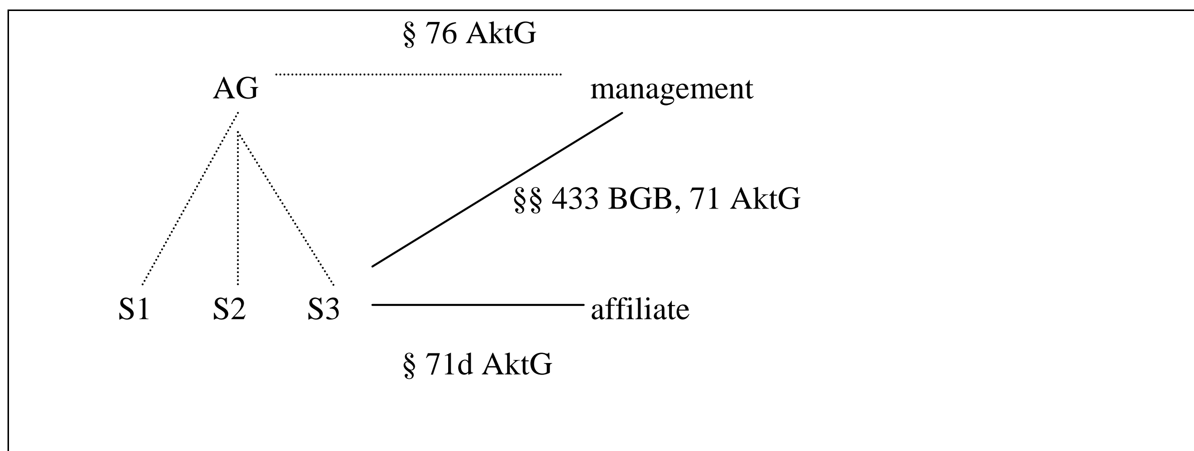
Also the evaluation of the shares by the capital market will be influenced when the management of the company buy its own stock capital. When third persons ask for the shares their demand tentatively causes an increase of the market value because they will be ready to pay the price which is necessary to bring offer and demand to cover. If the demand is caused artificially by the management of the company itself the market will be decepted in a way. In cases of minor quantity, one calles this strategy in German words a „Kurspflege“ (rate procurment).

Mainly these two reasons were the basis of Art. 19 sec.1 lit.a/b DSC which provides the following:

- the nominal value of the acquired own stock capital must not be more than 10 % of the whole nominal stock value. Reasonable exemptions can be provided by the national legislation;
- the shareholders meeting must participate in the dicision of the management.

The German AktG has transformed these provisions in §§ 71 sec. 2/3. Own shares can only be bought in narrowly defined cases, e.g., for preventing a havy and dircetly exspectable danger for the enterprise (risk management, sec. 1 lit.1), for the workers‘ participation (lit.2), or for compensation of minority shareholders if the corporation has concluded a contract of domination and/or surplus transfer with another enterprice (lit.3). Exemptions from the 10% limit are given only in the cases of workers participation (sec. 2). In the case of risk management, the board has to give information to the following regular shareholders‘ meeting.

These provisions would be easy to circumvent if the Chanaging Directive of 1992[21] did not provide, in its Art. 24a, that a purchase of a buyer who buys for the account of the company is to be seen as done by the company itself. The same is provided for the case that the company has an affiliated company which acts as the buyer of the stock capital. In this case, the credit security function may not be reduced automatically because the affilliated company acts as a legally independent person. The economic relations, however, between the mother company and its affilliate justify the provision of Art. 24a sufficiently.



AG=Aktiengesellschaft; S=shareholder

2. One Person Companies. As mentioned above, German stock corporations have been required to have 5 shareholders who must overtake the whole stock. The one person

[21] As quoted above.

companies directive which dates of December 1989[22], led to the abandonment of this provision. The German act for the small stock corporations of 1994 (Fed.Legislation I, 1961) changed § 2 AktG like § 1 GmbHG has been changed, in 1980 allready (Fed.Legislation I, 836). Now, one person companies are generelly possible if the company is a legal person. The one person OHG is still not admitted, the one person KG even being logically impossible.

The main reason for the one person company directive was to give single persons an opportunity to restrict their personal liability when taking market risks. Of course, creditors run a certain risk if they give credits to a limited liability company. There is no reason, however, why the risk allocation between creditors and debtors should be fixed by law, inflexibly. May the markets decide what the best risk allocation is, especially who will be able best to cover the risk by diversification, insurance, etc. (so called cheapest cost avoider).[23]

3. Takeover Bids. The European Commission published a proposal of a directive on takeover bids in Nov. 1997 (OJ C 378/10), which was changed to a certain extent, but was generally succeeded by the directive's passage of 3/30/2004.[24] The structure of the draft, however, has its roots in the Pennington draft of 1974, which also led to the British self-regulations of the London City Code on Takeovers and Mergers.[25] While Germany had already enacted an Acquisition and Takeover Act in 2002 (WpÜG), the definite EU directive came in 2004.[26] A German amendment of the WpÜG followed in 2006.[27]

The main characteristics shall be discussed in the following:

A takeover bid is a public offer to buy shares of a target company in exchange for the power to control a majority of it. If the acquiring party already has an amount of shares which can be seen as a control majority (30 %, § 29 WpÜG),[28] he or she must offer his or her prices and conditions to the general public and is obliged to treat all interested shareholders equally (Art. 3 of the directive; § 3 sec. 1 WpÜG). An adequate and equal offer of exchanging shares of the acquiring party may be sufficient. For controlling these provisions, the legislature of the Member States could make a choice whether it prefers a state authority or a more or less private panel. Alternatively, the Member States could provide for equivalent measures. This is why in Germany, some scholars believed that the regulation of §§ 304 et seqq., 311 et seqq. AktG was sufficient.[29] In the cases of a domination contract and the like, the minority shareholders can apply for an adequate compensation; and in the cases of factual domination, the majority shareholder has to compensate any caused disadvantages. The Federal Authority of Financial Services Supervision is currently empowered with the special tasks of the Act (§ 4 WpÜG).

The management of the target company shall be obliged to cease and desist from any action which could effectively result in a bona fide offer being frustrated or in the shareholders of the "offeree" company being denied the opportunity to decide on its

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[22] 12th directive 89/667 EWG on the field of the law of companies with one shareholder of 21st of December 1989, J.Off. No. L 395/40.

[23] For further details see R. Posner, The Rights of Creditors of Affiliated Corporations, 43 U. Chicago L. R. S.1976, p. 499-526.

[24] See OJ L 142/12; Steinmeyer/Häger, WpÜG-Commentary, 2nd ed.2007, introduction before § 1 WpÜG, margin 9 and attachment, p. 969 et seqq.; for the legislative history see s. *Kirchner*, BB 2000, p. 105,106.

[25] See Johnston, The City Take-over Code, p. 30 et seqq.

[26] See supra, in fn. before.

[27] As amended again 1/5/2007, BGBl. I, p. 10.

[28] As different from earlier drafts, the drafts of 1997 and 1999 did not set an exact percentage.

[29] Cf. statement of the German peak association of industry associations as cited in *Neye*, DB 1996, p. 1121, 1123; further references in *Habersack*, op. cit., margin 350.

merits (neutrality and hold-still duty, § 33 sec. 1 WpÜG). Additionally, the management must work out a statement on the consequences of the takeover bid to the interests of the shareholders and stakeholders (Art. 8 sec. 1 lit. b, as transformed in § 14 sec. 4 WpÜG). Stakeholders are, in particular, the employees of the target enterprise and their representatives, called the management council,[30] but also creditors, etc.[31]

Like the London City Code, the takeover bids directive allows the management to seek for a white knight if this is done bona fide, i.e. the offer of the white knight must be more favorable for the shareholders and stakeholders. § 33 sec. 1 p. 2 WpÜG is similar, but only provides that the defending strategies would have been undertaken by a careful manager also. This can be done by the board with consent of the supervising board, even if decisions that are normally within the power of the shareholders' meeting are at stake (sec. 2). However, the constitution of the corporation can opt out of the takeover § 33 WpÜG (§ 33a sec. 1 WpÜG). The legal intent of the defending power is to give the home country enterprises more protection against hostile foreign takeovers. One must see, however, that the protectionist provision is not promulgated directly by statutory law, but is only an option let to the general meeting or to the constitution of the target enterprise.[32]

If there are special shareholders' rights restricting their sale to others, the constitution of the corporation can provide that these restrictions shall not be applicable during the time of a takeover offer (§ 33b sec. 2 no. 1 WpÜG, known as the "Break-Through Rule"). However, also this anti-protectionist rule is optional for the constitutional autonomy of the corporations.[33]

The takeover bid directive and the WpÜG 2001/4 have been discussed critically because the duties of the target company's management may be strictly controlled by the supervising authority or the panel on takeovers.[34] Others stress the point that a takeover bid can offer shares of the acquiring company without offering the alternative of compensation. The London City Code provisions, which are different in this respect and require an alternative cash offer (compensation), would be preferable.[35]

It is not intended to work out a further standpoint here, since the decision of the German statutory law, in principle, is final. It shall be mentioned, however, that the capital market-oriented concepts of corporate governance would clearly favor a regulation which leaves the management of the target company, as well as the management of the acquiring company some flexibility in finding out autonomously which of the possible alternatives would be best for serving their own interests, while also meeting the needs of the market to the extent possible.

In 2005, the ECJ *Sevic* case decided on a cross-border takeover, whose main facts are summarized in the following chart.

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[30] See again § 14 sec. 4 p. 2 WpÜG.

[31] They are protected by the publication duty of § 14 sec. 2, 3 WpÜG.

[32] Also, see the reciprocity rule of § 33c sec. 1 WpÜG.

[33] See the reciprocity rule of § 33c sec. 2 WpÜG, again.

[34] Cf. *Kirchner*, op. cit. p. 107 et seq., comparing the U.S. Williams Act and the business judgment rule, which gives the management of the target company a certain discretion. It must be doubted, however, that the comparison of the U.S.-American law will become the basis of the majority in the EU legislation.

[35] S. *B. Mävers*, Die deutsch-britische Börsenfusion zwingt Brüssel zum Handeln, HBl. (Handelsblatt) of 5/16/2000 p. 2, arguing against the planned merger of the London and Frankfurt stock exchange.

ECJ Sevic (2005)

The **German Sevic** Systems AG applied for registration of a **merger with a Luxembourg Societé Anonym** (SA). The German Commericial Register (Handelsregister) denied the merger, because the UmwG (Transformation Act) only provides for mergers with a registered seat in Germany.

ECJ struck down the ruling, because:

- The UmwG leads to **different treatment of domestic and international mergers**, which is in conflict with Art. 43 ECT;
- the differentiation is not within the principal of **proportionality**, since international mergers are impossible as such, and by this the UmwG goes beyond what is necessary for protecting public interests.

Germany reacted to this decision by amendment of § 122a UmwG. Now mergers from a foreign EU country to Germany are legalized. For cross-border exits of German companies, it was still uncertain if the principle of the *Sevic* decision of the ECJ shall be applied. Since the more recent ECJ decision of Dec./16/2008 in *Cartesio*,[36] the moving-out cases can be restricted by national provisions dissolving the moving-out company.

The European Court of Justice in *Cartesio* stresses the argument that such moving-out rules may be in conflict with the logic of the ones for moving-in, but Art. 43 ECT does not provide for an interdiction against inlanders.[37] Most of the literature has argued critically to this point,[38] and to the negative consequences for EU internal commerce.[39] The regulation of moving-out cases of companies has indirect consequences for the commercial activities in the Member State of destination, and cannot only be seen as a question of discrimination of inlanders.[40] One must admit that the external effect of moving-out restrictions is not discrimination in the narrow sense of Art. 43 sec. 1 ECT, but this provision was extended to restrictions of interstate commerce a long time ago by the ECJ.[41]

It would be much better, therefore, to look at eventual justifications under the *Dijon* doctrine. For certain enterprises of national importance, for example, one can easily imagine that moving-out restrictions are justified by high-ranking public interests. Companies which have received substantial state aid in the past may also be treated restrictively. However, general moving-out restrictions for companies of a Member State will not pass the proportionality test, which was developed within the *Dijon* doctrine[42] as

[36] C-210/06, as published in parts, NJW 2009, p. 569; BB 2009, p. 11; full version in NZG 2009, p. 61.
[37] As quoted under no. 110; cf. ECJ of 9/27/1988, C-81/87, Offic. Publ. 1988, p. 5483, no. 19 (*Daily Mail*); *Richter*, IStR 2008, p. 719, 721.
[38] *Grohmann-Gruschinske*, EuZW 2008, p. 463 et seq.; *Frobenius*, DStR 2009, p. 487 et seq.;
[39] See *Eidenmüller/ Rehm*, ZGR 2004, p. 159, 175 et seqq., only.
[40] To this question see *Lach*, Umgekehrte Diskriminierung im Gemeinschaftsrecht, 2008; also called reverse discrimination.
[41] For an overview of the case law see *Randelzhofer/Forthoff* in Grabitz/Hilf, Kommentar, loose-leaf collection, Art. 43 ECT, margin 83 et seqq.
[42] See ECJ, C 120/78, Rewe-Zentrale/Bundesmonopolverwaltung (*Cassis de Dijon*), NJW 1979, p. 1766; cf. ECJ of 12/5/2006, C-94/04 and C-202/04 (*Cipolla*); overview of the case law in *Herrmann*, EWS 2009, p. 10, 12 et seq.

an examination, if there is no less restrictive measure to reach the aims of the alleged justification. Therefore, the *Cartesio* decision should not have much impact on the further development of the EU company law.

4. Further Directives and Proposals – Overview. There is quite a lot of other directives, proposals, chanced proposals and drafts of directives which cannot be discussed here, in detail. Even a selected view on exemples which could be generalised is impossible. Instead of it, the following list shall give an overview:

Undiscussed Directives etc.*

name in short	published	transformed i.Germany
Directives on Mergers of Enterprises	full version of Oct.1978: J.Off. L 195/36 (changed Jan.1995, J.Off. L1/142)	Umwandlungsgesetz of 1994, BGBl. I, 3210
Directives on Splittings of Enterprises	latest version of Dec.1982: J.Off. L 378/47	Umwandlungsgesetz of 1994, BGBl. I, 3210
Accounting Directives of Companies of Certain Legal Forms	full version of July 1978: J.Off. L 222/11	Bilanzrichtliniengesetz of 1985, BGBl. I, 2355
Accounting Directives of Consolidated Enterprises	of June 1993 J.Off. L 193/1	EWR-Ausführungsgesetz of 1993, BGBl. I, 512, 530
Draft on Organic Merger Constitution	latest version of 1975: published in Lutter (Ed.), Europäisches Unternehmensrecht, 4th ed.1996 p. 187 ss.	------
Dichotomic Concept	latest version of 1984: published in Lutter (Ed.), Europäisches Unternehmensrecht, 4th ed.1996 p. 244 ss.	------

* The drafts on Take Over Bids will be discussed below (s. No. IV)

For a first understanding of the directives on mergers and splittings of enterprises one must see, first of all, the difference between a merger of this kind and an integration within the meaning of § 319 AktG. In the case of an integration, the integrated company keeps being existent: it can receive directions of the main company, and after dissolution of the integration, it will exist indegendently, even (see § 327 AktG. This difference, however, does not mean that the problems of minority protection, creditors protection etc. are totally different. Mainly the problems of compensation of minority shareholders and the information assymmetries are very similar. That is why the German legislator of the §§ 293 a-e AktG has provided for nearly the same report and auditing duties as they are requested in the cases of the Umwandlungsgesetz (s. § 8-12 UmwG).

The accounting directives belong to a special field of economic and law research. One must see, however, that the european accounting law has contributed to the opening of the national market barriers very much. Most important is the provision that a company

can be exempted from most of the national accounting law if it is registered at a foreign capital market and must account under the foreign accounting law (s.§§ 264 sec.3, 291-292a HGB).

The drafts on merger constitutions, finally, are also very interesting despite the fact that they have no realistic chance to become definitely legislated, in the near future. From the German point of view, it is most remarkable that the earlier versions of 1974 and 1975 tried to develope an organic merger constitution which does not make the principle difference between enterprise contracts and factual domination (but see §§ 291 ss., 311 ss. AktG). Since the changed version of 1984, however, this concept seems to be abandonned, more and more because the differenciations between general compensations within the meaning of §§ 304 s. AktG and compensations of special causations of disadvantages of the affiliates contains a more adequate variety of instruments to protect minority shareholders, creditors and other participants of the enterprise.

5. Limited Liability Companies in Germany. The following law of European origin is not causes by directives, but by single decisions of the ECJ, which most of all were not decided on German law . This is why it belongs to the section of European and German Law.

a. From the Seat Theory to the European-Wide Freedom of Choice of Legal Form. Every state can determine its international private law i.e. determine the rules which apply to cases dealing with international matters, but which have to be applied by the courts in the inland (so called international private/ company law).

Accordingly, international company laws of the European Member States strongly deviate from each other. Until recently, the pure theory of registered seat has been in effect in Germany, which states that any company has to take on one of the legal forms provided by the national law where the registered office (central place of administration and control) is situated.

Consequently, e.g. a U.K. private limited company (Ltd.) moving their central place of administration and control to another Member State had to be registered with the local competent commercial register as GmbH or Kommanditgesellschaft (KG, limited partnership). In this case, prior to it being newly incorporated in Germany the U.K. legal person had to wind up, with all the consequences that winding-up entails such as tax relevant assignation of assets (turnover) and a multitude of single acts of conveyance. Likewise was - and still is up to now – the situation when a German enterprise wanted to "emigrate" to another Member State.[43] The seat theory leads to the dying of the corporation at the border.[44]

Ever since, as the so-called theory of foundation (Gründungstheorie) is in effect, not referring to the seat but to the act of foundation of the company, the English law has been less restrictive. Therefore, if the deed of partnership bases on English law and grants the respective legal form, the company can move its registered office without any consequences to any location. Assets would not have to be assigned and taxed when the company moves its registered office across borders. Furthermore, the previously mentioned regulations on minimum contribution of capital in respect of the GmbH do not apply; particularly, those concerning the substitution of equity by means of loans of associates (partners) do not apply to the same extent. For this reason, from the viewpoint

[43] Differently now Art. 2 of the EU draft directive on merger of corporations, 18.11.2003, KOM (2003) „VerschmelzungsRichtl."

[44] See Luther, BB 2003, 7, 10: „… an der Grenze totgeschlagen "; with a look to other European countries, rationale for EU-draft-directive on merger, see loc.cit. **no. 1**

of the partners and the company, there is a certain inducement to take on the legal form of an English limited liability company, even if one wants to operate in Germany at last.

On account of such attempts, the ECJ had repeatedly to decide on the international company laws of the Member states in recent years and thus made essential restrictions on the theory of registered seat. These do not result in the states that apply the theory of seat having to readjust to the theory of foundation, but there are essential restrictions:
In Centros, the Court dealt with the establishment of a branch of an English limited liability company in Denmark. One refused to register the branch as such in the Danish commercial register, because the national rules of capitalization differed from each other. The Danish authorities refused the registration for the reason of public-policy interests as the liberal English rules unendurably jeopardize creditors interests. The ECJ took the view of this being a restriction on the freedom of establishment laid down in Art. 43 (1) EC for it rejected a justification on the grounds of public policy. The law of another Member State could not be regarded as being virtually harmful to the public welfare.[45]

The case of Überseering[46] also dealt with a foreign company, established in the Netherlands this time. According to domestic law in force it represented a legal person with limited liability and subjected to no special regulations of minimum contribution of capital. Here, all Dutch capital shares were transferred to German residents, central management activities were ceased in the Netherlands and continued in Germany. Since no registration to the commercial register was requested, in a trial of the Überseering association, the question arose, whether the company could be party to a lawsuit. The German Federal Supreme Court (BGH) submitted this question to the ECJ. After the Court had ruled that it would be an infringement of the freedom of establishment, if the ability to be party to a lawsuit would be denied solely on the ground of the German theory of registered seat, the BGH, due to a recent change in his jurisprudence, approved the ability of Übersee to be party to a lawsuit in the form of a so called association of private law (GbR).[47]

The development was continued by the decision in the Inspire Art case. No existing company was "moved" abroad but the Dutch partners set up a private limited company of English legal status and applied for the registration of a branch hereof in their native country. Under Dutch law, either the minimum contribution for a Besloten Vennootschap (GmbH/ Ltd.) had to be paid in and the additional term of „formal foreign association" had to be used, or an association with full personal liability of the partners came into existence. The ECJ judged on the basis of the 11th directive on associations (directive on the establishment of branches / Zweigniederlassungsrichtlinie).[48] It sets up requirements for information and documents regarding the company, its legal status, personal data of the persons nominated as representatives and documents concerning accounting. However, it does not require the designation as „ formal foreign corporation". The ECJ

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[45] ECJ, Slg. 1999, I-1459=NJW in 1999, 2027 „ Centros"; to this, Muelbert/Schmolke, (2001), 233 ZVglRWiss 100; overview on further jurisprudence at Zimmer, NJW 2003, 3585 ff. with further examples.
[46] ECJ, 5.11.2002, Rs. C-208/00, NJW 2002, 3614; for the decision of the BGH on the issue see below in subsequent text.
[47] BGH BB 2002, 2031; to this, Roehricht, Aktuelle höchstrichterliche Rechtsprechung, in: Gesellschaftsrechtl. Vereinigung (Hrsg.), Gesellschaftsrecht in der Diskussion 2002, 2003, p. 11 ff.
[48] Directive of the Council, 22.12.1989 concerning the disclosure of branches, that were set up in a Member State by companies of a specific legal form and that are subject to the law of an other Member State, ABl.EG no. L 395 v. 30.12.1989, p. 36 ff.

viewed the information required by the directive to be the maximum possible[49], so that no further information duties could be imposed in the Netherlands in order to avoid personal liability.[50] Moreover, one was sufficiently warned of possible liability deviations of the foreign company law as to the association was designated in a foreign language.[51]

b. Deficiencies of Transformation Law. Consequently, it seems to be resolute that German nationals can set up an establishment in other Member States and register a branch hereof in the inland without being exposed to personal liability. Whether the same applies, if – similar to the case in *Überseering* – the central administrative office is to be in Germany, has not yet been decided by the BGH. As previously mentioned, the BGH approved the ability of *Überseering* to be party to a lawsuit understood as an association of private law. The Court, however, did not explicitly answer the question of liability. Although in literature a limitation of liability is partially acknowledged, reference to the insufficiently clarified legal position is added.[52] In part, one considers allowing a period of time for the company's registration in Germany as a limited liability company (GmbH) and granting it the status of a "pre-GmbH" with moderate liability for the partners in the meantime until it is officially registered.[53]

Further questions seem too unresolved by the case law. They can be summarized as follows:

Main **Undecided** Cases

- Ltd. founded in the UK, but **taking its seat only in a foreign country** within the EU, e.g. Germany
- **Moving-out of a German AG by merger** with a foreign entity (but see Merger Directive of 2005/06, text in electr. reader on chair page).
- The principles of minimum standards and **seat theory** seem to be **not overruled**.

c. Why Ltds. in Germany? The overviewed case law leads to some consequences for the practice of entrance of legal entities into Germany. This is seen in the following charts which were explained in the course. As the charts are intended to be sufficiently straight

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[49] In detail Hermann VersR 2003, 1333, 1337 f.

[50] ECJ NJW 2003. 3331 no. 101 (Inspire Art).

[51] Loc. it. no. 135.

[52] See *Zimmer* loc. it. p. 3587 not even a warning in analogy to § 19 sec. 2 would be necessary since the ECJ held an incorporation under a foreign name to be of sufficient warning; other opinion: *Bockelmann*, in: MuenchKomm-HGB, 1996, § 19 margin 59; differentiating *Zimmer*, in: Ebenroth/Boujong/Joost, HGB, 2001, § 19 margin 21; against a warning that goes further than the EU directive, ECJ 5.3.2002, C-386/00, VersR 2002, p. 1011-*Axa Royal Belge SA./.Georges Ochoa*; to this again *Hermann*, VersR 2003, 1333, 1337 et seq.; ibid DZWiR 2004, 95.

[53] See *Roehricht*, loc. cit p. 13: but it was "allein Sache des Gesetzgebers."

forward, only a few additional comments are added. First of all, the question arises of why Ltds. become more and more prevalent throughout Germany.

Commercial estimations from January 2006 record ca. 25,000 Ltds. in Germany.[54] In 2001 we had 850,000 "GmbHs" (limited liability companies) and 12,000 "AGs" (stock corporations).[55] The number of Ltds., however, seems to already be of some economic importance. If one asks for the reasons for this development, one can distinguish legal and economic factors.

Legal Reasons

- Principle of **no compulsory legal form** (exemption, e.g., § 7 VAG).
- **No personal liability** (even Ltd. & Co. KG possible, e.g. Rolls Royce Ltd. & Co. KG).
- Minimum stock capital of **1 BPS**.
- Notification at the trade office (Gewerbeamt) is compulsory and possible.
- Registration at the UK House of Companies and the **German Commercial Register (Handelsregister) is compulsory (§13 d, e, g HGB)** and possible.
- **No obligatory IHK** (Chamber of Industry and Commerc) **membership**.

For better assessment, one should have a broad understanding of the main differences in the legal forms of companies in the UK.

UK –Legal Forms

Company	Liability	Equivalent
Priv. comp. ltd b. shares	amount of shares	GmbH
Priv. comp. ltd. by guarantee	payments in case of insolvency	KG
Priv. unltd. Comp.	unlimited	OHG
Publ. ltd. comp. (PLC)	amount of shares	AG/börsen-not. AG

[54] Limited Aktuell, 1/2006, p. 2; also www.go-limited.de.

[55] S. *Wiedemann/Frey*, Gesellschaftsrecht, 6. ed. 2002, p. 265, no. 293; *Herrmann/Nägel*, a.a.O. p.122.

The economic reasoning can be summarized as follows:

Economic Reasons

- Limitation of Liability: **Creditors** tend to be **less reckless**, because liable assets are restricted.
- § 13e sec. 2 HGB requires acknowledgemet (notarielle Beglaubigung) but **fees are less**, because based on 1 BPS stock cap.
- No **IHK membership fee**.
- **Buy-outs** are easier and take **less time**.

d. Correct Company Name. The following chart contains some practical recommendations for finding an adequate name for the firm, the enterprise of which shall be registered as a Ltd. If one fails to meet the provisions exactly, one can still be certain that the Companies House will reject the wrong name by written correspondence (post or e-mail). In this case, one should see a specialized attorney, because the Companies House does not typically advise on how to correct the rejected application.

Registration of Names

- Registration at **Companies House**, Cardiff (main office) and 21 Bloomsbury Street, London, WC1B 3XD (phone: 0870 3333636)
- Personal name or other key words
- **No similar** name registered before
- No violation of law or public policy
- Special license required if "British," "European," "insurance," etc.
- **No notarial** certification required
- Takes days, not months
- Adaptation must be signed by each shareholder

After having succeeded in registration, one must be sure to meet the provision on correct labeling. Also in this respect, the following chart is self-explanatory.

Correct Labels

- registered name, plus
- **"registered in England** & Wales"
- address of main office (but not directors' names, etc.)
- at **external front door** of each subsidiary, office, on letter heads, brochures, bills, receipts

e. Necessary Actions for Start-Up. First of all, two basic resolutions of the company must be prepared by the founders: the memorandum of association and the articles of association. For this purpose, one has to invite the members to an initial meeting. Normally this is done before the registration application, because the founders will only be ready to sign the application after they know exactly what their rights and duties are, and how their representatives can act for the new company.

Minimum Content of Company Contract*

Memorandum of association (**external**)

- s. form 10, at www-page under statutory forms
- name, seat in England, purpose of company, possibly preference shares

Articles of association (**internal**)

- easiest: cross standard of "Table A" (min. 2 directors, s. Art. 65)
- take over most of the text of Table A, but say at Art. 65: "one director"
- no min. qualification of directors required

**List of service firms with prices, Goldstein/Wulferding, EURO-GmbH, 2004, p. 27 et seqq.*

The next step is to notify the German *Gewerbeamt* (trade office), *Handelsregister* (Commercial Register) and *Finanzamt* (tax office).

In Germany

- Notification at the trade office **(Gewerbeamt)**, §§ 14 et seqq. GewO ("stehendes Gewerbe", non-travelling business)
  - "sonstige Rechtsform" (other legal form) (-), alternatively "GmbH"
  - get "Betriebsnummer" (company registration number, asked for by banks, Federal Employment Office, Finanzamt, etc.)
- Notification at the **Handelsregister** (Commercial Register)
  - Registration court of the city of the German subsidiary ("öffentl. Beglaubigg - legalization" required, s.above)
- Notification at the German **Finanzamt** (Tax Office)
  - (automatic info. of Gewerbeamt, but separate declaration: Ltd. Exclusively in Germany)

f. Management Duties and Powers. The following is restricted to the differentiation between directors and secretaries, and to the typical formal duties they have.

Directors & Secretaries

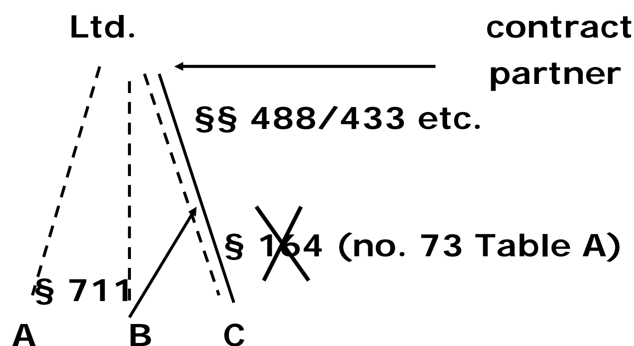
- two directors, No. 65 Table A as a rule (changeable, s. above; also delegation to one agent)
- one **secretary is compulsory**
- both appointed by **simple majority** in Annual Gen. Meeting (AGM) or Extr. GM or by directors until next AGM
- agent must care for **announcement of delegations to Companies House** in timely manner,
- but **external effectiveness** before (s. follow. chart)

Of course, the range of duties is much more complex, especially since the directors have the duty to make an effort for good business. If they do not succeed, the legal consequence is not that they are liable for every unsuccessful development. Rather, the following questions are analyzed:

- Was any damage caused?
- Was it done by a breach of contract or by violation of a duty of tort law?
- Was it done by negligence?

For the last question, the well-known business judgment rule comes into play. Under this rule, the director has a degree of discretion in regards to the extent to which decisions of commercial assessment are taken. Normally only gross negligence leads to liability being placed on the management.

Directors have representative power, which can be compared to the *Einzelvertretungsmacht* (individual power of representation) of German law. If directors exceed any limitation of their power, the contract with the third party is untouched. This also seems to be comparable to German law.



Secretaries have more formal duties. The following keywords can be summarized:

Secretary

- compulsory, but **delegation**
- **no personal union** of director and secr.
- responsible for "**annual return**" with updates of names of directors, secretaries, etc. (Jahresbericht; annual request of comp. House containing all data of previous year)
- duty to work out and **store the statutory books**:
  - member register
  - directors & secretaries register
  - directors' interests, i.e. shares & credits
  - register of charges (mortgages of the comp.)
  - minute register (decisions of the directors; Ord.GM/Extr.GM)

g. Dissolution and Liquidation. Due to space constraints, this chapter has been drastically shortened. Only the main aspects can be listed in the following chart.

Procedure & Ranking

- preparatory steps
  - termination of leasing contracts (with shareholders)
  - sale of comp's property
- satisfaction of creditors' claims (pro rata)
- pay back of credits of "shadow directors" (dominating shareholders)
- return of investment and possibly surplus (pro rata)