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Private Company Law in Europe – Time for Reform?

Summary

Within the European Union, Member State policies on companies not listed at a stock exchange are less restrictive. There is very little path dependence, and lawmakers have pledged, albeit with varying degrees, to assure freedom of contract. The jurisprudence of the European Court of Justice has opened the floodgates for private company mobility. Against this background, private companies have come to be the preferred form of corporate organisation for start-up businesses and private equity funds. Apparently, the English Private Limited Company stands to become the major beneficiary of liberalisation in company law. Regulatory competition has unleashed legislative activities in some Member States. This paper surveys English, Dutch, French and German statutes on private companies in order to assess the competitiveness of national corporate law systems. Insights from political economy are added to the current debate on a European Private Company Statute.

Keywords: *European company law, regulatory competition, private company law reform.*

I. Introduction

1. Why Focus on Private Company Law Reform?

Choosing a business organisation from a menu of various corporate law options requires a careful cost-benefit analysis¹⁾. The enabling character of a national corporate law system is as important as the agency costs which may arise under certain organizational settin-

gs²⁾. In this context, private companies have come to be the preferred organizational form for start-up businesses³⁾ and private equity funds⁴⁾.

Within the corporate governance community, the private company is a latecomer. The short term priorities of EU Action Plan for 'Modernising Company Law and Enhancing Corporate Governance' focus on (non-)regulatory measures applicable to listed corporations⁵⁾: A more stringent regulatory framework is suggested for listed companies whereas private companies should enjoy a greater amount of flexibility⁶⁾. Similarly, one of the leading international treatises on corporate law devotes most of its attention to public companies as their shares trade freely in a public market⁷⁾. Only recently, private companies have begun to attract the interest of both, scholars and politicians⁸⁾. Member States of the European Union are amending their laws on private companies⁹⁾ and, in February 2007, the European Parliament urged the Commission to study the prospects of a European Private Company Statute¹⁰⁾.

1. This includes an insolvency law analysis as insolvency proceedings may limit contractual choice: cf. *Ribstein*, The Important Role of Non-Organizational Law, *Wake Forest L. Rev.* 40 (2005), 751 (786 et seq.); *Andres/Grund*, Die Flucht vor deutschen Insolvenzgerichten nach England, *Neue Zeitschrift für das Recht der Insolvenz und Sanierung (NZI)* 2007, 137 (at p. 138 et seq.); see also *Becht/Mayer/Wagner*, Corporate Mobility and the Costs of Regulation, European Corporate Governance Institute, Law Working Paper N^o. 70/2006, on the crucial importance of regulatory costs in small company formation due capital constraints. Cf. the carefully balanced analysis in the Report of the *High Level Group of Company Law Experts* on A Modern Regulatory Framework for Company Law in Europe, at p. 114 et seq., Brussels, November 4, 2002.
2. Cf. *Callison*, Venture Capital and Corporate Governance: Evolving the Limited Liability Company to Finance the Entrepreneurial Business, *J. Corp. L.* 26 (2000), 97 (98, 111 et seq.); *Sahlman*, The structure and governance of venture-capital organizations, *J. Fin. Econ.* 27 (1990), 473 (474, 487 et seq.).
3. See *Becht/Mayer/Wagner*, Corporate Mobility Comes To Europe: The Evidence, Working Paper, Université Libre de Bruxelles/Saïd Business School, Oxford University (October 2005); *Ventoruzzo*, "Cost-based" and "Rule-based" Regulatory Competition: Markets for Corporate Charters in the U.S. and the EU, Bocconi University – Institute of Comparative Law "Angelo Sraffa" (I.D.C.) Legal Studies Research Paper N^o. 14 (2006), p. 5 et seq.
4. British Financial Services Authority (FSA), Discussion Paper DP 06/6, Private equity: a discussion of risk and regulatory engagement, London, November 2006, available at http://www.fsa.gov.uk/pages/library/policy/dp/2006/06_06.pdf; cf. *Vallender*, Gefahren für den Insolvenzstandort Deutschland, *Neue Zeitschrift für das Recht der Insolvenz und Sanierung (NZI)* 2007, 129 (at p. 132 et seq.).
5. Communication from the Commission to the Council and the European Parliament, *Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward*, Brussels, May 21, 2003, COM (2003) 284 final, p. 7 et seq.: "... [E]ffective and proportionate protection of shareholders and third parties must be at the core of any company law policy ... in order to achieve business ... competitiveness".
6. *Ibid.*, p. 8.
7. *Hansmann/Kraakman*, What is Corporate Law?, in: *Kraakman/Davies/Hansmann/Hertig/Hopt/Kanda/Rock*, The Anatomy of Corporate Law – A Comparative and Functional Approach (2004), I (at 15 et seq.).
8. See *McCahery/Vermeulen*, The Evolution of Closely-held Business Forms ins Europe, *J. Corp. L.* 26 (2001), 855 et seq.; and the volume edited by *McCahery/Raaijmakers/Vermeulen*, The Governance of Close Corporations and Partnerships: US and European Perspectives (2004).
9. Cf. *McCahery/Vermeulen/Hisatake/Saito*, Traditional and Innovative Approaches to Legal Reform: 'The New Company Law', *Eur. Bus. Org. L. Rev. (EBOR)* 8 (2007) (forthcoming).
10. European Parliament Resolution of February 1, 2007, with Recommendations to the Commission on the European Private Company Statute, P6_TA-PROV(2007)0023.

2. European Company Law – The State of Art

The current regulatory approach towards company law in the EU has been shaped by developments which appear to be unrelated. Corporate scandals on both sides of the Atlantic have ignited a debate on how to improve corporate governance in listed companies¹¹). Against the background of the US Sarbanes-Oxley Act, the European Commission has expressed its intention to assert a more active role in developing a coherent European approach towards corporate governance¹²). The Commission's Action Plan offers a mix of binding and non-binding policy measures, marking a departure from previous regulatory policy instruments of the European Union¹³). The diversity of national corporate governance schemes is acknowledged. Moreover, there is a growing awareness that Member States are ambivalent about centralised EU guidance on how to devise investor-friendly corporate statutes¹⁴).

The European Court of Justice (ECJ) has added a highly dynamic element to corporate law analysis. In attacking negative externalities of national corporate law systems the ECJ requires the Member States to recognise non-domestic European companies without re-incorporation¹⁵). Member States which have applied the seat theory in corporate law are to liberalise their restrictive regimes on companies from the so-called incorporation states of the EU. This introduces both, regulatory competition and regulatory arbitrage to company law¹⁶): Investors may decide freely which corporate law jurisdiction offers the least costly corporate law regime to set up a business¹⁷). Ideally, the cases on company mobility should operate as a powerful incentive for Member States to re-evaluate their national company laws¹⁸), bringing forth corporate law standards attractive to investors. Nonetheless, reality is more complicated than theoretical reasoning. History suggests that the corporate law policies of the Member States of EU tend to establish a non-cooperative equilibrium, foreclosing long-term regulatory competition. National corporate law systems are marked by path de-

11. See collection of papers in Armour/McCahery (eds.), *After Enron – Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (2006).
12. See the Commission's statement in the Action Plan, supra N. 5, at p. 5: "*The EU must define its own European corporate governance approach, tailored to its own cultural and business traditions. ... Corporate governance is indeed an area where standards are increasingly set at [an] international level, as evidenced by the recent developments observed in the United States. ... In many areas, the EU shares the same broad objectives of the Sarbanes-Oxley Act and in some areas, new initiatives are necessary. Earning the right to be recognised as at least "equivalent" alongside other national and international rules is a legitimate and useful end in itself.*"
13. For an assessment of the Commission's mix of binding and non-binding policy measures: *Davies*, *Enron and Corporate Governance Reform in the UK and the European Community*, in: Armour/McCahery (supra N. 11), at p. 415 et seq.
14. Cf. *Armour*, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, European Corporate Governance Institute, Law Working Paper N^o. 54/2005 (June 2005).
15. Cf. *Roth*, *From Centros to Überseering: Free Movement of Companies, Private International, and Community Law*, I.C.L.Q. 52 (2003), 177 et seq.; *Micheler*, *The Impact of the Centros Case on Europe's Company Laws*, *Comp. Law* 21 (6) (2000), 179 (180 et seq.); *Eidenmüller*, *Europäisches und deutsches Gesellschaftsrecht im europäischen Wettbewerb der Gesellschaftsrechte*, in: *Festschrift Heldrich* (2005), 581 (582); *Grundmann*, *The Structure of European Company Law: From Crisis to Boom*, *Eur. Bus. Org. L. Rev. (EBOR)* 5 (2004), 601 (611 et seq.).
16. Cf. *Enriques*, *Silence Is Golden: The European Company as a Catalyst for Company Law Arbitrage*, *J. Corp. L. Stud.* 4 (2004), 77 (83 et seq.).
17. Cf. *Trachtman*, *International Regulatory Competition, Externalization, and Jurisdiction*, *Harv. Int'l. L. J.* 34 (1993), 47 (65 et seq.), on the cost aspects of regulatory competition.

pendence, relatively high switching costs and tax law obstacles¹⁹). In assessing the competitive effects of the ECJ's cases on company mobility greater attention should be paid to private companies: National regulatory policies are less restrictive on private companies and partnerships²⁰). The English Private Limited Company has come to be the major beneficiary of the current state of law²¹). In what amounts to an astonishing combination of deregulation and defensive law-making Member States are reconsidering their laws on private companies. This begs the question how far a Member State can go in defending its regulatory traditions and whether there is a need for a European statute on private companies.

3. Outline of the Paper

This paper will first portray the framework for regulatory competition as developed by the ECJ. It will then highlight the policy implications of company mobility and survey types of private companies currently available under various national legal orders in the EU. This survey is not intended to be comprehensive²²). Rather, it serves to assess the potential for evolutionary processes unleashed by the ECJ's jurisprudence. Critics of 'light-weight' foreign companies claim that unlimited private ordering in company law places a considerable burden on host countries. This assumption will be tested against the background of recent court cases on English private limited companies operating in Germany. A trade-off is found to exist between the requirements of company mobility and cost internalisation. It is an unresolved matter whether a unified EU statute on Private Companies

18. See para. 43 to the Opinion of Advocate-General *Geelhoed* of February 23, 2006, Case No. C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*: "Indeed, in itself, the existence of disparities may well have a positive effect on Member States' economies and benefit the internal market. With the exception of certain extreme cases – for example, the cases of 'harmful tax competition' – there is a powerful argument that transparent regulatory competition in tax regimes, as in other spheres, gives Member States an incentive to be as efficient as possible in the administration and structure of their tax systems and in the use of their direct tax receipts."
19. Cf. *McCahery/Vermeulen*, Does the European Company prevent the 'Delaware-effect'?, Tilburg University, TILEC Discussion Paper DP 2005-10 (March 2005), arguing that "there are few political incentives for lawmakers to pass legislation that might serve to disrupt the EU's non-competitive equilibrium in company law"; and *Kirchner/Painter/Kaal*, Regulatory Competition in EU Corporate Law after *Inspire Art*: Unbundling the Delaware's Product ECFR 2, 159 (176 et seq.) (2005), pointing out to the switching costs an established company would face in migrating from one national legal order to another.
20. It is one of the astonishing aspects of the debate on company mobility in the EU that the factual settings of the cases before the ECJ are often overlooked: The *Centros*, *Überseering* and *Inspire-Art* rulings dealt with close corporations or private companies. See also: *McCahery*, Harmonization in European Company Law: The Political Economy of Economic Integration, in: Curtin/Smits/Klip/McCahery, European Integration and the Law – Four Contributions on the Interplay between European Integration and National Law to celebrate the 25th Anniversary of the Maastricht University's Faculty of Law (2006), 155 (182 et seq.). Cf. *Ribstein*, Why Corporations?, *Berkeley Bus. L. J.* 1 (2004), 183 (191 et seq.), analysing the choice between corporation and partnership from a US perspective; and *McCahery/Vermeulen*, Understanding (Un)incorporated Business Forms – Topics in Corporate Finance 12, 9 et seq. (2005), assessing the legal regime for closely held firms.
21. *Becht/Mayer/Wagner*, supra N. 3; cf. *Rajak*, The English Limited Company as an Alternative Legal Form for German Enterprise, *EWS* 2005, 539 et seq.
22. See *Águila-Real*, Lowering Legal Barriers to Entry through Technology without Touching Vested Interests: The Spanish *Sociedad Limitada – Nueva Empresa*, *Eur. Bus. Org. L. Rev. (EBOR)* 5 (2004), 449 et seq., on private company law reform in Spain, and *Ventoruzzo*, Experiments in Comparative Corporate Law: The Recent Italian Reform and The Dubious Virtues of a Market for Rules in the Absence of Effective Regulatory Competition, *Tex. Int'l. L. J.* 40 (2004), 113 et seq., on corporate law reform in Italy.

might address the problems of regulatory competition which political economy analysis has found to exist²³). A section on the perspectives for private company law reform in Europe concludes.

II. Regulatory Competition as Defined by the European Court of Justice

1. Basics

Company mobility has both, entry and exit aspects. Under artt. 43, 48 of the EC Treaty companies duly established under the laws of one Member State have an actionable right to move freely within the EU (and to invest wherever they please). In determining the scope of the freedom of establishment from an entry perspective, the ECJ has attacked private international law rules and unduly restrictive creditor protection rules²⁴). A non-domestic European company may not be denied access to justice for the sole fact that it has been incorporated under the laws of another Member State. Creditor protection is a valid purpose of Member State company laws. But the commencement of business activities may not be conditioned upon the deposit of funds to satisfy potential creditor claims. Moreover, it is illegal to impose specific liability rules on the director of a non-domestic company which is no longer operative in its country of incorporation. Pseudo-foreign companies are part and parcel of corporate Europe²⁵): Absent fraud, it is a legitimate aim of corporate planning to circumvent the restrictive laws of one Member State and resort to the more liberal company law regime of another²⁶). This includes the freedom to demonstrate mobility by consummating a cross-border merger²⁷).

The ECJ's holdings intuitively invoke an informational model that balances the interests of companies against those of creditors and employees²⁸): The Member State may

23. *Tjong*, Breaking the Spell of Regulatory Competition: Reframing the Problem of Exit (2000), p. 25 et seq. (available at http://papers.ssrn.com/paper.taf?abstract_id=267744); cf. *Kerber*, Interjurisdictional Competition within the European Union, *Fordham Int'l. L. J.* 23 (2000), 217 (at p. 246 et seq.).
24. ECJ judgments of March 9, 1999, Case N^o. C-221/97, *Centros Ltd. v. Erhvervs- og Selskabstyrelsen*, [1999] E.C.R. I-1459; May 11, 2002, Case N^o. C-208/00, *Überseering B.V. v. Nordic Construction Company Baumanagement GmbH (NCC)*, [2002] E.C.R. I-9919 et seq.; September 30, 2003, Case N^o. C-167/01, *Kamer van Koophandel en Fabrieken v. Inspire Art Ltd.*; and *SEVIC*, infra N. 27.
25. US experience with pseudo-foreign corporations highlights the potential for debate from a public policy perspective: cf. *Latty*, Pseudo-foreign Corporations, *Yale L. J.* 65 (1955), 137 (148 et seq.); *Greenwood*, Democracy and Delaware: The Mysterious Race to the Bottom/Top, *Yale L. & Pol'y. Rev.* 23 (2005), 381 (386).
26. See para. 95 et seq. of the ECJ's judgment of September 30, 2003, Case N^o. C-167/01, *Kamer van Koophandel en Fabrieken v. Inspire Art Ltd.*, "... *The reasons for which a company chooses to be formed in a particular Member State are, save in the case of fraud, irrelevant with regard to application of the rules on freedom of establishment... (T)he fact that the company was formed in a particular Member State for the sole purpose of enjoying the benefit of a more favourable legislation does not constitute abuse even if that company conducts its activities entirely or mainly in that second State ...*".
27. ECJ Judgment of December 13, 2005, Case N^o. C-411/03, *SEVIC Systems AG*, [2005] ECR I-10805 et seq.; Case Note by *Behrens*, *CMLR* 43 (2006) 1669 et seq.; see also the Directive of the European Parliament and of the Council on cross-border mergers of limited liability companies, O.J. L 310 of December 13, 2005.
28. Cf. *Eidenmüller*, in: *Eidenmüller* (ed.), *Ausländische Kapitalgesellschaften im deutschen Recht* (2004), § 3, 32; *Grundmann*, *Ausbau des Informationsmodells im Europäischen Gesellschaftsrecht*, *Deutsches Steuerrecht* 2004, 232 (235 et seq.).

limit the freedom of establishment of non-domestic companies for public policy reasons, but must observe the principles of proportionality and non-discrimination. As long as there is enough information on the market, restrictions on company mobility are unacceptable²⁹). This puts some confidence in creditors' abilities in dealing with a non-domestic company. It also instructs (national and EU) lawmakers to analyse cost internalisation aspects of cross-border mobility and regulatory arbitrage³⁰). Ideally, investors would prefer to establish a company under the least onerous jurisdiction and then relocate to the Member State with the most attractive business climate. This assumes an optimal mix of freedom of contract in the incorporation state and of a non-discriminatory approach in the host country. A closer reading of the case law demonstrates that the European judges have always been mindful not to overstretch the integrationist thrust of their holdings on company mobility³¹). In fact, tax law and fiscal considerations have put a major block on the road to the freedom of establishment. In the *Daily Mail*³²) case the ECJ upheld a British law imposing a direct tax burden on a company which intended to move its corporate head-offices to another Member State. Since then, no cases on the tax liability of limited companies with relocation plans have come up to the ECJ. There is, however, some indication that the European judges might be inclined to reconsider their stance on tax-related aspects of company mobility in the EU³³). The X and Y and de Lasteyrie du Saillant cases³⁴) involve tax liabilities of individuals who held shares of European multinational companies. Obviously, the current state of Member State tax law makes it rather difficult for listed corporations to relocate freely within the EU. On the other hand, private companies have succeeded in

29. See the ECJ's reasoning in para. 36 of its judgment of March 9, 1999, Case N^o.C-221/97, *Centros Ltd. v. Erhvervs- og Selskabsstyrelsen*, [1999] E.C.R. I-1459 (1495): "*Since the company concerned in the main proceedings [in Denmark] holds itself out as a company governed by the law of England and Wales and not as a company governed by Danish law, its creditors are on notice that it is governed by laws different from those which govern the formation of private limited companies in Denmark and they can refer to certain rules of Community law which protect them such as the Fourth Council Directive ... on the annual accounts of certain companies ... and the Eleventh Council Directive ... concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State*".
30. Cf. *Ulen*, Economic and Public-Choice Forces in Federalism, *George Mason L. Rev.* 6 (1998), 921 (926 et seq.) (1998); and *Trachtman*, supra N. 17, *Harv. J. Int'l. L.* 34 (1993), 47 (65 et seq.); *id.*, Economic Analysis of Prescriptive Jurisdiction, *Va. J. Int'l. L.* 42 (2001), 1 (74), addressing safeguards against externalization in a European context. This includes the risks of a restrictive regime forcing firms to withdraw business and assets from a Member State: cf. *Ribstein*, supra N. 1, *Wake Forest L. Rev.* 40 (2005), 751 (788).
31. Moreover, the private international law implications of the ECJ's jurisprudence on company mobility are from clear: see *Mansel*, Anerkennung als Grundprinzip des Europäischen Rechtsraums – Zur Herausbildung eines europäischen Anerkennungs-Kollisionsrechts: Anerkennung statt Verweisung als neues Strukturprinzip des Europäischen internationalen Privatrechts?, *Rabels' 70* (2006), 651 (at p. 672 et seq.); *Schön*, Playing Different Games? Regulatory Competition in Tax and Company Law Compared, *Com. Mkt. L. Rev.* 42 (2005), 331 (355); *Charny*, Competition Among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the "Race to the Bottom" in the European Communities, *Harv. Int'l. L. J.* 32 (1991), 423 (454 et seq.).
32. ECJ judgment of September 27, 1988, Case N^o. 81/87, *The Queen v. H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc.*, [1988] E.C.R. 5483.
33. See the detailed analysis by *Burwitz*, Tax Consequences of the Migration of Companies: A Practitioner's Perspective, *European Business Organization Law Review (EBOR)* 7 (2006), 589 (at p. 596 et seq.).
34. ECJ judgments of November 21, 2002, Case N^o. C-436/00, *X and Y v. Rijksskatteverk*; March 11, 2004, Case N^o. C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*. See also judgment of March 6, 2007, Case N^o. C-292/04, *Meilicke, Weyde and Stöffler v. Finanzamt Bonn-Innenstadt*.

avoiding tax-related barriers to exiting from their country of incorporation. Investors frequently opt for an English private limited company, continue to have it registered in the United Kingdom (UK) and organise their activities from head offices on the European continent³⁵. There is no taxable income in the UK, but the shareholders may reap the benefits of English company law which they prefer to its continental counterparts³⁶.

2. Policy Implications

Regulatory competition gives rise to rather complex cost internalisation problems. Admittedly, companies operating within the EU may internalise the costs of their relocation decision by warning creditors that they might be exposed to a non-domestic corporate liability regime. But this micro-economic perspective tends to overlook to what extent the host state has the potential to accommodate the consequences of company mobility³⁷. It is matter of political controversy whether cost internalisation problems indicate market failure to be addressed by harmonised EU legislative action³⁸. The ECJ has implicitly acknowledged that regulatory competition does not come without risk. The Member States are required to recognise non-domestic companies, but may restrict their mobility for imperative reasons of public interest³⁹. Nonetheless, a Member State is bound to refrain from acting in an arbitrary manner which would be tantamount to an outright negation of the freedom of establishment⁴⁰. The ECJ cites to creditor and employees' rights as legitimate cases for unilateral action. This caveat might be thought to pay tribute to the debate of subsidiarity between the EU and the Member States. The Court, however, refers to a problem of great importance in the day-to-day business of European integration. Non-domestic companies which have been established under different governance and liability rules are bound to cause frictions with the established rules of the host Member State which are currently challenged on case-by-case basis⁴¹.

35. It is estimated that some 30,000 Private Limited Companies have now moved their headquarters to Germany: *Westhoff*, *Die Verbreitung der limited mit Sitz in Deutschland*, *GmbH-Rundschau* 97, 525 (528) (2006); *Becht/Mayer/Wagner*, supra N. 3; *Rajak*, supra N. 21, EWS 2005, 539 et seq.

36. The same holds true for Private Limited Companies which are established in off-shore centres such as the British Virgin Islands or the Cayman Islands. The provisions of the EC Treaty on the freedom of establishment are equally applicable to these companies.

37. Cf. *Tjong*, supra N. 23, at p. 25 et seq., and *Ventoruzzo*, supra N. 3, at p. 34.

38. Cf. *Pistor/Xu*, *Incomplete Law*, N. Y. U. J. Int'l. L. & Pol. 35 (2003), 931 (962); *Gerardin/McCahery*, *Regulatory co-opetition: transcending the regulatory competition debate*, in: *Jordana/Levi-Faur* (eds.), *The Politics of Regulation* (2004), 90 (99 et seq.). On the broader implications see: *Drury*, *The European Private Company*, Paper submitted for the Public Hearing by the European Parliament Committee on Legal Affairs (June 22, 2006); *Eidenmüller*, *Free Choice in International Corporate Law: European and German Corporate Law in European Competition between Corporate Law Systems*, in: *Basedow/Kono* (eds.), *Economic Analysis of Private International Law* (2006); *Schön*, *Mindestharmonisierung im europäischen Gesellschaftsrecht*, *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht* 160 (1996), 221 et seq. A public policy assessment is undertaken by: *Deakin*, *Eur. L. J.* 12, 440 et seq. (2006); *van den Bergh*, *Towards an Institutional Legal Framework for Regulatory Competition in Europe*, *KYKLOS* 53 (2000), 435 et seq.

39. ECJ judgment of November 30, 1995, Case N^o. C-55/94, *Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*, [1995] I-4165 et seq.

40. See *Armour*, *Who Should Make Corporate Law?*, supra, N.; at p.13 et seq., analysing, *inter alia*, barriers to the entry of 'start-up' companies; and *Rehm*, in: *Eidenmüller* (supra, N. 28), § 2, para. 39 et seq.

Legal certainty and creditor protection are legitimate objects of national regulatory policies and do not establish a *per se* case of protectionism. As the ECJ proscribes national measures which raise the cost of relocating within the EU, national rules on statutory minimum capital and capital maintenance are problematic⁴². They are not illegal in a purely domestic context, may however, put national companies at a competitive disadvantage with respect to other competitors from the EU. Conversely, insolvency law concepts predicated upon the existence of rules on minimum capital pose problems⁴³: It is difficult to defend a system of *ex ante* capital maintenance rules against competitors who have been established under an *ex post* approach towards creditor protection⁴⁴. Company mobility challenges national judges as they apply private international law rules, addressing conflicts between diverging concepts of company and insolvency laws. The ECJ's jurisprudence is also a test for national lawmakers how to strike the balance between a mandatory and an enabling corporate law regime.

In the following, national laws on private companies will be evaluated in order to scrutinise how external competitive pressures are accommodated. It will then be analysed how German courts handle conflicts which arise English and German concepts of company law and creditor protection clash due to company mobility in the EU.

III. Private Companies in Europe

1. The United Kingdom

a. The Private Limited Company

English 19th century company law did not make a distinction between private and public companies⁴⁵. Victorian legislative politics attempted to relegate businesses of small numbers of people to partnerships, but ultimately failed⁴⁶. Private companies became in-

41. Frictions between various national company and insolvency law systems translate into problems of private international law, but they do also have implications for the law of substance: *Rehm*, in: Eidenmüller (supra N. 28), § 2 para. 44 et seq.
42. The majority of German commentators makes an implicit cost argument by explaining that, in deference to the ECJ, the national law of the country of incorporation should apply: *Rönnau*, Haftung der Direktoren einer in Deutschland ansässigen englischen *Private Company Limited by Shares* nach deutschem Strafrecht – eine erste Annäherung, *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 2006, 832 (834); *Forsthoff/Schulz*, Gläubigerschutz bei EU-Auslandsgesellschaften, in: Hirte/Bücker (eds.), *Grenzüberschreitende Kapitalgesellschaften – Praxishandbuch für ausländische Kapitalgesellschaften mit Sitz im Inland* (2005), § 15, 1; cf. *Sandrock*, Sitzrecht contra Savigny? – Zum angeblichen Chaos im internationalen Gesellschaftsrecht, *Betriebs-Berater* 2004, 897 (899 et seq.).
43. Cf. *Fischer*, Die Verlagerung des Gläubigerschutzes vom Gesellschafts- in das Insolvenzrecht nach "Inspire Art", *Zeitschrift für Wirtschaftsrecht (ZIP)* 2004, 1477 (1478); *Goette*, Deutsches Steuerrecht 2005, 197 (198); *id.*, *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 2005, 261 (263 et seq.); *Fleischer*, *Deutsches Steuerrecht* 2000, 1015 (1016 et seq.).
44. *Engert*, Solvenzanforderungen als gesetzliche Ausschüttungssperren bei Kapitalgesellschaften, *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht* 170 (2006), 298 (318), offers a realistic explanation why the current system of statutory minimum capital and capital maintenance does not cause too much havoc in the business community: Companies have chosen relatively low levels of minimum capital and there are largely accepted possibilities to circumvent the current regime of capital maintenance.
45. *Davies, Gower and Davies' Principles of Modern Company Law* (7th ed., 2003), p. 3 et seq.; *Prime/Scanlan*, *The Law of Private Limited Companies* (1996), p. 6 et seq.; cf. *Fox & Bowen*, *On the Law of Private Companies* (2nd ed. 1995), p. 11 et seq.

creasingly popular after the House of Lords had recognised the choice of small numbers of people to organise their business in a corporate form⁴⁷): Converting a privately-owned business into a small private company with limited liability is not illegal *per se*⁴⁸). But important differences in the governance structure of public and private companies remain.

aa. A Lighter Regulatory Approach under the Companies Act of 2006⁴⁹)

Under section 4 (1) of the 2006 Companies Act⁵⁰) registered limited companies which do not fulfil the statutory requirements for public limited companies, are by inference private limited companies. Private limited companies may either register as companies limited by shares or a legal entities limited by guarantee. Part 20 of the 2006 Companies Act makes it illegal for private limited companies to offer to the public any securities of the company, or to allot or to agree to allot any securities of the company with a view to their offering to the public. Private limited companies are not subject to a statutory minimum capital requirement⁵¹). If a private limited company is limited by shares, the memorandum of association has to specify the contributions the shareholders will make. There is, however, no statutory duty to pay in the full amount of the authorised capital. Section 643 of the 2006 Companies Act provides for simplified statutory mechanism for reducing the company's capital: The capital of the private company may be reduced if such announcement is accompanied by the director's statement on solvency⁵²). If a private company is limited by guarantee, the commencement of business activities does not depend on shareholders making an immediate financial contribution. The immediate shareholder liability is limited by the amount he has undertaken to contribute in the event the company is wound up. Under these circumstances borrowing plays an important role in initiating business activities of private limited companies. Debentures are issued which entitle banks or third-party investors to guaranteed returns on their loan⁵³).

In structuring its financial dealings, a private limited company enjoys substantial advantages over a public company. In order to recover loans given to its own shareholders,

46. *Davies*, in Gower and Davies (supra N. 45), p. 5.

47. *Salomon v. Salomon & Co. Ltd.*, [1897] A.C. 22 (HL); cf. *In re British Seamless Paper Box Co.*, (1881) L.R. 17 Ch. D. 467.

48. *Salomon v. Salomon & Co. Ltd.*, [1897] A.C. 22 (HL) (per Lord Herschell, at p. 43 et seq.).

49. It is one of the major goals of the Companies Act of 2006 to apply a 'lighter' regulatory approach to private limited companies: cf. House of Commons Library Research Paper 06/30 (June 2, 2006), *The Company Law Reform Bill [HL]*, Bill 190 2005 – 2006, p. 16 et seq.; *Henning*, *The Company Law Reform Bill, Small Businesses and Private Companies*, Comp. L. 2006 (27) (4), 97 et seq.; Sheikh, *Company Law Reform*, I.C.C.L.R. 2006 (17), 13 (p. 18 et seq.), 96 (p. 101 et seq.) (on the "Think Small First Approach"); *Jänig*, *Die Company Law Reform Bill: Zur Reform des Gesellschaftsrechts im Vereinigten Königreich, Recht der Internationalen Wirtschaft 2006*, 270 (271); *passim Torwege*, *UK Companies Act 2006 – (Almost entirely) Enacted!*, *GmbH-Rundschau 2007*, 195.

50. *Companies Act 2006* (2006 chapter 46).

51. The current statutory minimum capital for public companies is at £ 50, 000.

52. The solvency statement can only issue if supported by *all* directors. If one director disagrees, a new solvency statement may only be prepared after the dissenter's resignation from office.

53. Research undertaken in the United Kingdom reveals that small businesses rely initially on internal funds for operating and investment purposes. Bank credits provide additional funding to these businesses, whereas investors in high-risk ventures would normally demand significant equity participation in return (*Finch*, *Corporate Insolvency Law – Perspectives and Principles* (2002), p. 69 et seq.). It would seem that, in providing the necessary funds for start-ups, investors get an opportunity to scrutinise the viability of a project-oriented private limited company.

the private limited company may award itself wider charges. When dividends are distributed no provision need be made for unrealised capital. There is greater leeway for directors in their financial dealings with the company, and assistance may be provided for the (re)purchase of the company's own shares⁵⁴). To a certain degree, established principles of transparency on capital markets may be disregarded: The true ownership of private company shares may be shielded against public interest, however substantial the holding.

The 2006 Company Act attempts to further deregulate the law on private limited companies. The Act introduces the company's constitution which has to be filed with the Company Registrar whereas the articles of association shall henceforth contain only stipulations on the internal proceedings. A private limited company must have one director, but under the new 2006 rules, the company is no longer required to have a secretary. The director shall act in accordance with the traditional duties of care, but in case of doubt, the company's constitution shall be controlling. Thus, the director may authorise conflicts of interests that would otherwise constitute a breach of duty towards the company. Directors may also allot new shares. Decisions of the shareholders may be taken by using a written procedure. The members of the company are required to appoint an auditor. The company is subject to the regular accounting rules⁵⁵).

English law on private companies refrains from imposing strict capital maintenance rules comparable to those applicable under German law⁵⁶). Instead, a more flexible approach prevails. The Insolvency Act of 1986 takes an *ex post* approach towards companies facing insolvency⁵⁷). Company directors are encouraged to undertake rescue attempts, only to put their company into liquidation when there is no reasonable hope of saving it⁵⁸). When a company has gone insolvent into liquidation, a case of wrongful trading lies, if the director, prior to liquidation, had known or ought to have known that there was no hope for going on, and had taken insufficient steps to minimise the potential loss⁵⁹). A wrongful trading claim against the insolvent company's director is a collective one. It can only be

54. *Morse*, in: Charlesworth's Company Law (17th ed. 2005), at p. 182 et seq.

55. Cf. *Just*, Die englische Limited in der Praxis (2005), p. 60 et seq.

56. See *infra.*, sub III.4.

57. See section 214 of the British Insolvency Act of 1986 (Wrongful trading):

- (1) *Subject to subsection (3) below, if in the course of the winding up of a company it appears that subsection (2) of this section applies in relation to a person whom is or has been a director of the company, the court, on the application of the liquidator, may declare that that person is liable to make such contribution (if any) to the company assets as the court thinks proper.*
- (2) *this subsection applies in relation to a person if –*
 - (a) *the company has gone into insolvent liquidation,*
 - (b) *at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and*
 - (c) *that person was a director of the company at that time; ...*
- (3) *The court shall not make a declaration under this section with respect to any person if it is satisfied that after the condition specified in subsection (2)(b) was first satisfied in relation to him that person took every step with a view to minimizing the potential loss to the company's creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken. ...*
- (7) *In this section 'director' includes a shadow director.*

58. See on directors' liability for wrongful trading in the context of private limited liability companies: Cf. *Rajak*, The English Limited Company as an Alternative Legal Form for German Enterprise, EWS 2005, 539 (542 et seq.).

pursued by the liquidator, hoping to add further funding to the distributable asset. Such a claim does not exist when there are no distributable assets and the company is struck off the register without liquidation proceedings. In applying common law principles courts have further buttressed the *ex post* approach towards rule-making. Returns of capital are unlawful if the payout of funds exceeds the distributable profits or sales under value. Common law principles in non-UK jurisdictions might further clarify the duties UK directors owe towards creditors in the vicinity of insolvency.

bb. Investor Preferences

Private limited companies have severe governance problems. Minority shareholders are liable to majority oppression and selling shares is not a viable alternative⁶⁰. Nonetheless, private limited companies are highly attractive to English and non-English investors. Private limited companies are quick and relatively cheap to establish, there is no statute law on capital. Venture capital funds rely on private limited companies as important investment vehicles, bringing forth elaborate governance structures by private ordering. But English private limited companies have also come to be perceived as an inexpensive device for setting up businesses in continental Europe. Under English private international law rules the nationality of a corporation is determined by the country of its incorporation⁶¹. A company registered in England under the Companies Act is regarded as present, and documents may be served on the company by sending these to the company's registered office⁶². A private limited company will not lose its English 'citizenship' as long as it remains incorporated in the United Kingdom. In fact, the ECJ's disapproval of outright hostility towards pseudo-foreign corporations mandates that English corporate law will be applied to these companies even if they do not have any business activities in the United Kingdom. In this context, 'company mobility' is evidenced by relocating the company headquarters to continental Europe while remaining formally incorporated in the United Kingdom. German investors increasingly rely on English private limited companies in order to escape the mandatory rules of the German law on the *Gesellschaft mit beschränkter Haftung* (GmbH) which are perceived as being too burdensome⁶³.

59. *Davies*, in: Gower and Davies, supra N. 45, 198 et seq.; *id.*, *Davies*, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency, *Eur. Bus. Org. L. Rev. (EBOR)* 7, 301 (310) (316 et seq.) (2006); *Finch*, supra N. 53, 413 et seq.; *Morse*, in Chatsworth's *Company Law*, supra N. 54, 317 et seq.

60. This assessment does not include the capital market aspects of private companies. In venture capital financing investors prefer a clear separation of ownership and control (cf. *Callison*, supra N. 2; see also *Hansmann/Kraakman/Squire*, *Law and the Rise of the Firm*, *Harv. L. Rev.* 116 (2006), 1333 (at p. 1343 et seq.), on the benefits of entity shielding).

61. *North/Fawcett*, *Cheshire and North's Private International Law* (13th ed. 1999), 289.

62. Cf. section 725 (1) of the 1985 Companies Act.

63. It is estimated that some 30,000 Private Limited Companies have now moved their headquarters to Germany: *Westhoff*, *Die Verbreitung der limited mit Sitz in Deutschland*, *GmbH-Rundschau* 97 (2006), 525 (528); *Becht/Mayer/Wagner*, *Corporate Mobility Comes To Europe: The Evidence*, Working Paper, Université Libre de Bruxelles/Saïd Business School, Oxford University (October 2005).

b. The Limited Liability Partnership

Traditional partnership law has been not able to shield partners against voluminous claims for professional negligence⁶⁴). The Limited Liability Partnerships Act of 2000⁶⁵) offers a new corporate form to businessmen and professionals who want to limit their risk of exposure to litigation⁶⁶). It is also attempts to stave off regulatory competition from the US and Jersey⁶⁷), accommodating demands for a more appropriate form of business organisation for venture capital financing⁶⁸).

A limited liability partnership combines rules on external corporate governance with a great amount of freedom of contract in internal matters. It constitutes an independent body corporate which acts as a contracting party and alone is liable for its debts⁶⁹). Like shareholders of a company the members have to make a financial contribution. But any personal liability for debts incurred by the limited liability partnership will be limited the amount of members' financial interests. The limited liability company is not required to have a director. Instead, the partners decide for themselves on the internal governance structure and may play an active role in the day-to-day business of their corporate entity. This creates a hybrid between traditional partnerships and private limited liability companies⁷⁰). It has been suggested that this internal governance structure is most appropriate for venture capital financing⁷¹), as the statutory pattern offers an incentive to negotiate freely for internal governance structures in the best interest of the partner-investors.

Nonetheless, there are significant drawbacks in the statutory concept of the 2000 Limited Liability Partnerships Act⁷²). The statute offers default rules which still have to meet a sustained practicability test⁷³). Moreover, it remains to be seen how the courts will succeed in integrating the statutory scheme in traditional concepts of partnership and company law. There is a certain risk that the courts may expose a member which plays a very active role in the governance of the limited liability company to personal liability⁷⁴).

64. *Blackett-Ord*, Partnership – The modern law of partnership, limited partnership and limited liability partnership (2nd ed. 2002), § 21.1.

65. Limited Liability Partnerships Act 2000 (2000 chapter 12).

66. *Bötger*, Mitwirkungs- und Kontrollrechte des englischen Limited Partners im Rahmen der Reform des englischen Partnership Law, *Jenaer Studien zum deutschen, europäischen und internationalen Wirtschaftsrecht* 7 (2006), 51.

67. Cf. *Morse*, Partnership for the 21st Century? – Limited Liability Partnerships and Partnership Law Reform in the United Kingdom, *Singapore J. Leg. Stud.* 2002, 455 (at p. 462 et seq.), on the legislative history of the statute.

68. *McCahery/Vermeulen*, Limited Partnership Reform in the United Kingdom: A Competitive, Venture Capital Oriented Business Form, *Tilburg University, TILEC Discussion Paper DP 2004-024* (2004), 24.

69. On the statutory details cf. *Morse*, *Partnership Law* (6th ed., 2006), p. 294 et seq.

70. Cf. *Morse* (supra N. 67), *Singapore Leg. Stud.* 2002, 455 (at p. 465).

71. Cf. the analysis undertaken by the British Financial Services Authority (FSA), in: FSA, *Private equity*, supra N. 4.

72. *McCahery/Vermeulen* (supra N. 68), at p.25 et seq.

73. *Morse* (supra N. 67), *Singapore J. Leg. Stud.* 2002, 455 (at p. 466 et seq.).

74. *Morse*, *Partnership Law* (supra N. 69), p. 296.

2. Company Law Reform in the Netherlands – Modernising the Besloten Venootschap (B.V.)

The Dutch 1971 statute on private companies owes its existence to developments in European Law⁷⁵). After the European Community had adopted the First Company Law Directive⁷⁶) listed corporations were required to publish their financial statements. As a reaction the Dutch legislator sought for a business organisation which would be exempt from European regulatory efforts on disclosure, but would nonetheless fit into the established set of Dutch company law principles on bodies corporate. The 1971 statute is therefore not instructed by a deregulatory philosophy. Instead, the intellectual underpinnings of the B.V. are grounded in the law on public corporations. In envisaging a limited number of shareholders the 1971 law imposed a mandatory minimum capital and capital maintenance rules. Shareholders were not allowed to contract out of the statutory regime in order to tailor an internal organisation according to the needs of their own business. Dutch law provided almost no incentives for private ordering under the domestic legal order⁷⁷).

The jurisprudence on the ECJ on company mobility has sounded the death-knell for statutory rigidity on private ordering in B.V.'s. The Dutch Ministry of Justice appointed an expert commission which recommended substantial amendments to the current statute, opting for minimum of mandatory rules. The export proposal makes a plea for shareholder freedom to determine the internal structure of the corporation⁷⁸). But it does not opt for the US or English approaches of adding new corporate entities to the menu of business organisations currently available under statute law. Instead, an attempt is made to deregulate the existing rules on B.V.'s while maintaining the dogmatic structure of company law. In short, the expert group vows to combine freedom of contract and creditor protection with a policy response to the challenges of regulatory competition in the European Union. In what looks like a convergence on the English Private Limited Company, the current legislative proposal pledges to abolish the minimum capital requirement⁷⁹). This has far-reaching consequences for established concepts of corporate finance and insolvency law. In order to ascertain whether distributions to shareholders are feasible the law is intended to introduce net asset and liquidity tests⁸⁰). Board members may be held liable to reimburse the company funds if insolvency occurs as a consequence of such a distribution. Moreover, shareholders will be required to return their dividends if the company becomes insolvent in less than one year after the distribution. This is an approach hardly to be reconciled with economic analysis. Current corporation law and economics analysis suggests that adjusting (i.e. volun-

75. See the account by *Kroeze*, Flexibility and Function of Private Company Law Statutes, Eur. Bus. Org. L. Rev. (EBOR) 8(2007) (forthcoming).

76. First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, O.J. L 65 of March 14, 1968.

77. *Kroeze*, supra N. 75.

78. *De Kluijver*, Private Ordering and Buy-Out Remedies within Company Law: Towards a New Balance between Fairness and Welfare?, Eur. Bus. Org. L. Rev. (EBOR) 8(2007) (forthcoming).

79. For a detailed analysis see: *Lennarts*, Directors' and Shareholders' Liability as a Means of Protecting Creditors of the B.V., Eur. Bus. Org. L. Rev. (EBOR), 8 (2007) (forthcoming).

80. *Lennarts*, supra N. 79.

tary) creditors can safeguard their interests by private ordering. Non-adjusting (i.e. tort) creditors should be protected by insurance, unless they are free-riding on the contractual efforts by their adjusting counterparts. The current proposal adopts a comprehensive protective approach irrespective of whether the adjusting creditors may have been able to stipulate for protection. Apparently, director liability is intended to compensate for the perceived effects of abolishing statutory minimum capital. Liability is triggered whenever a director at the time of distribution knows that the company, after distribution would be unable to meet its financial obligations. The draft statute builds on a rebuttable assumption that the board knew, but an individual director may exonerate himself that he does not any personal responsibility for the decision to distribute dividends. It is as yet unclear whether this provision is intended to introduce English standards on wrongful trading into Dutch company law.

Although private companies are generally known to be a problematic environment for minority shareholders, most statutes do not provide for a right of exit. Minority shareholders stand to suffer considerable financial losses if they attempt to bargain for a negotiated exit. The current Dutch draft proposal pledges to bring capital market standards to close companies⁸¹). In what appears to be a *non sequitur* a buy-out remedy is suggested as freedom of contract comes to private companies. In this context, it is assumed that minority shareholders will not be able to negotiate *ex ante* for an adequate compensation should they later decide to sell their participation to their fellow-shareholders. Under the envisaged amendments to the statute a minority shareholder oppressed by the majority may apply for a court order mandating the company to buy back the shares. Currently, there is a debate on whether fairness dictates that comparable provision are warranted if the minority shareholders decides to part with 'his' company because he has become aware of better business opportunities elsewhere⁸²).

3. The French *Société par actions simplifiée* (SAS)

The 1994 law on the SAS marks the first addition to the French menu of corporate choices since 1925⁸³). It is a legislative reaction both to competitive pressures from the Dutch B.V. and to growing domestic demands for greater freedom of contract for companies limited by shares⁸⁴). Under the French corporation statute the SAS is a body corporate which parts with the traditional rigidity of mandatory rules on the organizational structure of listed corporations. Instead, its members enjoy a considerable amount of freedom of contract to devise the optimal governance scheme. The shares of the SAS are not traded at a stock exchange. It may not raise capital by issuing new shares to the capital market.

When the SAS was introduced in 1994, it had to meet rather restrictive capital requirements. Similar to other continental European jurisdictions, a statutory minimum capital requirement was imposed which is currently at € 37,000. Moreover, the SAS was only

81. Cf. *de Kluiver*, supra N. 78

82. *De Kluiver*, *ibid.*

83. *Périn*, SAS – La société par action simplifiée, *Études – Formules* (2005), p. 3 et seq.

84. Cf. *Périn*, supra N. 83, at p. 18 et seq.; *Hirschmann*, *Neue Gestaltungsfreiheit im französischen Gesellschaftsrecht: Die Société par actions simplifiée (SAS)* (2001), p. 24 et seq.

open to corporate shareholders which as a group disposed of an aggregated minimum capital of at least € 225,000. Under these circumstances the SAS played an important role for strategic planning within corporate groups⁸⁵⁾. The 2001/2003 corporate law reforms have opened the SAS to non-corporate investors⁸⁶⁾. The aggregated minimum capital requirement for shareholders has been dropped whereas the statutory minimum capital of € 37,000 has been upheld. At the same, the French legislator paved the way for listed corporations to transform into an SAS⁸⁷⁾. As of July 2005, the total number of SAS's had surpassed those of listed corporations, second only to the French equivalent of the German GmbH, the Société à responsabilité limitée (Sàrl)⁸⁸⁾. In fact, the SAS has become a viable alternative for those businessmen who feel uneasy about the increased disclosure requirements now applicable to listed corporations. The directors of the SAS are under no duty to disclose their income, their membership on the board of other companies or to have the annual consolidated statement approved⁸⁹⁾.

Contrary to listed and other public corporations the shareholders are free to tailor a corporate organization to their needs⁹⁰⁾. The SAS has to be represented by a president, but the internal decision-making processes may be confided to a chief executive officer or a managing board of directors which, if the shareholders so elect, is subject to the scrutiny of a supervisory board or ad hoc committees. The optional structure of the statute allows for a considerable amount of shareholder participation in the day-to-day business of the SAS⁹¹⁾. On the other hand, the current SAS appears to be only workable if the shareholder act in great unanimity⁹²⁾. This, in turn, requires careful drafting of the corporate charter of the SAS. With some justification it has been suggested that the contractual freedom of the shareholder is predicated on their willingness to incur transaction costs⁹³⁾. From the point of view of regulatory competition the SAS has fared relatively well in comparison with the pre-modernisation Dutch B.V. and the German GmbH⁹⁴⁾, but still falls behind the liberal scheme of the English Private Limited Company⁹⁵⁾.

85. *Hirschmann*, supra N. 84, at p. 25.

86. *Guyon*, *Les sociétés – Aménagements statutaires et conventions entre associés* (5th ed., 2002), at p. 125.

87. *Le Camu*, *Droit des sociétés* (2nd ed., 2003), at p. 599 et seq.

88. As of July 31, 2005, there were 89,667 SAS's, 88,289 public corporations (Société anonyme – S.A.) and 1,060 667 Sàrl's: *Périn*, supra N. 83, at p. 4.

89. *Guyon*, supra N. 86, p. 126.

90. *Le Camu*, supra N. 87, at p. 603 et seq.; *Couret*, *La société par actions simplifiée comme forme alternative entre la société anonyme et la société à responsabilité limitée*, in: *Chambre de Commerce et d'Industrie de Paris/Centre de Recherches sur le Droit des Affaires, Les petites et moyennes entreprises et les réformes du droit des sociétés dans l'Union européenne*, Madrid, February 4/5, 2004.

91. *Le Camu*, supra N. 87, at p. 606 et seq.

92. Cf. *Masquelier/Simon de Kergunic*, *Société par actions simplifiée (SAS) – Création, Gestion, Évolution* (2000), p. 129 et seq.; *Périn*, p. 173 et seq.; *Charvériat/Couret*, *Société par actions simplifiée – Nouveaux atouts après la loi "Nouvelles réglementations économiques"*, *Juridique, fiscal, social*, Éditions Francis Lefebvre (3rd ed., 2001), p. 195 et seq.

93. *Périn*, supra N. 83, at p. 13.

94. See *infra*, sub III.4.

95. *Périn*, at p. 19.

3. The German Gesellschaft mit beschränkter Haftung (GmbH) Exposed to Competition

a. Statutory Basics

Private companies organised as limited liability companies (GmbH's) are the most prevalent form of business organisation in Germany⁹⁶. The 1892 law on limited liability companies (GmbH-Gesetz) was designed to address the financial needs of enterprises where only a limited group of shareholders would be prepared to make an investment⁹⁷: The official report on the 1892 law emphasises the personal ties among shareholders. Shareholders of limited liability companies were thought to be more willing to inject additional funds should business necessities so dictate⁹⁸. The stock of a GmbH (*Geschäftsanteile*) is not listed at stock exchanges, but is otherwise freely tradable. Nonetheless, the German GmbH has been quite remote from traditional capital market influences⁹⁹. The legislative history of the 1892 law makes it clear that 'membership' (*Mitgliedschaft*) in a GmbH is expected to be of a long-term nature¹⁰⁰. Today, shareholder agreements restricting the transferability of stock are quite common¹⁰¹.

Like an English private limited company or a limited liability partnership the GmbH is a body corporate that can conclude contracts independent of its members. Its internal governance structure combines elements of close corporations with those of partnership law. A German GmbH must have a director (*Geschäftsführer*) who is responsible for organising business activities in accordance with the law. The director is under a duty to file for insolvency if he has reason to believe that the GmbH is heavily indebted or unable to honour its financial obligations. The members of the GmbH may, however, play an active role in the administration of the company as they are entitled to give instructions to the director. Compared to their English private company counterparts the founders of a GmbH still have to face rather burdensome procedures before the new corporate entity may commence business. In this, current German law betrays a strong penchant for protecting business partners and creditors against what appears to be perceived as potentially risky type of corporate organisation. The new GmbH may not register unless the relevant permits from the public authorities have been obtained. Moreover, the GmbH is subject to statutory rules on minimum capital and capital maintenance. The current minimum capital is at € 25,000,

96. *Lutter/Hommelhoff*, GmbH-Gesetz (16th ed. 2004), Einleitung para 1. et seq.

97. *Birkenbihl*, Das Reichsgesetz betreffend die Gesellschaften mit beschränkter Haftung vom 20. April 1892 (1893), at p. 9.

98. Quoted from *Birkenbihl*, supra N. 97, at p. 10.

99. Moreover, as dissolution is not readily available, minority shareholders may be trapped in a freeze-out situation engineered by the majority without any perspective of reclaiming the invested capital.

100. *Birkenbihl*, supra N. 97, at p. 104.

101. *Baumann/Reiß*, Satzungsergänzende Vereinbarungen – Nebenverträge im Gesellschaftsrecht, *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 1989, 157 (184); *Zöllner*, in *Henze/Timm/Westermann* (eds.), *RWS-Forum 8. Gesellschaftsrecht* (1996) 89 (93); *Noack*, *Gesellschaftervereinbarungen bei Kapitalgesellschaften* (1994), 282 et seq.; cf. *Lutter*, *Die Rechte und Pflichten des Vorstands bei der Übertragung vinkulierter Namensaktien, Die Aktiengesellschaft* 1992, 369 et seq.; *Reichert/Winter*, in: *Lutter/Ulmer/Zöllner* (Hrsg.), *Festschrift 100 Jahre GmbH-Gesetz* (1992), 209 (210 et seq.); *Hoffmann-Becking*, *Der Einfluß schuldrechtlicher Gesellschaftervereinbarungen auf die Rechtsbeziehungen in der Kapitalgesellschaft*, *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 1994, 442 (443).

half of which has to be paid in before a petition for registration may be filed¹⁰²). The statutory rules on minimum capital operate as mechanism for creditor protection both, from an *ex ante* and an *ex post* perspective. *Ex ante*, the rules on capital maintenance set framework under which the GmbH's director will have to decide whether to ask for additional shareholder funding or petition for insolvency. *Ex post*, capital maintenance rules clarify whether creditors may hold the GmbH's director personally liable for having delayed a petition for insolvency proceedings. In this context, a major difference between English and German rules on creditor protection in the vicinity of insolvency should be noted. Under the English rules on wrongful trading directors are invited to try to protect a going business firm as long as possible. German law, however, tends to emphasise the interests of creditors who had a business relationship with a faltering firm.

b. A Reform Project

After the ECJ has handed down its rulings on company mobility, the GmbH lost much of its traditional popularity with German investors¹⁰³). Business people have come to regard an English private limited company as a viable alternative towards German GmbH's¹⁰⁴). In June 2006, the Federal Ministry of Justice launched a company law reform project which is not openly defensive. One of the authors of the reform project confesses to the need of countering the competitive drive unleashed by the English private limited company¹⁰⁵). In this, the reform project steers a middle course between deregulation and the defence of the statutory mechanism on capital maintenance and creditor protection¹⁰⁶).

The reform project lowers the threshold for founding a GmbH to a statutory minimum capital of € 10,000: Under certain circumstances a GmbH may henceforth start trading as soon as € 5,000 have been paid into the company funds. The future GmbH will not be exonerated from obtaining the necessary permits from the public authorities, but trading may commence as soon as petitions for the relevant permits have been filed. Trading in shares of the GmbH will become more liberal. The reform project makes an important contribution to the private international law of companies. In clear reaction to the ECJ's jurisprudence on company law mobility, the project dispenses with the requirement that the

102. Each shareholder is mandated to pay in at least 25 pc of the nominal value of the total of shares he or she has signed up for.

103. *Niemeier*, GmbH und Limited im Markt der Unternehmensträger, Zeitschrift für Wirtschaftsrecht (ZIP) 2006, 2237 (at p. 2240 et seq.); *Wegen/Schlichte*, GmbH oder EU-inländische Gesellschaft – die Qual der Wahl für Unternehmer und Berater in der Praxis, Recht der Internationalen Wirtschaft (RIW) 2006, 801 (at p. 803).

104. It is interesting to note that, although Liechtenstein companies enjoy an EU-wide freedom of establishment under the Agreement on the European Economic Area, German investors appear to have shunned the various forms of business organisation which the liberal regime of the principality offers.

105. *Seibert*, GmbH-Reform: Der Referentenentwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Mißbräuchen – MoMiG, Zeitschrift für Wirtschaftsrecht (ZIP) 2006, 1157 (at p. 1158); *id.*, Closed Corporation – Reforming Company Law: European and International Perspectives, European Business Organization Law Review (EBOR) 8 (2007) (forthcoming).

106. Cf. *Schäfer*, Reform des GmbHG – viel Lärm um nichts?, Deutsches Steuerrecht 2006, 2085 et seq.; *Noack*, Reform des deutschen Kapitalgesellschaftsrechts: Das Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen, Der Betrieb 2006, 1475 et seq.; *Dierksmeier/Scharbert*, GmbH und englische Ltd. im Wettlauf der Reformen 2006, Betriebs-Berater 2006, 1517 et seq.; *Triebel/Otte*, Reform des GmbH-Rechts: MoMiG – ein vernünftiger Schritt zur Stärkung der GmbH im Wettbewerb oder Kompromiss auf halber Strecke?, Zeitschrift für Wirtschaftsrecht (ZIP), 2006, 1321 et seq.

head offices shall be located at the seat of the company as stipulated in the corporate charter. Arguably in corporate Europe, a German GmbH stands to become as much a pseudo-foreign corporation as English private limited liability companies, Dutch B.V.'s or a Liechtenstein body corporate.

The reform project is helpful in speeding up the registration process for newly founded companies. In the vicinity of insolvency, it clarifies the law on shareholder loans¹⁰⁷⁾ and it sharpens director responsibility in the context of dividends and other payments to shareholders. Regrettably, the reform proposal does not shed much light on the viability of the concept of capital maintenance after the statutory minimum has been lowered to an almost symbolic amount of € 10,000. The interdependence between capital maintenance and insolvency rules is defended. On the other hand, the reform project adds a token solvency test to the German law on private companies: The current wording of the proposal for a statutory provision on director liability for payments to shareholders introduces an element of foreseeability, mildly reminiscent of the Anglo-Saxon solvency test in the vicinity of insolvency¹⁰⁸⁾. But it is equally clear from the materials that the reform project is not intended to initiate a move from an *ex ante* to an *ex post* perspective in creditor protection. Although director duties in the vicinity of insolvency are fleshed out, the traditional function of capital maintenance rules as a device of creditor protection is upheld.

In the age of company mobility the reform project is almost too discreet about its private international law implications. The materials published with the reform project refrain from re-calibrating the relationship between creditor protection and company law. Admittedly, this is a topic that continues causing a lively debate in current legal Germany¹⁰⁹⁾. Nonetheless, the reform adopts a pragmatic approach which might be thought to be mildly defensive against English private limited companies. The proposal on sharpening director liability classifies the prohibition of pay-outs to shareholders as an insolvency-related problem. This comment has to be read against the background of the European Insolvency Regulation (EIR)¹¹⁰⁾. Under art. 3(1), 4 (1) EIR¹¹¹⁾ the insolvency law of the Member State applies where the insolvent company has its main interests¹¹²⁾. Under the theory advanced by the reform project, an English private limited company operating as a pseudo-foreign company in Germany would be subject to German insolvency law rules, including the rules on director liability¹¹³⁾. This would expose the director of an English private limited company to direct claims from German creditors, although English insolvency confides

107. Cf. *K. Schmidt*, Eigenkapitalersatz, oder Gesetzesrecht versus Rechtsprechungsrecht, *Zeitschrift für Wirtschaftsrecht (ZIP)* 2006, 1925 et seq.; *Bayer/Graff*, Das neue Eigenkapitalersatzrecht nach dem MoMiG, *Deutsches Steuerrecht* 2006, 1654 et seq.

108. S. Referentenentwurf – Entwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) (May 29, 2006), at p. 64.

109. Cf. the study prepared by *Haas*, Reform des gesellschaftsrechtlichen Gläubigerschutzes, Gutachten E zum 66. Deutschen Juristentag, Stuttgart 2006 (2006) [2006 Meeting of the German Lawyers' Association (Deutscher Juristentag)] and the report on the resolutions taken by the economic law section of the Deutsche Juristentag by *Habersack*, Das MoMiG ante portas – Nachlese zum 66. DJT, *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht* 170 (2006), 607 et seq.; *id.*, Der Entwurf des "MoMiG" und weitergehende Vorschläge zur Bekämpfung des Missbrauchs der GmbH, *GmbH-Rundschau* 2006, 729 et seq.

110. Council Regulation (EC) No. 1346/2000 of May 29, 2000 on insolvency proceedings, O.J. L 160/1 of June 30, 2000.

the exercise of this right to the company liquidator¹¹⁴). Admittedly, English company law does not provide for 'non-domestic' claims for wrongful trading. But what has to be assessed in the light of the ECJ's jurisprudence is whether this approach would not recalibrate the governance structures under English law. Thus, it is likely that the current German reform project will just mark another round in the ongoing process of regulatory competition for the most attractive statute on private companies.

IV. Regulatory Challenges in the Age of Private Company Law Reform

1. Imperative National Policy Reasons?

Reforming national laws on private companies against the background of regulatory competition is a policy strategy based on general welfare considerations. Such considerations betray a penchant for self-defence. It is assumed that a more attractive company law regime will offer sufficient incentives to investors to stay in the country, foregoing the benefits of the laws of other Member States. A closer reading of the ECJ's jurisprudence on company mobility suggests that company law reform in the age of regulatory competition is more complicated. Member States may restrict mobility within the European Union on imperative grounds of public interest. This is an argument of both, macroeconomic and microeconomic dimensions¹¹⁵). It leaves sufficient leeway for Member States to pursue their own national policies. But it also invites microeconomic analysis on how regulatory competition affects creditors and workers. 'Foreign' companies benefiting from intra-European mobility are operating in a different legal environment and may therefore produce externalities which the host country is incapable of containing. The microeconomic effects of regulatory competition may therefore provoke regulatory action, guided by macroeconomic considerations.

111. Art. 3(1) EIR:

The courts of the Member State within the territory of which the center of the debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or a legal person, the place of the registered office shall be presumed to be the center of its main interests in the absence of proof to the contrary.

Art. 4(1) EIR:

Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effect shall be that of the Member State within the territory of which such proceedings are opened, hereafter referred to as the 'State of the opening the proceedings'.

112. See ECJ judgment of May 2, 2006, Case N^o. C-341/04, Eurofood IFSC Ltd.; and *Schmidt*, Eurofood – Eine Leitentscheidung und ihre Rezeption in Europa und den USA, *Zeitschrift für Wirtschaftsrecht (ZIP)* 2007, 405 et seq.

113. This appears to be in line with a proposal by *Schön*, Die Zukunft der Kapitalaufbringung/-erhaltung, *Der Konzern* 2004, 162 (at p. 170), that company should be relegated to incorporation aspects whereas a territorially oriented insolvency law would address problems of creditor protection raised by undercapitalised pseudo-foreign companies.

114. Conversely, the envisaged amendment on the registration requirements for German branches of foreign companies would introduce specific standards for disqualifying directors independent of the English statutes. From a practical perspective, however, it remains to be seen whether these statutory standards would not largely reproduce the admonishments of their English counterpart.

115. Cf. *Tjong*, supra N. 23, at p. 25 et seq.

2. Some Practical Experiences – Germany

Under the influence of the ECJ's jurisprudence, it is well settled that the law of incorporation controls the internal affairs of the corporation or private company¹¹⁶). Nonetheless, Member States may impose restrictions on foreign companies operating on their territories for the benefit of consumer protection¹¹⁷) and transparency on capital markets¹¹⁸). In this, the majority of German courts have resisted the temptation on forcing (discriminatory labels) on the German branches of English Private Limited Companies: It is for the market to detect regulatory differences between the English and German laws on private companies¹¹⁹). This begs the question to what extent Member States may still disqualify directors from operating an English Private Limited Company as a pseudo-foreign corporation: In the past, German individuals have been barred from undertaking certain business activities¹²⁰), only to reappear on the marketplace in the capacity of the director of an English Private Limited Company with its headquarters in Germany. This issue is still pending before the German Federal Supreme Court¹²¹), but the new draft law on private company law reform answers this question in the affirmative¹²²).

Company mobility in the European Union critically depends on the insolvency regime under the EIR. Artt. 3(1), 4 (1) EIR lay down a mandatory choice of law rule which is doubly inefficient: It gives rise to protracted litigation and invites *ex post* forum shopping¹²³). Moreover, it forecloses the positive effect of *ex ante* contracting for an optimal insolvency law regime for a corporate entity¹²⁴). Arguably, the application of national insolvency law

116. *Stöber*, Anwendbares Recht und Gerichtsstand bei Bestellung und Abberufung des Geschäftsführers einer in Deutschland tätigen Limited, GmbH-Rundschau 2006, 1146 et seq. This includes litigation on the scope of director liability: Oberlandesgericht (OLG/ Court of Appeal) Celle, judgment of August 16, 2006, GmbH-Rundschau 2006, p. 1269 (liability of director of Czech company).

117. Cf. Landgericht (LG/ District Court) Dresden, judgment of April 11, 2006, GmbH-Rundschau 2006, 1159 (at p. 1160 et seq.), applying German Unfair Trading law on an English Private Limited Company operating exclusively in Germany.

118. Under German securities regulation, this would also include rules on disclosure: BGH (German Federal Supreme Court), Judgment of September 13, 2004, Case No. II ZR 276/02, involving a partnership between a British Virgin Islands Private Limited Company and German investors. Under EU law, British Virgin Islands companies have to be given the same treatment as United Kingdom companies.

119. Cf. OLG (Court of Appeal) München, Decision of August 17, 2005, Der Betrieb 2005, 1955; OLG (Court of Appeal) Düsseldorf, Decision of February 21, 2006, Der Betrieb 2006, 1102; LG (District Court) Frankfurt, Decision of February 15, 2005, GmbH-Rundschau 2005, 1135. On the cost aspects of having a local branch of an English Private Limited Company entered into the commercial register: OLG (Court of Appeal) Frankfurt, Decision of December 29, 2005, Der Betrieb 2006, 269 (270 et seq.); OLG (Court of Appeal) Hamm, Decision of June 28, 2005, GmbH-Rundschau 2005, 1130 et seq.; LG (District Court) Cottbus, Decision of February 14, 2005, Entscheidungen zum Wirtschaftsrecht 21 (2005), 733; LG (District Court) Berlin, Decision of June 22, 2004, Zeitschrift für Wirtschaftsrecht (ZIP) 2004, 2380 (2381 et seq.); LG (District Court) Bielefeld, Decision of July 8, 2004, Case No. 24 T 7/04; and the recent preliminary ruling by the ECJ, judgment of June 1, 2006, Case No. C-452/04, In the Matter of *innoventif Limited*, reference from LG (District Court) Berlin, Decision of August 31, 2004, Case No. 102 T 57/04. See, however, the isolated attempts to play reputation games by the district courts of Freiburg and Ravensburg: LG Freiburg, decision of July 22, 2004, Case No. 10 T 5/04, and LG Ravensburg, decision of February 14, 2005, GmbH-Rundschau 2005, 489.

120. OVG (Court of Administrative Law Appeals/Oberverwaltungsgericht) Münster, Decision of September 9, 2005, Case No. 4 A 1468/05, Entscheidungen zum Wirtschaftsrecht 22 (2006), 17; OLG (Court of Appeal) Jena, Decision of March 9, 2006, Neue Zeitschrift für Gesellschaftsrecht 2006, 434 et seq.

121. Cf. *Mankowski*, Die deutsche Ltd.-Zweigniederlassung im Spannungsverhältnis von Gewerbe- und Registerrecht, Betriebs-Berater 2006, 1173 (1174 et seq.).

122. See supra III.4.b.

to pseudo-foreign corporations might be justified as a policy device to internalise the costs of regulatory competition¹²⁵). This ignores that organisational aspects of insolvency law may also destabilise the original asset partitioning scheme agreed upon by the founders of the company¹²⁶). As the administration of national insolvency is subject to the ECJ rules on company mobility¹²⁷), it would seem that the EIR has to recognise a *de facto* choice of law for a corporate entity¹²⁸).

Critics of English private limited companies point with some justifications to the fact that section 214 of the British Insolvency Act¹²⁹) can only be invoked in insolvency proceedings in the United Kingdom¹³⁰). In a German environment, the absence of (the English) statutory incentives is feared to distract a director of a pseudo-foreign corporation from undertaking rescue attempts or, alternatively, from protecting funds otherwise available to creditors¹³¹). It is not a foregone conclusion, though, that as a consequence German law should prevail in order to fill a 'regulatory gap'. In comparing English and German approaches towards corporate insolvency Professor *Davies* points out that English insolvency law focuses on a rescue culture which considers the untimely liquidation of a company as wasteful¹³²). Section 214 of the Insolvency Act addresses the perverse incentives for directors of a company in the vicinity of insolvency. A (costly) rescue attempt is acceptable as long as information available on cash flow and balance sheet tests have not established a case for liquidation¹³³).

123. English and German courts have recently made an attempt to curb forum shopping: Amtsgericht Nürnberg (AG/Magistrate's Court), Decision of August 15, 2006, *Zeitschrift für Wirtschaftsrecht* 2007, 81; London High Court of Justice, Order N^o. 6211/2006, of December 8, 2006; *Kebekus*, Note, *Zeitschrift für Wirtschaftsrecht* 2007, p. 84 et seq.; cf. on forum shopping under a federal bankruptcy law: *LoPucki*, *Courting Failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts* (2005); *Zywicki*, *Is Forum Shopping Corrupting America's Bankruptcy Courts?*, *Geo. L. J.* 94, 1141 (1160 et seq.) (2006).
124. *Eidenmüller*, *Wettbewerb der Insolvenzrechte?*, *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 35, 467 (474 et seq.) (2006); *id.*, *Free Choice in International Company Insolvency Law*, *Eur. Bus. Org. L. Rev. (EBOR)* 6, 424 (429 et seq.) (2005).
125. *Vallander*, *Die Insolvenz von Scheinauslandsgesellschaften*, *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 35, 425 (454) (2006).
126. Cf. *Ribstein*, supra N. 1, *Wake Forest L. Rev.* 40 (2005), 751 (762, 773 et seq.); *Schön*, *Die Zukunft der Kapitalaufbringung/ -erhaltung, Der Konzern* 2 (2004), 162 (170).
127. *Armour*, *Legal Capital: An Outdated Concept?*, *Eur. Bus. Org. L. Rev. (EBOR)* 7, 5 (at p. 25) (2006); *Berner/Klöhn*, *Insolvenzantragspflicht, Qualifikation und Niederlassungsfreiheit*, *Zeitschrift für Wirtschaftsrecht (ZIP)* 2007, 106 (at p. 111 et seq.).
128. See *Eidenmüller*, supra N. 124, arguing for freedom of choice on the corporate insolvency law regime.
129. See supra, N. 57.
130. German scholars perceive the English Private Limited Company as an attempt to reinforce the principle of *caveat emptor*, setting statutory incentives for private contracting on creditor protection (*Fleischer*, *Gläubigerschutz in der kleinen Kapitalgesellschaft: Deutsche GmbH versus englische private limited company*, *Deutsches Steuerrecht* 38, 1015 (1021) (2000)). A similar criticism has been voiced against the European Court of Justice which is thought to favour adjusting over non-adjusting creditors: *Goette*, *Wo steht der BGH nach "Centros" und "Inspire Art"?*, *Deutsches Steuerrecht* 43, 197 (198) (2005); *Eidenmüller*, in: *Eidenmüller*, supra N. 28, § 3, 37 et seq.
131. See the arguments advanced in the judgment of the LG (District Court) Kiel of April 20, 2006, *GmbH-Rundschau* 2006, 710 (711), and in: *Wächter*, *Persönliche Haftung des Gründers einer englischen private limited company*, *Betriebs-Berater* 2006, 1463 (1464 et seq.).
132. *Davies*, *Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency*, *Eur. Bus. Org. L. Rev. (EBOR)* 7, 301 (329 et seq.) (2006)
133. *Davies*, supra N. 132, *Eur. Bus. Org. L. Rev. (EBOR)* 7, 301 (319 et seq.) (2006).

Section 64 (1) of the German statute on close corporation imposes liability on a director who has not filed a timely petition for insolvency proceedings¹³⁴. This rule is designed to provide for a 'safe harbour', exonerating the director from personal liability once he has filed for insolvency. Section 64 (1) has the potential to become 'infected' by English regulatory policies, although it grants a direct creditor claim against the director¹³⁵. In construing section 64 (1) German courts would have sufficient leeway to exempt a director (of an English private limited company) who made a reasonable rescue attempt¹³⁶. Conversely, the director who distributed funds after the company became insolvent may be held liable on an analogy with the norm applicable to close corporations (i.e. section 64 (2) of the German law on close corporations)¹³⁷. The German statute on close corporations and general tort law concepts are sufficiently broad to incorporate English law concepts developed under section 214 of the Insolvency Act or under common law¹³⁸. This approach does, of course, not address the German disinclination to pay heed to the English preference for collective claims against the director (in insolvency proceedings). It is perhaps too early to determine whether this would create a serious obstacles or disincentives for the director of such a (pseudo-foreign) company.

One major difference between the English and German regulatory tests to ascertain (in)solvency remains: Section 214 of the Insolvency Act operates on a balance sheet test whereas, under the German statute, creditor-regarding duties arise under the cash flow *and* balance sheet tests¹³⁹. Arguably, these English law concepts could be translated into the interpretation of the relevant German statutes. But there is always the risk that courts, in relying on German law concepts exclusively, will be in breach of the ECJ's jurisprudence on company law¹⁴⁰. This is not so much a question of whether the founders of a Private Limited Company are prepared to buy the costs of buying English law expertise. Rather, they have to persuade a foreign (i.e. German) court to apply English corporate law principles¹⁴¹.

134. S. 64 (1) of the German statute on close corporations (*GmbH-Gesetz*) requires the director of an insolvent or illiquid close corporation to commence insolvency proceedings without undue delay. The maximum statutory delay is three weeks. Failure to comply with this duty may also give rise to a claim for damages under Germany's tort law statute.

135. The judgment of the LG (District Court) Kiel of April 20, 2006, *GmbH-Rundschau* 2006, 710 (711), is the first case where a German court held section 64 (1) of the close corporation to apply to the director of a (pseudo-foreign) English Private Limited Company, taking a rather broad brush approach towards liability without evaluating the underlying regulatory policy of section 214 of the British Insolvency Act. In the end, the court skirted the issue by deciding that there was also a clear case of fraud so that the relevant German tort statute would apply. Cf. *Wachter*, *Persönliche Haftung des Gründers einer englischen private limited company*, *Betriebs-Berater* 2006, 1463 (1464 et seq.).

136. Cf. BGH (German Federal Supreme Court), Judgment of May 24, 2005, *Betriebs-Berater* 2005, 1923 (1925 et seq.); *Flitsch*, Case Note, *Betriebs-Berater* 2005, 1928.

137. Cf. *Goette*, *Zur systematischen Einordnung des § 64 Abs. 2 GmbHG*, in: *Festschrift für Kreft* (2004), 53 et seq.

138. Cf. *Schall*, *Zeitschrift für Wirtschaftsrecht (ZIP)* 2005, 965 (975); *Goette*, *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 2006, 261 (279).

139. See *Davies*, supra N. 132, *Eur. Bus. Org. L. Rev. (EBOR)* 7, 301 (318 et seq.) (2006).

140. *Just*, Case Note, *Zeitschrift für Wirtschaftsrecht (ZIP)* 2006, 1251 (1253).

141. *Griffiths/Tschentscher*, *The Straw Dogs of Europe*, *Insolvency Intelligence* 17 (4), 57 (61) (2004); cf. *Goette*, *Zu den Folgen der Anerkennung ausländischer Gesellschaften mit tatsächlichem Sitz im Inland für die Haftung ihrer Gesellschafter und Organe*, *Zeitschrift für Wirtschaftsrecht* 27, 541 (544) (2006).

V. The European Private Company Statute

1. Regulatory Thrust

Regulatory competition among the various national private company statutes does not come without a cost. Operating a private company in another member state requires a carefully drafted charter and an open-minded judiciary in the host state who is capable of balancing national policy imperatives against the ECJ's jurisprudence on company mobility. This has given rise to a debate on which companies stand to benefit most from the current state of regulatory competition and, as some would claim, to a lack of legal certainty. There are also political overtones in this debate as the regulatory climate in the Member States oscillates between a liberal approach and rigorous law-making¹⁴²). When the European Commission had launched a public consultation on future priorities for the implementation of its action plan many¹⁴³), many respondents argued for a European Private Company (EPC) Statute, creating more choice for companies without creating any new burdens on them¹⁴⁴). Closer examination suggests that the plea for an EPC Statute is motivated by a concern about transaction costs from cross-border operations. Respondents suggested that a statute would create a truly European company which would operate under the same set of rules in every Member State, facilitating joint-ventures and the establishment of foreign subsidiaries. According to the supporters of the EPC, the regulatory thrust of the statute would go well beyond a common set of harmonised principles. In order to avoid the current difficulties with pseudo-foreign countries the statute should enact uniform supranational rules with few references to national law. While ensuring flexibility and freedom of contract mandatory rules would apply with respect to protecting creditors and shareholders (including minority shareholders)¹⁴⁵).

In 2006, the European Parliament seized the initiative. The Committee on Legal Affairs held a public hearing in order to prepare a report on the European Private Company¹⁴⁶). On February 1, 2007 the European Parliament passed a resolution, inviting the Council and the Commission to take legislative action¹⁴⁷). The European Commission has promised to prepare yet another feasibility study which is to focus on a simple, user-friend-

142. See *Étude de faisabilité d'un statut européen de la PME* (July 2005), p.18 (Feasibility Study on a European Private Company Statute commissioned by the European Commission).

143. European Commission Press Release, *Company Law and Corporate Governance: Consultation on Future Priorities for Action Plan*, Brussels, December 20, 2005 (IP/05/1639).

144. Directorate General for Internal Market and Services, *Consultation and Hearing on Future Priorities for the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union – Summary Report*, p. 24 et seq., Brussels (2006); (http://ec.europa.eu/internal_market/company/docs/consultation/final_report_en.pdf).

145. See the then head of Unit – DG "Internal Market", *Van Hulle*, discussing the relationship between freedom of contract: "... there is a need to leave more to shareholders to regulate for themselves. But at the same time, we cannot leave the law uncertain and the managers and owners of small companies simply do not have the time and the resources to take complex legal advice.", in: *Le Droit des Sociétés au Service des Entreprises dans l'Europe du XXI^e siècle – Des Perspectives Anglaises et Françaises aux Perspectives Européennes*, Roundtable Paris December 6, 1999, Chambre de Commerce et d'Industrie de Paris/Centre de Recherches sur le Droit des Affaires.

146. Cf. European Parliament Committee on Legal Affairs, *Draft Report with Recommendations to the Commission on the European private company statute*, September 15, 2006 (PROVISIONAL 2006/2013(INI)); *Drury*, supra N. 38.

ly statute for the benefit of small firms¹⁴⁸). At the same time, the Commissioner for Internal Market and Services cautions against introducing a multiplicity of European corporate forms¹⁴⁹). The European Parliament's resolution is influenced by French regulatory thinking about the *Société par actions simplifiée*. The concept of minimum capital is upheld, although the envisaged amount of € 10,000 is considerably below its French counterpart. There should be at least one executive director, but the shareholders may at their discretion decide on more elaborate governance structures. The 'bodies of the company' shall be directly liable to the company for all acts committed in breach of civil and criminal law applicable to the company. Moreover, 'company bodies' shall be liable to third parties for acts whereby the assets of the EPC have been reduced, provides that such acts were not in the interests of the company. A direct liability of the director shall also be established if, case of insolvency, a petition for the relevant proceedings is filed with undue delay, thereby causing losses to the creditors.

The thrust of European Parliament's proposals goes well beyond substantive company law. In fact, the recommendations attempt to lay down principles of private international law which would end regulatory competition in this field. The proposals vow to dispense with references to national law. Instead, the company law provisions of the envisaged EPC statute should apply exclusively and Member States would lose their prerogative to legislate in this area. European law would control the legal status of the company and its capacity to act. But the new statute would also supply a set of corporate governance principles for the EPC, including its organisational structure, liability issues and the duties of the management with respect to the company. On the other hand, the recommendation pledges to allow a maximum of freedom of contract to the shareholders who should tailor a company to their own needs. Nonetheless, the resolution is far from clear about the relationship with national company law principles and insolvency rules. The European Parliament refers to the subsidiarity of Member State law, but does not specify how comparable rules of national company law could instruct the interpretation of a new EPC statute¹⁵⁰).

There is a correlation between the movement for a new EPC statute and the regulatory climate in each Member State. The legislative movement for a harmonised European regulation on private companies has received a lukewarm welcome from the British government and financial community. From the perspective of English law, it is admittedly rather difficult to acknowledge a need for another corporate form that should add to the opportunities already available under the statutes on the English private limited company and the limited liability partnership. Representatives from French and German industries have greeted the new EPC 'movement'. This is in respect to earlier legislative proposals pre-

147. European Parliament Resolution with Recommendations to the Commission on the European Private Company Statute, P6_TA-PROV(2007)0023.

148. European Commissioner *McCreevy*, addressing the European Parliament Committee on Legal Affairs on November 21, 2006 (European Commission Document SPEECH/06/720).

149. It is as yet unclear whether this statement was intended to comment on the multiplicity of corporate forms in the US or the United Kingdom.

150. See, however, the statement by *Teichmann* at the European Parliament Hearing on the European Private Company on June 22, 2006, who makes a plea for European liability regime that would have priority over the European Insolvency Regulation. According to *Teichmann*, this liability regime should be instructed by the English law standards on wrongful trading.

pared by French and German scholars¹⁵¹). Although the argument for a European regulation on private companies sounds intuitively convincing¹⁵²), a cost-benefit analysis suggests that little can be gained from an EPC statute¹⁵³). The proposals emanating from the European Parliament do not explain on how to integrate the EPC into national company and insolvency laws, nor do they offer guidance on how to balance creditor and stakeholder interests. The conflict of law issues that lawyers have been acutely aware of under regulatory competition will persist. Applying national law on a complimentary level will just magnify the problems that national judges have set out to address when the English Private Limited Company came to continental Europe. In the light of US experiences *Bebchuk/Ferrell* have argued for an additional federal law statute which the parties could opt into¹⁵⁴). In the context of the European Union it would seem that such an additional statute is unhelpful. Allowing greater choice under the current menu of European company and insolvency statutes would just as well guarantee the freedom of contract which is thought to allow economic growth.

2. Whither Private Company Law?

Private company law reform in Europe is motivated both, by competitive and defensive concerns. National legislators want to offer investor-friendly statutes which attract new business. There is broad support for allowing a maximum of freedom of contract without sacrificing acknowledged principles of creditor protection. As major jurisdictions are set to abandon minimum capital requirements creditor protection will move from an *ex ante* to an *ex post* perspective, focusing on director and shareholder liability. The regulatory approach to director and shareholder liability needs to be calibrated as well as the relationship between company and insolvency law. Currently, the choice of law rules of the European Insolvency Regulation invite *ex post* forum shopping and infelicitous races to insolvency courts in various Member States. After the ECJ's jurisprudence on company mobility the argument for free choice of a national insolvency statute merits serious scrutiny.

In the age of regulatory competition private company law reform raises social welfare issues¹⁵⁵). Consequently, national legislators ponder on how to protect established regulatory concepts¹⁵⁶). The ECJ's jurisprudence draws a fine line between protectionism and safeguards inspired by imperative national interests. In the context of company mobility the ECJ has developed an informational model which is designed to protect creditors and

151. Cf. *Boucourechliev/Hommelhoff* (eds.), *Vorschläge für eine Europäische Privatgesellschaft – Strukturelemente einer kapitalmarktfernen europäischen Gesellschaftsform* (1999), at p.229 et seq.; *Hommelhoff/Helms*, *Grundlagen und konzeptionelle Fragen in der Europäischen Privatgesellschaft*, in: *Hommelhoff/Helms* (eds.), *Neue Wege in die Europäische Privatgesellschaft* (2001), at p. 3 et seq.

152. See the Position Paper prepared by the European Office of the VDMA (The German Engineering Federation), *Creation of a European Private Company*, Brussels, March 2006.

153. See however *Helms*, *Die Europäische Privatgesellschaft* (1998), at p. 15 et seq., who argues for cost efficiencies to be made under an EPC statute.

154. *Bebchuk/Ferrell*, *A New Approach to Takeover Law and Regulatory Competition*, *Va. L. Rev.* 87 (2001), 111 (at p. 140 et seq.); see also: *Bebchuk*, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, *Harv. L. Rev.* 105 (1992), 1435 (at p. 1503 et seq.).

155. Cf. *Vestal*, *Not "Like Sailors or Idiots or Infants": Social-Welfare Based Limits on Private Ordering in Business Association Law*, *Eur. Bus. Org. L. Rev.* (EBOR) 8(2007) (forthcoming).

employees. What is missing from the current debate, however, is an in-depth analysis of the macroeconomic and microeconomic aspects of regulatory competition. This would also include a closer scrutiny of private international law principles which are operate as to accommodate potential frictions between national company law policies.

As private companies turn into important vehicles for establishing start-ups and venture capital businesses corporate governance issues are likely to surface. Obviously, statutory law is not intended to deter investors from choosing a private company from the menu of corporate options. Although there is a presumption in favour of freedom of contract further study is necessary on the benefits of certain mandatory governance rules for non-listed bodies corporate. Private company law reform comes at a time when traditional financing instruments are increasingly inaccessible for smaller or new businesses. Private ordering will therefore have to satisfy their liquidity demands. Current regulatory processes reveal a preference for non-interventionist strategies towards private financing. It may well be that, in the interest of market transparency and creditor protection the balance between mandatory and enabling laws will have to be re-assessed.

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ПРИВАТНО КОМПАНИЈСКО ПРАВО У ЕВРОПИ - ВРЕМЕ ЗА РЕФОРМЕ?

Резиме

У оквиру Европске Уније, мање је рескриптиван однос држава чланица према друштвима чијим се акцијама и уделитема не тргује на званичном берзанском листингу (тј. приватне компаније). У овој области компанијског права не постоје унификована правила, а законодавци покушавају да очувају слободу уговарања као основни принцип. Јуриспруденција Европског суда правде је остворила веома већу мобилност приватних компанија. Имајући у виду наведено, приватне компаније су постале омиљена форма корпоративног организовања за новонастале компаније и приватне инвестиционе фондове. Изгледа да ће ен-

156. See on the political economy of the law-making process and national regulatory mechanisms to contain the negative effects of foreign business laws: *Casagrande/Spallone*, Relaxing Liquidity Constraints for Start-Ups: A Welfare Analysis Over the Italian Revised Corporate Law, *Eur. J. L. Econ.* 20, 339 et seq. (2005); *Laffont/Zantman*, Information acquisition, political game and the delegation of political authority, *Eur. J. Pol. Econ.* 18 (2002), 407 (423 seq.); *Ulen*, supra N. 30, *George Mason L. Rev.* 6 (1998), 921 (926 et seq.); *O'Hara*, Opting out of Regulation: A Public-Choice-Analysis of Contractual Choice of Law, *Vanderb. L. Rev.* 53 (2000), 1551 (1570 et seq.); *Carney*, The Political Economy of Competition for Corporate Charters, *J. Leg. Stud.* 26 (1997), 303 (311 et seq.).

Ѕлески Закон о приватним компанијама постоји највећи корисник либерализације у компанијском праву. Регулативна конкуренција је ослободила сљедећа законодавне активности у неким државама чланицама. Овај чланак приказује енгле, холандске, француске и немачке законе о приватним компанијама, како би уредио националне корпоративне правне системе. Ради бољег разумевања, дебате која се тренутно води око усвајања Савезне европске приватне компаније додате су и одређена знања из политичке економије.

Кључне речи: *Европско компанијско право, регулативна конкуренција, реформа приватног компанијског права.*