

German law governing private companies in a group

by Frank Wooldridge

INTRODUCTORY REMARKS

The German *Aktiengesetz* of 1965, as amended, contains a number of provisions which govern the situation of public companies (*Aktiengesellschaften*) in a group of companies. These comprise paragraphs 15-21 *AktG* which contain a number of provisions concerning affiliated enterprises (*affiliated enterprises*) (*verbundene Unternehmen*) as well as paragraphs 291-328 *AktG* which contain further and frequently detailed provisions governing such undertakings. Certain of the provisions contained in paragraphs 15-21 and 291-328 *AKk* affect private companies, because they mention an *Unternehmen*, which includes such companies. There has been a considerable amount of academic discussion concerning the position of private companies (*Gesellschaften mit beschränkter Haftung*) in a group of companies, and the Second Senate of the German Federal Supreme Court (*Bundesgerichtshof*) has made a number of important decisions governing the position of private companies in such a group in recent years; these decisions have involved a considerable change in the approach taken to this matter.

According to paragraph 18(1) sentence 1 *AktG*, if a controlling and one or more dependent undertakings are brought under uniform management (*einheitliche Leitung*), they are treated as forming a group. Companies between which are integrated with one another (paragraph 319 *AktG*), are treated as being under uniform management (*einheitliche Leitung*) (para 18(1) sentence 2 *AktG*). Furthermore, controlling and dependent enterprises are deemed to form a group (para 18(1) sentence 3 *AktG*). The concept of uniform management seems as much an economic as a legal one: enterprises would, it seems, be treated as being under uniform management if the controlling one determined policy guidelines for the enterprise dependent on it to follow.

A *de facto* group is one which is not governed by a control contract between a controlling enterprise and those dependent on it. The term qualified *de facto* group (*qualifizierte faktische Konzerne*) used to be used to denote groups in which it was not possible to isolate particular prejudicial measures taken by the controlling enterprise and to calculate the compensation due in relation to them in accordance with the usual rules attributable to *de facto* groups. The qualified *de facto* group has been otherwise

defined as existing when the subsidiary company has lost its independence to the extent that it is reduced to the position of a mere branch of the controlling one. Finally, it has also been treated as existing where the continued harmful damage to the interests of the subsidiary company is such as to indicate that the controlling company has no regard for the former company's interest.

The first of the three proposed definitions appears to be the preferable one. However, the Supreme Court has abandoned the use of the concept of the qualified *de facto* group in its recent decisions, and has replaced it with the concept of the existence of liability for acts by a dominant shareholder which threaten the continued existence of a subsidiary company (*existenzvernichtender Eingriff*). The latter approach places emphasis on the legal rules concerning the maintenance of capital. This new approach was first taken by the Supreme Court in *Bremer Vulkan* (BGHZ 149, 10), which has been followed in a number of recent cases.

The creative activity of the Supreme Court has been rendered necessary by reason of the fact that there is no codified German law concerning contractual or *de facto* groups in which a private company is the dependent company. The government draft project of 1973 (*Regierungsentwurf*) paragraphs 230 et seq of which were intended to introduce such legal provisions was never adopted. It underwent considerable academic criticism, and its failure to be adopted was also influenced by the vicissitudes of coalition politics. The rules governing contractual or *de facto* groups, in which a private company is the dependent company, have largely been made by the courts.

CONTROL CONTRACTS AND THE PRIVATE COMPANY

A control contract involving a *GmbH* as the dependent party may be drawn up, but a similar relationship with a controlling enterprise to that established by a control contract may come about as the result of a suitable provision in the private company's articles. It is questionable what majority is required for such a *GmbH* to give its consent to a control contract. It is sometimes argued that the unanimous consent of the shareholders in the general meeting of the *GmbH* is necessary, whilst it has

also been contended that the same majority as that which is necessary for the alteration of the *GmbH's* articles is all that is necessary, ie three quarters of the votes cast at a general meeting. The contract must be drawn up as a deed and be duly registered. If the controlling enterprise is also a *GmbH* its agreement to the contract must be given by means of a resolution of its general meeting.

If a *GmbH* is the dependent party to a control contract, the controlling enterprise may give instructions to it which may prove disadvantageous, provided that they are in the interests of the controlling enterprise or other enterprises in the same group. The controlling enterprise is also required to pay compensation for any net annual loss suffered by the dependent company, and appears to be obliged to acquire the shares of any minority (*aussenstehenden*) shareholder upon demand by such shareholder (see paragraphs 302 and 305 *AktG*, which are treated as applicable by way of analogy).

GmbHs are more likely to be dependent companies in a *de facto* group of companies rather than in a contractual one. This is largely because in a *GmbH*, the shareholders have the power to give instructions to managers in accordance with paragraphs 37(1) and 45(1) *GmbHG* and control contracts are not necessary for this purpose. There may however be tax advantages in making use of the contractual group in which a private company is the dependent company. The use of private companies in a group of companies is sometimes facilitated by the fact that their shareholders may be given multiple voting rights, which is impossible in a public company.

THE GMBH AS A DEPENDENT COMPANY IN A DE FACTO GROUP

The *Aktiengesetz* contains detailed provisions in paragraphs 311-18 thereof concerning the liability of controlling enterprises to dependent public companies in the absence of a control contract. It does not seem that it has been generally thought appropriate to apply these provisions by way of analogy to govern the position of dependent private companies in a *de facto* group. The Second Chamber of the Federal Supreme Court has decided a number of cases concerning the protection of shareholders and creditors in such groups. It has made use of the concept of the qualified *de facto* group in its jurisprudence concerning creditor protection, but it appears to have abandoned this approach recently. One of its most important decisions concerning minority protection was the *ITT* case (BGHZ 65, 15).

In the above case *ITT*, a large multinational undertaking based overseas, which was the majority shareholder in a private company which was itself a member of a private company limited partnership (*GmbH & Co KG*), induced the private company and one of its subsidiaries to conclude a contract for services with a subsidiary of the large multinational company *ITT*, according to which the private company and its subsidiary were required to contribute

one per cent of their annual turnover to the subsidiary of *ITT*. A minority shareholder in the *GmbH* brought an action against *ITT* on behalf of the *GmbH & Co KG* for recovery of the sums wrongly paid to the subsidiary of *ITT*. The Second Chamber found in favour of the minority shareholder. It based its finding on the breach of the duty of good faith owed by the 85 per cent majority shareholder to the minority shareholder. The majority shareholder had put pressure on the management of the private company to act in a way detrimental to the minority shareholder. Shareholders in a private company owe duties of good faith to one another and their company.

The Supreme Court has made a number of decisions concerning the protection of creditors in a private company belonging to a *de facto* group in recent years, and since its decision in *Bremer Vulkan* (BGHZ 149, 10) it has changed the basis of its approach to this matter. In *Fertinghaus* (BGHZ 68, 312), the Eighth Chamber of the Supreme Court refused to open the corporate veil in order to enable the creditor of a single member *GmbH* to receive payment out of the assets of another company, which gave instructions to the former undercapitalised *GmbH*. A different approach was taken by the Supreme Court in *Autokran* (BGHZ 95, 330), which received some criticism in K. Schmidt's treatise (*Gesellschaftsrecht*, 3rd ed, Karl Heymanns Verlag 2003, pp 1219-20 and 1223). In this case, a leasing company had leased 39 cranes to seven private companies, in all of which the defendant was in effect the sole shareholder, and was also the sole manager. The latter person had formed another company which was responsible for the accounts and financing of the group, and which entered into factoring contracts with each of the seven private companies, and took charge of all their cash. The private companies failed to pay the sum of DM 700,000 to the leasing company in respect of the lease of the cranes.

The Second Chamber upheld the claim of the leasing company against the defendant sole shareholder for payment of the relevant sum. The court found that the relevant group of companies could be treated as a qualified *de facto* group, because the sole shareholder had organised it as if its individual members were mere branches, and used his managerial powers over it in a lasting and comprehensive manner. According to the court, in the particular circumstances the plaintiff had a claim for reimbursement as the result of the application of paragraphs 303, 322(2) and (3) *AktG* by way of analogy. The first of these provisions is applicable to *de facto* groups in which an *Aktiengesellschaft* is the dependent company, and it provides for the protection of creditors in the case of the cancellation or termination of a control contract or a profit transfer one. The other two provisions govern the liability of a principal company to one integrated with it.

It was also emphasised by the Second Chamber of the Supreme Court that the finding that a group of companies was a qualified *de facto* one only resulted in the

presumption that the business of the dependent company was conducted to further the interests of the group. The controlling enterprise might escape liability if it could demonstrate that a conscientiously (*plichtgemäß*) acting manager of an independent private company would not have carried on the business of the dependent company in a different way in the given circumstances.

As is pointed out by Kübler and Assmann at page 453 of their work *Gesellschaftsrecht* (6th edition, C F Müller Verlag, 2006), the Supreme Court upheld its decision in *Autokran* in *Tiefbau* (BGHZ 107, 78), but modified its conclusions in that case to some extent. In the latter case, the court somewhat controversially found that a qualified *de facto* relationship existed where an enterprise was responsible for financial control in another one. The court also held that paragraph 302 *AktG* was applicable by way of analogy in the particular circumstances. Paragraph 302(1) *AktG*, which is applicable to dependent public companies, provides that in the case of a control or profit transfer agreement, the other contracting party shall compensate any annual net loss due to the agreement to the extent that such loss cannot be compensated for by withdrawing sums from the profits reserves which were transferred to such reserves during the course of the agreement.

The decision in *Video* (BGHZ 115, 187) unsurprisingly caused considerable controversy. In that case, the Supreme Court held that a sole or majority shareholder in a *GmbH* who was at the same time a sole manager and who in addition acted as a sole entrepreneur was liable in accordance with the rules applicable to the qualified *de facto* group. The court corrected the controversial view that it had adopted in *Video* and which was much criticised by German jurists in *TBB* (BGHZ 122, 123). In the latter case it found that a shareholder who has a dominant position in a private company will incur liability in accordance with the rules applicable to the qualified *de facto* group if he shows insufficient consideration for the affairs of the dependent *GmbH*. The view was adopted by the court that such lack of consideration could not be presumed but would first of all have to be shown and evidenced by the plaintiff. Insofar as the plaintiff has inadequate insight into the manner of running the business of the company, the court found that it is up to the defendant to explain the relevant matters known to him. It held that in a particular case the question whether payments between different members of the group were properly entered in the accounts, such that possible detriment to the dependent private company could be corrected by a compensatory payment to that company was of importance.

THE NEW APPROACH TO LIABILITY IN A DE FACTO GROUP

A new cause of action resulting in unlimited liability for the managers of a German private company was established by the German Supreme Court in *Bremer Vulkan* (BGHZ 149,

10). In this case, the court held that the protection of a dependent private company against the wrongful acts of its shareholders should not be based upon the rules contained in paragraphs 291-310 *AKGG*, applicable to contractual groups, or those contained in paragraphs 311-17 *AKGG*, applicable to *de facto* groups, in which the dependent company was an AG. It should rather take place in conformity with the rules governing the maintenance of capital and the safeguarding of the continued existence of the company.

The Supreme Court held that no such consideration was given when the company was rendered unable to discharge its debts due to the activities of its sole shareholder. It also found that if the sole shareholder persuaded a dependent private company to maintain its funds in the central treasury of a group dominated by that shareholder, it was obliged to make sure that when disbursements took place from such funds, proper consideration should be given to the company's ability to fulfil its obligations and continue its existence. The court found that the action of the sole shareholder would only result in his liability if the capacity of the company to satisfy its creditors could not be restored by the repayment of the share capital which had been lost to the company in accordance with the provisions of paragraph 31 *GmbHG*. This somewhat complex text provides that payments made by a private company which infringe the rules contained in paragraph 30 *GmbHG* governing the maintenance of capital have to be returned to the company. The same principles would be applicable if there were several dependent private companies in a *de facto* group.

A justification of the new concept governing liability was given by the German Supreme court in *KBV* (BGHZ 151, 181), in which the claim for causing insolvency (*existenzvernichtenden Eingriff*) provided for in *Bremer Vulkan* was accepted. The Court found that such a claim was acceptable when a shareholder in a private company disregarded the required need to consider the preservation of the assets for the satisfaction of the company's creditors, and through open or concealed withdrawals substantially prejudiced its capacity to fulfil its obligations. The court added that such conduct, which involved a misuse of the corporate form of the *GmbH*, would lead to the loss of the limited liability of the private company provided for in paragraph 13(2) *GmbHG* unless the loss suffered by it would be compensated fully through the application of the rules governing the maintenance of capital contained in paragraphs 30 and 31 *GmbHG*. The court found that a private company may not have a right to its continuance, but that its termination must take place in as ordered procedure which guarantees the preferential availability of the property of the company for the satisfaction of its creditors.

Although it seems that the concept of the qualified *de facto* group will no longer be employed by the German courts, the rules set out in *TBB* regarding the burden of proof which have already been explained, still appear to be valid.

The plaintiff is thus required to demonstrate a prejudicial interference with the company's assets by shareholder. The burden is then placed upon the shareholder to show that his actions did not cause or contribute to the downfall of the private company, or that compensation may take place by avoiding particular transactions and that such compensation is appropriate.

The Supreme Court considered the concept of causing liability for insolvency in two decisions which it gave in 2004. In the first of these *Autohändler* [2005] ZIP 115, the court found that an indirect shareholder who owned all the shares in a private company which became insolvent might be found liable for causing insolvency if he transferred all its assets to himself or to another company in which he was a shareholder without furnishing adequate consideration to the company. A further precondition for imposing unlimited liability was the impossibility of the company being compensated by avoiding identifiable individual transactions. However, the court held that the shareholder could limit his liability if he could demonstrate that by comparing the actual situation of the company with the hypothetical situation which should have resulted if he had acted appropriately, the company would have only suffered a small loss.

The second of these two cases was *Unterschlagung* [2005] ZIP 250. In that case, the court held that the concept of liability for causing insolvency was not based on mismanagement, but required the deliberate deprivation of the assets of the private company for non-operational purpose. It found that such interference should be with assets which were actually available for the satisfaction of the unsecured creditors in order for liability to be imposed for causing insolvency.

It appears from the decided cases that there are two positive conditions for the imposition of such liability. These two conditions are that the shareholders must deprive the private company of its assets without full consideration, and this deprivation must inhibit the ability of the company to pay its debts. If a claim for causing insolvency is brought, this may result in the unlimited

liability of those shareholders who consented to interference with the company's assets.

The recently established concept under German law of unlimited shareholder liability for causing the insolvency of a private company (*Existenzvernichtungshaften*) has undergone recent revision as the result of the important judgment of the Supreme Court in 2007 in *Trihotel* (II ZR 3/04). The Court held that such shareholder liability would in principle only be towards the company itself, and not its creditors. It would be based upon Article 826 of the German Civil Code, which provides for delictual liability for damage cause intentionally and in violation of good moral behaviour. The requirement mentioned in earlier cases that unlimited shareholder liability is only imposed if the loss cannot be recovered in accordance with paragraphs 30 and 31 *GmbHG* will no longer be applicable.

CONCLUDING REMARKS

The approach of the German Supreme Court to *de facto* groups in which a private company is the dependent company has fluctuated in recent years to a greater extent than that to contractual groups of a similar kind. It is difficult to say whether the development of the law regarding the former type of groups is now at an end. This development has been rendered necessary by reason of the fact that the government draft project of 1973 (*Regierungsentwurf*) of 1973 was never enacted. The apparent abandonment of the concept of the qualified *de facto* group is somewhat surprising. It may have been occasioned partly by the fact that it was thought difficult to distinguish such groups from other *de facto* groups. Furthermore, it may also have been thought by some that the use of the above mentioned concept had led to too dynamic an approach to the development of the law (note in this regard, Kübler and Assmann, *Gesellschaftsrecht*, 6th ed, Müller 2006, p 456). 

Dr Frank Wooldridge