Introductory Editorial: Renovating the German Private Limited Company - Special Issue on the Reform of the GmbH

By Gregor Bachmann[*]

A. The German MoMiG - A Small Corporate Law Revolution

On 28 June 2008, the German *Bundestag* (Federal Parliament) passed a bill on the reform of German corporate law. Known as the *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen* (MoMiG – Law for the Modernization of the GmbH and to Stop its Misuse) the bill is a milestone, the single most important reform of the most commonly used German corporate form. The reform will bring about major changes. Among other things the reform will make it possible to establish a GmbH with a share capital of nothing more than € 1 EURO (previously, € 25,000 had been required) and to establish a GmbH that has no active business in Germany but solely operates abroad. Although the bill still has to be approved by the *Bundesrat* (Federal Council of the States), which will probably vote on this matter on 19 September, experts have little doubt that the reform easily will pass this last hurdle and enter into force as soon as 1 November.

The editorial board of the *German Law Journal* believes that this revolutionary bill is worth more than a brief notice. This special issue is devoted to the MoMiG and will analyze some of its most important features. With this effort the *German Law Journal* continues a tradition engaging with corporate law issues that are of interest to more than German lawyers and scholars. From an international lawyer's perspective the modernized GmbH might be a corporate form that offers attractive legal conditions for taking on business in Germany while securely limiting the risk of personal liability. Also, the "new" GmbH may become a creature more often encountered outside its natural habitat.

From an academic's perspective the reform also is interesting because it may be viewed as a further step towards convergence of corporate legal regimes.

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For both of these reasons we are pleased to have gathered a group of excellent authors, including leading scholars and renowned attorneys, to scrutinize the reform, especially to test whether it delivers on its proponents' promises.

An introduction to the contributions to this special issue follows a brief comment on the reform's background. What is the GmbH, and why was it necessary to overhaul its structure after 112 successful years?

B. The German GmbH - A Success Story

To understand the GmbH, it is necessary to understand the German corporate system. Unlike the U.K. and the U.S., Germany (and the countries following its model) does not have a single corporate form that may be used either in an "open" form (like the plc) or in a "closed" version (like the Ltd.). Germany offers two different corporate forms, each regulated in a complete and separate code, one being the *Aktiengesellschaft* (AG – stock corporation) and the other being the *Gesellschaft mit beschränkter Haftung* (GmbH – private limited company). The AG is the older variant. Like its counterparts, the British plc or the French *Société Anonyme* (S.A.), the AG took up its modern form in the early nineteenth century when the industrial revolution made it necessary to attract large groups of small investors and to shield them from personal liability in order to finance projects such as railway systems.

Later, it became apparent that small businesses also were increasingly interested in limited liability. Realizing that the complex and intensively regulated AG was not quite fit for a private company not seeking access to the capital markets, the German legislature designed a completely new corporate form, the GmbH, which was introduced in 1892 by a special statute known as the *Gesetz über die Gesellschaften mit beschränkter Haftung* (GmbHG – Law Concerning the Private Limited Companies). The concept proved to be so convincing that the new legal form was not only eagerly adopted by entrepreneurs all over the country but also was copied by many other nations. Consequently, when the GmbH celebrated its 100th anniversary in 1992, Professor Marcus Lutter, a leading German corporate law scholar, discovered only "a few white spots" on the GmbH-map, notably in the English speaking world.[1]

What are the features that make the GmbH such an attractive corporate form, and why didn't the U.K. and the U.S. adopt this model? The most striking advantage of

[1] Marcus Lutter, *Die Entwicklung der GmbH in Europa und in der Welt* [*The development of the GmbH in Europe and in the world*], *in* 100 JAHRE GMBH-GESETZ 49, 55 (Marcus Lutter ed., 1992).

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the GmbHG is the fact that it takes heed of the idea "think small first."[2] The GmbHG consists of only 87 paragraphs, which gives much leeway to statutory freedom and leaves many questions simply unregulated (many of which have been answered by the highly specialized Second Civil Senate of the *Bundesgerichtshof* [Federal Court of Justice]).[3] Path dependence probably explains why the U.K., the U.S. and other English-speaking countries stuck to their concept of a single, one-size-fits-all company statute. Recent developments, however, demonstrate that a simple and easily accessible corporate form increasingly is desired in those countries too.[4]

The GmbH's success gave little reason to consider reform. The GmbH-model was the subject of serious scrutiny on only two occasions over the last century. First, when the Nazis gained power in 1933, some argued that honest "Aryan" entrepreneurs should not hide behind an artificial entity and pleaded for the abolition of the GmbH. This proposal was never realized. Second, in the wake of the regulatory enthusiasm of the 1960s and early 1970s, the government as well as a group of younger scholars pursued reform-proposals that would have more than quadrupled the number of paragraphs of the GmbHG, adapting it more or less to the *Aktiengesetz* (AG – Stock Corporation Law). Luckily, those proposals remained in the drawer. Of the minor reforms that have been realized, only two are worth mentioning. In 1980 the minimum share capital was raised from 20,000 Deutsche Mark (€ 10,000) to 50,000 Deutsche Mark (€ 25,000). At the same time new rules providing for the subordination of shareholder loans given at a time when a GmbH was in financial distress were introduced.

[2] More than 100 years after the "invention" of the GmbH, this very idea governed the reform of British Company Law by the Companies Act 2006: "Although the vast majority of companies are small, company law has been written traditionally with the large company in mind. The provisions that apply to private companies are frequently expressed as a tailpiece to the provisions applying to public companies. ... The Government intends that the Bill should reset the balance and make the law easier for all to understand. ... This policy runs as a thread through the drafting of all the provisions of the new Bill." *See* DEPARTMENT OF TRADE AND INDUSTRY, COMPANY LAW REFORM, 2005, Cm. 6456, at 13, 29.

[3] The 2nd Senate of the *Bundesgerichtshof* (Federal Court of Justice) deals exclusively with corporate and commercial law cases. It has thus gained an expertise in corporate law matters which equals that of the Delaware Courts.

[4] S*ee* COMPANY LAW REFORM, *supra* note 2 (providing an example of recent developments in Great Britain). In the U.S., many states have introduced a Limited Liability Company (LLC).

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C. The "Invasion" of the British Ltd. and Its Consequences

This peaceful picture was disrupted in 1999 when the European Court of Justice (ECJ) delivered a landmark-decision interpreting the freedom-of-establishment clause of the European Community Treaty. In the famous *Centros* case the ECJ decided that a businessperson may legally incorporate his or her business anywhere in the European Union, even if this happens for the sole reason of avoiding a stricter national corporate regime.[5] This judgment came as a shock to Germany and many other European countries. Although heavily attacked by politicians and legal scholars, the ECJ confirmed the *Centros* rule and even widened its range.[6] Now anyone willing to do so can establish a U.K. Ltd. and conduct business anywhere in Europe, even if the company is operating only outside the U.K. The reason why this option was considered a threat by German scholars and politicians (and welcomed by clever "Go Limited!"-service agencies) is simple: Although the Ltd. legal regime by no means is more transparent or accessible than the GmbH legal regime (or comparable European corporate forms) it can be established much faster and – most of all – does not require any minimum share capital.

In a first reaction many German scholars advocated an extension of the second EC corporate law directive, which imposes a minimum share capital, but is only applicable to the stock corporation (plc, AG, S.A. etc.). Since the U.K. and Ireland never would have consented to this extension, the proposal was moot in the first place. Instead the German government decided to move in the opposite direction and to make the GmbH a more serious competitor for the Ltd. Of the many changes that were discussed and envisaged during the last years, the most hotly debated topic was the financial structure. The most radical proposal was to abolish the required minimum share capital altogether, others suggested a reduction, and another camp strongly opposed any deregulation of the financial regime. In the end the government came up with the compromise briefly described in the following section of this introductory editorial.

[5] Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459.

[6] *See* Christian Kersting & Clemens Philipp Schindler, *The ECJ's Inspire Art Decision of 30 September 2003 and its Effects on Practice*, 4 GERMAN LAW JOURNAL 12 (2003), *available at* http://www.germanlawjournal.com/article.php?id=344; Killian Baelz & Teresa Baldwin, *The End of the Real Seat Theory (Sitztheorie): the European Court of Justice Decision in Ueberseering of 5 November 2002 and its Impact on German and European Company Law*, 3 GERMAN LAW JOURNAL 12 (2002), *available at* http://www.germanlawjournal.com/article.php?id=214.

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Culture explains why the issue of the legal capital is so sensitive. The German business tradition differs significantly from the Anglo-American tradition. Faced with the regulatory choice of either spurring entrepreneurial spirit or protecting the interests of potential creditors, continental legal systems prefer the second option. Realizing that a fixed minimum capital threshold cannot prevent insolvency and may deter innovative but penniless entrepreneurs, continental regulators typically consider it better to ask every possible start-up for a serious equity contribution before granting limited liability. From an economist's point of view this may turn out to be less efficient than a more liberal regime. But the utilitarian standpoint never was part of the continental legal tradition.

D. The Reform and its Coverage in this Special Issue

The reform-bill, known by its acronym MoMiG, will bring about several changes, the most important of which are covered in this special issue. It starts off with an article by Michael Beurskens and Ulrich Noack who highlight major points of the reform bill and put it into a broader context. Next, Jessica Schmidt examines newly-minted opportunity to establish a GmbH with an arbitrary amount of *Unternehmergesellschaft* (stated capital). This may be the reform's most controversial component. This opportunity is tied to an obligation to retain any future profits until the amount of the legal share capital is reached. Schmidt, in the issue's third article, comes to the conclusion that the U.K. Ltd. still offers more financial flexibility. The issue whether the complicated rules governing shareholder loans should be deregulated was also controversial. Dirk Verse analyzes the new regime and compares it to the abandoned statutory provisions as well as the supplementary court-created rules that will also be abolished by the reform.

As its name indicates, the MoMiG is not only intended to make the GmbH more competitive but also aims to prevent its abuse by dubious persons. For that reason both the liability of directors as well as the responsibility of shareholders has been tightened by the reform. Although this aspect was less disputed, it is an important foundation-stone if one wants to combine flexibility with ethical soundness. Details are discussed in the article by Matthias Casper. Proposals to allow for good-faith-acquisition of shares in a GmbH, however, speak to the deregulatory flavor of the reform effort. While there was broad consensus that such an acquisition should be made possible, it turned out that a workable rule that would also take into account the legitimate interests of those who opposed it was difficult to design. Christian Altgen presents the solution that was finally achieved on this point and he explores its boundaries. Finally, Jochen Vetter and Christian Schwandtner devote their attention to a problem of enormous practical importance. The legal protection of the stated capital made it difficult for a German GmbH to participate in a so called cash-pool, a method of finance quite common in (international) corporate groups.

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The amended law tries to strike a balance between the GmbH's interest in liquidity and the group's interest in saving financing costs. The authors, both lawyers in one of Germany's largest law firm, put the new rule to careful scrutiny.

There is no article on the reform of the choice-of-law rules that will allow the GmbHG to operate solely outside Germany. This reform is part of a larger codification project that is still under way and will mainly be realized in a different statute. Once that reform has reached its final stage the *German Law Journal* will cover it too.

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