The Reform of German Private Limited Company: Is the GmbH Ready for the 21st Century?

By Michael Beurskens and Ulrich Noack[*]

A. The GmbH: A Role Model for Privately Held Companies World-Wide

The *Gesellschaft mit beschränkter Haftung* (GmbH - Private Limited Company) is the most popular organizational form for businesses in Germany – numbering almost one million entities in 2007.[1] The GmbH is not only popular for entrepreneurs, but also serves a role in corporate groups and can be more or less easily upgraded to an *Aktiengesellschaft* (AG - public corporation). Nevertheless, few changes have been made since its inception in the late 19th century,[2] leading to complex case law that would most certainly put a smile on the face of any corporate lawyer.[3] The *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen* (MoMiG - Law for the Modernization of the GmbH and to Combat its Abuse),[4] the

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[1] *See* Udo Kornblum, *GMBH-Rundschau*, 99 GMBHR 19 (2008) (estimating a little less than a million companies in 2007).

[2] KLAUS J. MUELLER, THE GMBH - A GUIDE TO THE GERMAN LIMITED LIABILITY COMPANY 32 (2006). This is in stark contrast to the law of corporations, which was not only fundamentally revised in 1937 and 1965, but has also been undergoing a "permanent reform" (Wolfgang Zöllner, Aktienrechtsreform in Permanenz - Was wird aus den Rechten des Aktionärs?, 330 (1994)) since 1994 ("Gesetz für kleine Aktiengesellschaften und zur Deregulierung des Aktiensrechts"), 1998 ("Gesetz zur Kontrolle und Transparenz im Unternehmensbereich"), 2001 ("Gesetz zur Namensaktie und zur Erleichterung der Stimmrechtsausübung"); 2002 ("Gesetz zur weiteren Reform des Aktien- und Bilanzrechts, zu Transparenz und Publizität im Unternehmen"); 2005 ("Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts").

[3] The number of treatises, journals, and the steady stream of new decisions aptly illustrate this point.

[4] *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen* (MoMiG – Law for the modernization of Limited Liability Companies Act and for combating abuses), (BGBl. reference not yet available at time of editorial deadline); draft law reference: BRDrucks. 354/07; S*ee also* the *Bericht des Rechtsausschusses* (report of the Committee on Legal Affairs), BTDrucks 16/9737, *available at* the website of the German Federal Ministry of Justice, http://www.bmj.bund.de/media/archive/1236.pdf.

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most fundamental reform of the German GmbH, tries to replace much of that case law with statutory rules, while also eliminating certain formalities.

It is hard to underestimate the significance of the GmbH on the German economy, but also its historic influence on company law worldwide. Unlike the Anglo-American legal system, the German "*Aktiengesellschaft*" was not designed for small businesses.[5] By introducing the "*Gesellschaft mit beschränkter Haftung*" (GmbH), the legislature of 1896 reconciled the difference between smaller privately held companies and larger publicly traded enterprises by creating the GmbH. The GmbH combines the basic structure of partnership law with the benefits of limited liability.[6] Insofar, German Law differs significantly from the British and traditional US-American systems, where private limited companies are largely subject to the same rules as a public or listed companies.[7] In the past 112 years, the GmbH has not only proven its value domestically, but has also become Germany's most appreciated legal export.[8]

Nevertheless, the GmbH was always subject to abuse, especially in bankruptcy-cases, on one hand[9] and criticism for its relatively strict formalities, as compared to the British Private Companies (limited by shares) on the other hand.[10] The

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[5] RUDOLF B. SCHLESINGER ET. AL., COMPARATIVE LAW 801 (5th ed. 1988).

[6] Ingrid Lynn Lenhardt, *The Corporate And Tax Advantages Of A Limited Liability Company: A German Perspective*, 64 U. CIN. L. REV. 551 (1996); admittedly rules and ideas from one corporate form are often drawn upon to close gaps in the regulation of the other, e.g. regarding the voidability of decisions at shareholder meetings (skeptical WOLFGANG ZÖLLNER in ADOLF BAUMBACH & ALFRED HUECK, GMBH-GESETZ (18th ed. 2006) or groups of companies.

[7] A general overview is provided by KLAUS J. MÜLLER, THE GMBH - GESELLSCHAFT MIT BESCHRÄNKTER HAFTUNG - A GUIDE TO THE GERMAN LIMITED LIABILITY COMPANY (2006); Ulrich Seibert, *The Law Governing Capitalized Corporations in the Federal Republic of Germany (the AG and GmbH)*, *in* BASICS OF GERMAN COMMERCIAL AND ECONOMIC LAW (1994).

[8] *See* Marcus Lutter, *Zur Entwicklung der GmbH in Europa und in der Welt*, 96 GmbHR 1 (2005), and the essays in MARCUS LUTTER, 100 JAHRE GMBH-GESETZ (1992); Schlesinger, *in* MARCUS LUTTER, 100 JAHRE GMBH-GESETZ 830 (1992); BURKHARDT W. MEISTER & MARTIN H. HEIDENHAIN, THE GERMAN LIMITED LIABILITY COMPANY 24 (5th ed. 1988); Jan Thiessen, *Transfer von GmbH-Recht im 20. Jahrhundert - Export, Import, Binnenhandel* in VANESSA DUSS, ET. AL., LEGAL TRANSFER IN HISTORY 446 (Martin Meidenbauer Verlagsbuchhandlung, ed. 2006); *see also* HANDBUCH DES INTERNATIONALEN GMBH-RECHTS (Rembert Suess & Thomas Wachter eds., 2006) (providing comparative documentation).

[9] *See* Ulrich Seibert, *Die rechtsmissbräuchliche Verwendung der GmbH in der Krise - Stellungnahmen zu einer Umfrage des Bundesministeriums der Justiz*, *in* FESTSCHRIFT FÜR VOLKER RÖHRICHT 585-88 (Georg Crezelius et al. eds., Cologne, Schmidt 2005).

[10] Volker Triebel & Sabine Otte, *20 Vorschläge für eine GmbH-Reform - Welche Lektion kann der deutsche Gesetzgeber vom englischen lernen?* 27 ZIP 311 (2006).

criticism reached an all-time high when a series of recent ECJ-decisions[11] allowed German entrepreneurs to freely choose a Limited as an alternative to the GmbH. While the numbers have been debated extensively,[12] there is a significant amount of "pseudo foreign corporations" registered in Great Britain,[13] while being entirely owned by German shareholders and operating exclusively in Germany.[14] Furthermore, the recovery rate in bankruptcy was alarmingly low;[15] and it had become a popular business practice to "professionally bury" GmbH's in crisis by transferring shares to third parties, moving offices to new locations, and appointing naïve, yet insolvent persons as directors.[16]

The international demise of the GmbH as a role-model is also aptly illustrated by the example of Japan:[17] In 1940, following the example of the German statute, Japan adopted the yūgen kaisha ( ) as a special organizational form for small and medium sized enterprises. However, in 2006 that form was abolished in favor of a new entity modeled after the U.S. Limited Liability Corporation (L.L.C.), the gōdō kaisha ( ). Interestingly enough, all existing "GmbH's" were automatically converted to public corporations (kabushiki geisha). Simultaneously, the minimum capital requirement was dropped, making it is possible to incorporate with as little as 1 Yen (less than U.S.$ 0.01 !).

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[11] C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam/Inspire Art, 2003 E.C.R. I-10155; *see also* C-208/00 Überseering BV v. Nordic Construction Company Baumanagement, 2002 E.C.R. I-9919; C-212/97 Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459.

[12] According to a parliamentary inquiry, 23,496 new GmbHs were formed in 2005, while only 3,195 subsidiaries of English Limited companies entered the public registers, BTDrucks 16/283.

[13] Ironically, "simplification" was also one of the core goals of the UK Company Law Act 2006. UK Department of Trade and Industry, Companies Act 2006 – A summary of what it means for private companies (February 2007) *available at* http://www.dti.gov.uk/files/file37956.pdf.

[14] While Udo Kornblum, *Bundesweite Rechtstatsachen zum Unternehmens- und Gesellschaftsrecht, Stand 01.01.2006*, 98 GmbHR 25 (2007), estimates only 7.000 registered subsidiaries in Germany, one has to take into account a huge number of entrepreneurs who are unaware of, or simply ignore, their duties under the Eleventh Council Directive 89/666, 1989 O.J. (L 395), see Horst Eidenmüller, *Die GmbH im Wettbewerb der Rechtsformen*, 36 ZGR 168, 170 (2007).

[15] Specifically, in 2004 more than half of the GmbHs in crisis did not even have sufficient funds to initiate bankruptcy proceedings, JUSTUS MEYER & JUDITH HERMES, GMBHR 807, 809 (2005).

[16] The practice is aptly called "burying" the GmbH.

[17] The Company Law of the People's Republic of China still requires a minimum capital for both the "GmbH" and the Corporation, although the amount is significantly less than in Germany (RMB 30,000/US$ 4,100 for a "GmbH," and RMB 5 Million/US$ 697,412for a stock corporation). Both sums were significantly reduced in 2006. Previously these minimum amounts were RMB 500,000 and RMB 10 Million respectively.

The German government initially decided to go forward with a reform in 2004, following on the heels of the United Kingdom which finally completed a groundbreaking reform in 2006.[18] The first German attempt, the "*Mindestkapitalgesetz*"[19] only proposed a reduction of the minimum capital to € 10,000, while requiring disclosure of the registered capital in all written documents. This draft failed due to re-elections and heavy criticism from both scholars and practitioners.

The following reform schedule was often delayed. The first draft from 2006,[20] followed by an official government draft in May 2007,[21] was considered by the *Bundesrat* (the representatives of the German state governments in legislative proceedings) in July 2007,[22] and then forwarded to parliamentary proceedings. After a first plenary discussion in September 2007, the *Bundestag* (German parliament) delegated the draft (as is customary) to parliamentary committees. A hearing on the reform bill in the parliament's legal committee took place in January 2008. The final plenary discussion and vote in the *Bundestag* took place on 26 June 2008. The MoMiG was scheduled to be discussed again in the *Bundesrat* in September. It then has to be signed by the *Bundespräsident* (Federal President - but without any veto-right) and published in the Federal Gazette. Unless something entirely unexpected happens, it will enter into force in November.

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[18] See the official Internet site at www.dti.gov.uk/bbf/co-act-2006/index.html; detailed description in ALISTAIR ALCOCK, JOHN BIRD & STEVE GALE, COMPANIES ACT 2006: THE NEW LAW (2007); see also critical comments (especially regarding the size of the reform, containing approximately 1, 300 sections and 16 schedules) by David Bennet, *The Companies Act 2006 - A Megalosaurus in Holborn?*, 83 Bus. L.B. 1 (2006); Sandy Shandro & Paul Sidle, *Reforms To English Company Law*, 26 Am. Bankr. Inst. J. 34 (2007); Andrew Harvey, *The Director's Cut*, 104 L.S.G. 31 (2007).

[19] Gesetz zur Bekämpfung von Missbräuchen, zur Neuregelung der Kapitalaufbringung und zur Förderung der Transparenz im GmbH-Recht (Law to combat abuses, to re-structure raising of capital, and to strengthen transparency in the law of private limited liability companies), November 30, 2004.

[20] *See* Referentenentwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) of 29 May 2006, *available at* http://www.bmj.bund.de/files/-/1236/RefE%20MoMiG.pdf.

[21] *See* Regierungsentwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) of 23 May 2007, *available at* http://www.bmj.bund.de/files/-/2109/MoMiG-RegE%2023%2005%2007.pdf.

[22] *See* Bundesrats-Drucksache Nr. 354/07, *available at* http://www.bmj.bund.de/files/1d854d9273a0aaff04db3f2a2caf9b61/2602/Stellungnahme%20Bundesrat%20MoMiG_Beschluss.pdf.

The strong influence of academia in the reform process is noteworthy. While US scholars are generally ignored by both legislators and judges, German professors tend to find the ears of elected representatives. This is aptly illustrated by the fact that five university professors (out of a total of twelve experts) were asked their opinions during the draft's debate in committee.[23] It seems a bit worrisome, however, that this created the impression that the current statute was "not fully thought out," or even "experimental," and would endanger the GmbH's hard-earned reputation.[24]

B. Of Traditions and Change

The drafters of the reform bill faced a tough challenge: While any change was subject to strict scrutiny by legal scholars and practitioners, [25] the pressure to "modernize" was similarly compelling. Opinions were wide and varied, comparable to the situation during the reform of the civil code (*Buergerliches Gesetzbuch*) in 2001. The goal of balancing these conflicting interests, to uphold the established principles, while introducing more or less radical changes, is evident in every single line of the draft. While the most significant changes affect the financial structure and will be discussed in detail below, many other well-established features have been abolished and replaced by rules leaning in the opposite direction.

I. Formalities – Especially Formation

Formation of a GmbH (at least occasionally) proves to be a long and tedious process. It involves the drafting of the corporate charter/articles of incorporation[26] by a legally trained notary public (usually a highly qualified lawyer), the filing of these articles, and a number of assurances by the future directors, as well as proof of provision of the necessary minimum capital and possible state licenses[27] for the

[23] *See* Rechtsausschuss Stellungnahmen der Sachverstandigen *available at* http://www.bundestag.de/ausschuesse/a06/anhoerungen/28_MoMiG/04_Stellungnahmen/index.html.

[24] *See* DYCKMANS: Mangelhafte Gesetzgebung be GmbH nicht hinnehmbar, *available at* http://www.fdp-fraktion.de/webcom/show_websiteprog.php/_c-649/_lkm-84/_nr-9763/bis-/i.html.

[25] As evidenced in the decisions of the 2007 meeting of legal professionals (Deutscher Juristentag).

[26] Unlike most LLC-statutes in the US, German Law does not distinguish between the bylaws and articles of organization. A single document discussing both the core elements and the details of internal structures ("Satzung") is filed with the state and published according to the 1st Directive.

[27] Required e.g. for handcraft, car repairs or operation of an inn, cf. Sect. 1 para. 1 Handwerksordnung (Trade Regulation); sec. 2 para. 1 Gaststättengesetz (Law on the regulation of inns and pubs).

future business. Before registration, these documents require full review by the court keeping the register[28] *before* registration may occur. This could take up to half a year in complex cases. However, since the GmbH as such does not exist before registration, directors and/or shareholders will be personally liable for any losses incurred before registration. In a modern society the requirement for limited liability might arise very early in business operations.[29] Waiting for half a year might prove unacceptable under those circumstances.

Thus, the reform act tries to ease some of the long standing *formal requirements*[30] in order to speed up registration of "standard case" enterprises.

One way to speed up formation is the use of Internet forms and/or emails. A radical change would eliminate the necessity for notarization and instead rely on online-registration. The government draft, however, did not dare to go that far. As a compromise it provided model articles which were to be agreed upon in written form, but required verification of the identity of the signatories by a notary public. The benefit of this "simplification" was questionable at best, since cost-savings were minimal and a trip to the notary public was still unavoidable; thus eliminating any possible time savings. Still, even that change did not pass scrutiny by the parliamentary committee. The final reform bill requires the notary to fully notarize the agreement (i.e. not only verify the identity of the parties, but inform them of the risks), but provides a sample document to be used for this purpose (necessary for cost-savings).

Two simplifications passed parliamentary proceedings, however: Under the new law, no review of public licenses is necessary,[31] and the review of asset provision by shareholders is limited to cases which appear suspicious to a reasonable person.[32] There is also good reason to assume that the introduction of electronic registers in 2007 has led to a significant acceleration of the registration procedure. Some acceleration may also be attributed to the introduction of electronic registers in

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[28] In fact, a proposal shifting the burden of review upon the notaries was clearly declined at the 2007 meeting of legal professionals (*Deutscher Juristentag*).

[29] Namely to avoid personal liability for the statutorily required contractual warranties.

[30] *See* Ulrich Seibert, *Close Corporations – Reforming Private Company Law: European and International Perspectives*, 8 EBOR 83 (2007) (also emphasizing this point).

[31] Sect. 8 para. 1 No. 6 GmbHG (Act on limited liability companies—*GmbHG)* is repealed.

[32] Sect. 8 para. 2 GmbHG expressly states the limitation.

early 2007.[33] While this is unlikely to provide a competitive advantage vis-à-vis other European entities,[34] it certainly eliminated some delays. Still, a review (with regards to form as well as to substance) remains necessary, as does the involvement of a notary public. Thus, even though some requirements have been eased, formation of a GmbH is not as easy as formation of a corporation in most U.S. states. The costs of formation were also slightly reduced. Registration in public registers, filing of documents,[35] and certification of the corporate charter by a notary public amount to only 300 € in actual costs. Since the traditional requirement to publish the registration in newspapers will finally be abandoned in 2009, no further costs apply. In comparison, a German employing a service provider to form a British Limited[36] will generally be required to pay approximately 260 €, *plus* annual service fees of a similar amount for running a registered office in Great Britain.[37] Additional costs also arise from filing annual reports and for the possible filing of tax documents. Furthermore, the German "branch" of the Limited must be registered in Germany,[38] causing costs comparable to registration of a German entity. Formation within a day or less is still factually impossible.[39]

II. Handling of Shares and Membership Rights

Under previous law, the "shareholder"[40] of a GmbH holds a part of the *Geschäftsanteil* (company capital) in an amount divisible by 50 €, and totaling at

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[33] Gesetz über elektronische Handelsregister und Genossenschaftsregister sowie das Unternehmensregister (EHUG), BGBl. I 2006, 2553 ("Act on electronic registers of trade and co-operative societies and the company register").

[34] As all member states are required to provide such electronic registers under Directive 2003/58/EC of July 15, 2003 amending Council Directive 68/151/EEC of April 9, 2003, 2003 O.J. (L 221) 13 as regards disclosure requirements in respect of certain types of companies.

[35] In accordance with First Council Directive on coordination of safeguards which, for the protection of the interests of members and others, are required of companies (Directive 61/151/EEC) (as amended by directive 2003/58/EC), thus similar to the other European Union Member States.

[36] See only www.go-limited.de, www.Limited24.de, www.limited4you.de.

[37] www.go-limited.de/preise/preise-und-agb.html.

[38] As required by the Eleventh Council Directive (EEC) No. 89/666 of December 21, 1989.

[39] This was and is the core argument for the introduction of the new SLNE in Spain. See Fernando Juan-Mateu, *The Private Company in Spain – Some Recent Developments*, 1 ECFR 60-70 (2004).

[40] The GmbHG speaks of "Gesellschafter," which might be better translated as "member" or "partner," as it is the same term used for partners in a German partnership.

least 100 €.[41] To further complicate things, a shareholder may not hold more than one of these capital parts at the time of formation.[42] Dividing existing shares is subject to special and complex rules;[43] and voting is pro rata. However, The reform bill changes these requirements to make the "membership rights" more closely conform to shares of a corporation. Under the reformed statute, every shareholder may hold as many shares as he wants and the value of each part can be freely determined (in multiples of 1 €).[44]

Unlike most US states,[45] Germany does not require shareholders to be registered, but allows for bearer shares even in public corporations. In the GmbH, on the other hand, share certificates may not be issued, but there is no share register in the traditional sense either. However, the directors are required to file a "list of shareholders" with the register. Even though that list is available online[46] to anyone willing to pay 4.50 €,[47] it has no legal relevance regarding the relationship between a shareholder and the GmbH, or a shareholder and a potential purchaser of his shares. Under the new law, only shareholders on the official list are recognized as possessing rights.[48] Therefore, until the list has been updated and filed with the public register, the purchaser of membership rights is treated as a non-shareholder. This once again transfers an idea from the AG to the GmbH.

Finally, the transfer of shares has been improved. Under both previous and reformed law, a notary public is required to create an obligation to transfer shares and to perform that transfer.[49] The articles may, and often will, provide for further requirements, especially consent of all shareholders or compliance with rights of

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[41] Sect. 5 para. 1, 3 GmbHG.

[42] Sect. 5 para. 2 GmbHG.

[43] Sect. 17 GmbHG.

[44] By eliminating the aforementioned rules regarding formation in sect. 5 GmbHG, and simplifying the procedure for splitting shares in sect. 17 GmbHG.

[45] *See e.g.* Sect. 158 DGCL, sect. 185 CalCC, sect. 508 (c) (2) NYBCL.

[46] Central search mechanism of the commercial registers administered by the German States (*Länder*): <www.handelsregister.de>; Central federal register, providing access to the commercial registers: <www.unternehmensregister.de>.

[47] Sect. 7b JVKostO in connection with part 4 of the attached fee schedule.

[48] Sect. 16 para. 1 GmbHG as amended by the reform bill.

[49] *See* sect. 15 paras. 3 and 4 GmbHG.

first refusal.[50] However, the reform bill tries to protect a good faith purchaser, who relies on the shareholders list.[51] An inaccurate list may prove a basis for reasonable reliance. However, reliance is only considered reasonable if the shareholder list was incorrect for at least three years before the transactions, or if the erroneous list is somehow attributable to the true owner. Finally, it is also possible to file an objection in advance to prevent a loss of rights.[52] Whether these amended rules really benefit the practice of mergers and acquisitions is questionable.[53]

III. Internal Organization of the GmbH

Matters of internal organization are left largely unchanged. This is easy to explain: Unlike the *AG*,[54] the GmbH has always been one of the most flexible entities in Europe – requiring no "secretary" or annual meetings, and granting the shareholders almost infinite options in structure (including e.g. the choice to create a supervisory board).[55] The internal structure is largely left to the shareholders. Furthermore, the shareholders may exercise direct control over the management, as well as discharge them without cause.[56]

IV. Moving to a Better Place

Finally, and perhaps most importantly, the reform bill seeks to open the GmbH to off-shore operations. Under traditional law, it was (debatably) impossible to run a GmbH without any "real" business connection to Germany.[57] Thus, even a German corporation may not employ a GmbH for subsidiaries *exclusively* conducting

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[50] *See* Sect. 15 para. 5 GmbHG.

[51] Sect. 16 para. 3 GmbHG as amended by the reform bill; see in detail Altgen (in this issue).

[52] Sect. 16 para. 3, 2nd alternative GmbHG – evidently trying to copy the idea of the real estate registers (Grundbuch).

[53] *See* Martin Schockenhoff & Andreas Höder, *Gutgläubiger Erwerb von GmbH-Anteilen nach dem MoMiG: Nachbesserungsbedarf aus Sicht der M&A-Praxis*, 27 ZIP 1841 (2006) (discussing a previous draft).

[54] Sect. 23 para. 5 AktG prohibits deviations from the statute unless expressly allowed.

[55] Such a board may be constituted voluntarily (Sect. 52 GmbHG), or may be required for co-determination of over 500 employees (see Drittelbeteiligungsgesetz, MitbestG, MontanMitbestG, MitbestErgG), or due to special investors' needs (Sect. 5 para. 2 InvestmG).

[56] In the *AG*, decisions by the shareholders meeting on management issues are expressly prohibited, Sect. 119 para. 2 AktG.

[57] *See* s. 4a sect. 2 GmbHG, requiring the seat to be the place of actual operations.

business in the United States.[58] This also appears to be in line with ECJ case law, as it is easy to prevent entities from *leaving* their home country under the EC Treaty.[59] However, the German GmbH appears to be at a competitive disadvantage since Germany must accept other states' organizational forms under ECJ case law [60] or international treaties - which most modern corporate laws expressly allow.[61] Furthermore, forming GmbH's with their registered seat in Germany will also lead to international jurisdiction of German courts.[62] Whether this is an advantage, as it would be an *additional* forum to the place of the registered office, is subject to debate.[63]

There are two issue that arise, and each is handled separately. A GmbH or AG could previously only be registered at its "real seat,"[64] (i.e. the place where corporate headquarters are located and decisions are made).[65] This place has to be in Germany, as only German registers allow for "proper" registration of German associations. The MoMiG eliminated these rules (which were only added in 1998) and thereby separated the corporate seat from the place of registration. One necessary modification for such "de-localized" companies is the new requirement

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[58] *See* Ulrich Noack & Dirk Zetzsche, *Germany's Corporate And Financial Law 2007: (Getting) Ready For Competition*, *available at* http://papers.ssrn.com.

[59] *See* ECJ, Case 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 ("Articles 52 and 58 of the Treaty cannot be interpreted as conferring on companies incorporated under the law of a Member State a right to transfer their central management and control and their central administration to another Member State while retaining their status as companies incorporated under the legislation of the first Member State.").

[60] *See* Kilian Baelz & Teresa Baldwin, *The End of the Real Seat Theory (Sitztheorie): the European Court of Justice Decision in Ueberseering of November 5, 2002 and its Impact on German and European Company Law*, 3 GERMAN L. J. (2002).

[61] Art. XXV No. 5 Sent. 2 of the Treaty Of Friendship, Commerce And Navigation Between The United States Of America And The Federal Republic Of Germany, U.S. - Germany, July 14, 1956, 7 U.S.T. 1839.

[62] *See* Council Regulation 44/2001, Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, Art., 2000 J.O. (1) 60.

[63] *See* Horst Eidenmüller, *Die GmbH im Wettbewerb der Rechtsformen*, 36 ZGR 168, 206 (2007) (showing skepticism).

[64] Sect. 4a para. 2 GmbHG, Sect. 5 Aktiengesetz and also e.g. RGZ 7, 69 f; 88, 55; 107, 97; BGHZ 19, 105; BGHZ 29, 328.

[65] *See* Nicola Preuß, *Die Wahl des Satzungssitzes im geltenden Gesellschaftsrecht und nach dem MoMiG - Entwurf*, 98 GMBHR 57 (2007).

of a registered office within Germany, where service of court actions against a company may be filed.[66]

The other, more fundamental change will be part of a different reform bill.[67] Germany will finally give up the "real-seat theory" and follow the "incorporation theory." A discussion of the consequences of this change is sadly beyond the scope of this article.

C. The Fixed Capital System in Reform

I. Understanding the Fixed Capital System

One of the most fundamental ideas in German corporate law is that unlike partnerships, corporations require (1) certain minimum funds, (2) to be provided in full by the incorporators, (3) with certain limits on distributions to the shareholders. If these requirements are met, neither shareholders nor directors will generally be held liable for the debt of the corporation.

Even under the old law, the directors had a duty to file for bankruptcy if the company was unable to meet its obligations, or its debts exceeded the available assets.[68] This duty remains intact. If the directors do not act immediately they will become liable for any losses caused thereby.[69] Beyond that, there is no need for a "solvency test," no "wrongful trading," no "piercing of the corporate veil," and no "directors duties towards third parties." Thus, as a rule: "form governs substance" in financing.

This system was codified on a European level in the second Company Law Directive for public corporations, while EU member states remain free to implement their own system of creditor protection for privately held businesses. However, the European Parliament's recommendations on a European private company statute also provide for a fixed capital system (with additional

[66] Sect. 4a para. 1 GmbHG as amended by the reform bill.

[67] Referententwurf eines Gesetzes zum Internationalen Privatrecht der Gesellschaften, Vereine und juristischen Personen of 7 January 2008, http://www.bmj.de/files/-2751/RefE%20Gesetz%20zum%20Internationalen%20Privatrecht%20der%20Gesellschaften,%20Vereine%20und%20juristischen%20Personen.pdf.

[68] Sect. 64 GmbHG.

[69] *See* BGHZ 29, 100, 102 ff.; BGHZ 138, 211, 214.

safeguards).[70] While the debate[71] regarding reform of the second directive has come to an end, at least for now, the discussion of the capital system in private companies is still raging on.

It might be useful to compare the German capital protection system to the system implemented in the corporate laws of most U.S. states:

1. With regards to the first requirement – the "capital" – most states have abolished any **minimum capital requirement**,[72] but do accept the notion of a "stated capital,"[73] which can be determined far more freely than in Germany. Some states[74] have even abolished that last remainder of the fixed capital system.

2. The **payment of the shares** by the founders, or later shareholders, is guaranteed in only a very limited manner. For shares with par value, any distribution below that value is prohibited.[75] However, unlike the GmbH, corporations in most states may issue shares without par value and freely determine the consideration to be paid for them.[76]

3. The final requirement, the **limitations on distribution** to the shareholders, seems to present the largest differences. Unlike the German static system, most states base their limitations on an (in)solvency test – i.e. distributions are allowed unless they would render a company unable to pay its debt. Some states add a balance surplus test which is more comparable to the German system: distributions are limited to the difference between total assets and total liabilities insofar as they exceed the stated capital. For example, Delaware allows for "nimble dividends" to be paid out of the profits of the current or preceding business year. California, on the other hand, follows a different limitation on distribution. Distributions may only be made out of retained earnings (sect. 500 (a) CalCC) or meet a "net asset test" (sect. 500 (b) CalCC) requiring assets to be at least 125% of the debt and liquid assets (i.e. cash and assets immediately realizable in cash) to be at least equal to debt. Under

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[70] T6-0023/2007 of 01/02/2007.

[71] *See* LEGAL CAPITAL IN EUROPE (Marcus Lutter, ed. 2006).

[72] With the exception of South Dakota, Texas, and the District of Columbia, which require a minimum capital of $ 1,000.

[73] *See e.g.* sect. 124 DGCL; Sect. 102 (a)(12) NYBCL.

[74] E.g. California.

[75] Sect. 153 (a) DGCL; § 504 (c) NYBCL.

[76] California does not provide for par value anymore.

California law, directors are jointly and severally liable for prohibited distributions, but may seek indemnification from bad faith recipients.

It is noteworthy that the capital-system implemented for the GmbH differs in a number of important ways from the law for public corporations. The GmbH requires a lower minimum capital to be raised, which is half the amount necessary for a public corporation (*AG*).[77] Similarly, there are fewer restrictions on distributions of assets to the shareholders.[78] Since the shareholders in a GmbH are much closer to management, their *limited* liability is also subject to certain reservations.[79]

While it has been criticized that "competing" systems have to rely on complex instruments such as liability for wrongful trading, fraudulent trading or even "shadow directors," German courts have consistently eroded the privilege of limited liability to prevent abuse. For example, the road to personal liability by shareholders and/or directors is open in the following cases:

1. Personal liability **vis-à-vis third parties** is imposed on any person acting on behalf of the company before its registration (however, as soon as the company is registered, only the company will be liable).[80]

2. Directors are liable **to the company** (and not to third parties or shareholders) for breaches of their duties of care and duty of loyalty.[81]

3. Shareholders are liable **to the GmbH** if they do not pay the par value of their share[82] or if they receive distributions causing the capital to drop below the stated

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[77] *See* Sect. 5 para. 1 GmbHG; *see also* John Armour, *Legal Capital: An Outdated Concept?*, 7 EBOR 6-27 (2006); HORST EIDENMÜLLER, BARBARA GRUNEWALD & ULRICH NOACK, MINIMUM CAPITAL IN THE SYSTEM OF LEGAL CAPITAL IN LEGAL CAPITAL IN EUROPE (Marcus Lutter, ed. 2006).

[78] Compare Sect. 30 GmbHG to Sect. 57 AktG.

[79] According to Sect. 31 para. 1 a distribution to any shareholder lowering assets below the stated capital leads to a duty to return such distributions immediately. Furthermore, the **other shareholders** (even if they were in good faith) are liable according to Sect. 31 para. 3 if the beneficiary is unable to perform that obligation. Furthermore, under Sect. 24, GmbHG shareholders are also liable for the full payment of the registered share capital **by their co-investors**, although their liability is only subordinate.

[80] Sect. 11 GmbHG.

[81] Sect. 43 GmbHG; cf. sect. 64 para. 2 GmbHG, sect. 30 GmbHG.

[82] Sect. 9, 9a GmbHG.

capital.[83] It is worth noting that the director will be liable as well in those cases. If neither the director nor the recipient are able to return the withdrawn funds, all other shareholders will be held liable.[84] If a contribution in cash was agreed upon, but something else was provided (i.e. something which would have been considered a "contribution in kind"), the provision of assets is considered invalid. Similarly, circumventions of the required formalities for contributions in kind (including an express agreement in the articles which will be published by the register and a report by the shareholders regarding the value of the item, which are all subject to full review by the courts) is subject to nullity of the whole transaction. Thus, a shareholder who agreed to pay 10,000 € and provided his automobile worth 20,000 € will still be liable to the GmbH for 10,000 € (though he has a claim for the return of his automobile).

4. If a director continues to conduct business even though there is either an excess of debts over assets or the company is unable to pay its debts (i.e. is "insolvent"), he will be liable **to any new creditors** for their losses in full.[85]

5. Shareholders will be directly liable **to third parties** if they do not sufficiently separate their private funds from company capital, so-called "commingling" (e.g. by keeping separate accounts).[86]

6. Finally, under recent case law, shareholders will be liable **to the GmbH** for causing "intentional damage against public policy" (sect. 826 *Buergerliches Gesetzbuch* - German Civil Code) if they knowingly cause insolvency by withdrawing funds.[87] The limits of that rule are yet to be explored.

Thus, German company law was never a purely formalistic "capital maintenance system." This also forms the basis for the critique of the minimum capital/capital maintenance system which seems to provide a superfluous additional level of protection. However, even today, personal liability of shareholders or directors is an extreme exception under German law.

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[83] Sect. 30 GmbHG.

[84] Sect. 24, 31 GmbHG.

[85] BGHZ 126, 181; BGHZ 138, 211; see also Sect. 64 para. 2 GmbHG.

[86] BGH, ZIP 2006, 467; BGHZ 125, 366 , 368 f.; BGHZ 95, 330.

[87] *See* (most recently) BGH case no. II ZR 3/04 of 16 July 2007 - TriHotel.

II. The Reform

All three elements of the fixed capital system were changed considerably under the reform bill. In addition, responsibility of management was strengthened by requiring higher qualifications and stricter liability rules.

1. Minimum Capital and Unternehmergesellschaft

The whole reform debate started with the heavily advocated reduction of the minimum capital from € 25,000 (of which only 12,500 € must be provided immediately at incorporation) to € 10,000 (of which only 5,000 must be made available from the get-go).[88] This was alleged to be the "European average."[89] Just for comparison: The amount of 25,000 Reichsmark required in 1892 was sufficient to buy a luxury home or employ ten teachers for a whole year.[90] It was only the huge inflation in the early 20th century that caused the GmbH's dramatic rise in popularity. The change was only intended to remove *psychological* disincentives.

Strangely enough, the change that started it all does not appear in the final reform act, causing some critics to announce the failure of the whole reform project. However, keeping the amount the same is reasonable in light of the fact that these assets can be freely used in business-operations.[91]

The true revolution of the MoMiG is hidden in sect. 5a GmbHG: By forming an *Unternehmergesellschaft (haftungsbeschränkt)*,[92] (UG - entrepreneur company (limited liability)) - the peculiar and ugly addition in brackets may not be abbreviated or left

[88] *See* sect. 5 para. 1 GmbHG of the MoMiG-government proposal; previously introduced in the proposal for a Mindestkapitalgesetz in 2004.

[89] Seibert, *supra* note 30, at 87; it is also identical to the amount proposed for the EPC by the European parliament in its Resolution with Recommendations to the Commission on the European Private Company Statute, T6-0023/2007 of 01/02/2007; however, the proposal by the Commission only requires a minimum capital of 1 €.

[90] *See* Hans-Joachim Priester, *Mindestkapital und Sacheinlageregeln*, in Die GmbH-Reform in der Diskussion, VGR (Hrsg.) (Cologne, Otto Schmidt 2006).

[91] Wolfgang Zöllner, *Konkurrenz für inländische Kapitalgesellschaften durch ausländische Rechtsträger, insbesondere durch die englische Private Limited Company*, 1 GMBHR 5 (2006); Wilhelm Happ & Lorenz Holler, *Limited statt GmbH?*, 730 DSTR 732 (2004); Rüdiger Wilhelmi, *Das Mindestkapital als Mindestschutz - eine Apologie im Hinblick auf die Diskussion um eine Reform der GmbH angesichts der englischen Limited*, 13 GMBHR 21 (2006).

[92] The reform was influenced in a draft bill of March 2007 suggested by Member of Parliament, Jürgen Gehb, see <www.gehb.de/positionen/ugg/Arbeitsentwurf-UGG.pdf>.

out - it is meant to "warn" third parties that this is nowhere near as well established as a full GmbH; calling the company "UG" is thereby **expressly** prohibited - even when operating outside Germany) it is possible to achieve GmbH-style limited liability with a minimum capital of € 1.00. There are indeed a few caveats: First, the name of the firm must include the "unhandy" part, *Unternehmergesellschaft (haftungsbeschränkt),* or its abbreviation, UG (*haftungsbeschränkt*) (not merely "UG"!). Secondly, every share with a minimum par value of 1 € must be paid up in full and in cash before registration, contributions in kind are not allowed. Finally, a UG (*haftungsbeschränkt*) has to save 25% of its annual profits. These may not be distributed to the shareholders, but instead will be accumulated.

As soon as the shareholders increase the stated capital to € 10,000, the UG will turn into a "real" GmbH and there will be no need for mandatory savings. Apart from these three modifications, the "UG (*haftungsbeschränkt*)" is a fully grown GmbHwith the rules of the GmbHG applying directly and without any restriction. It is noteworthy that there are no specific liability rules or other precautions involved. Even under the different name "UG (*haftungsbeschränkt*)," the protection provided to creditors is no different from the rules associated with a "grown-up" GmbH.[93]

The drastic departure from the GmbH's minimum capital requirement shows that the days of such requirements are already running out.. By giving entrepreneurs a choice between the two forms and allowing a UG to eventually grow into a GmbH, German corporate law opens itself to a future freed of a minimum capital.

2. Rules on Raising Capital

Under the GmbH's capital maintenance system, each shareholder must provide the agreed-upon contribution (or at least half of the agreed amount) in liquid assets to the free disposal of the company. Contributions in kind require a special report regarding their value and must be published.[94] If there is only one shareholder, payment must be in full, or guarantees must be provided for the remaining sum. Finally, those requirements are subject to full review by the courts before registration.

This can lead to a considerable delay. If any assets are lost (e.g. due to operating the business or natural de-valuation) between the date of the organizational contract agreement and the date of registration, the shareholders are personally

[93] Compare Schmidt [in this issue] for more details on the UG.

[94] Sect. 5 para. 4 GmbHG; Sect. 9c para. 1 sent. 2 GmbHG.

liable to the GmbH for the specified amount.[95] Furthermore, as stated above, the persons acting on behalf of the company before registration can be held personally liable – a situation which makes the GmbH unattractive if an early start of business operations is desired.

The reform bill will not completely eliminate those slowdowns in the registration-process; however, some simplifications were enforced:

1. Registration of a GmbH may only be declined if there is a **"significant" difference between the alleged and the actual value of contributions in kind**.[96] Furthermore, the court may only request proof of the full provision of assets if there are "significant" doubts.[97]

2. The **guarantees** required for the formation of single-person entities was abolished,[98] insofar that the requirements were lowered to the minimum level allowed for by the Twelfth Directive.[99]

3. A new rule allows for the immediate return of assets provided to the GmbH, as long as there is a **legally and economically valid claim** for their return.[100] This new system corresponds, in essence, to the same approach one would take on a balance sheet: The actual form of assets is irrelevant as long as the GmbH receives a benefit of the agreed-upon value. A claim is sufficient, as long as it is enforceable in the full amount.

4. The idea that **contributions in kind** are an exception which have to be agreed upon, evaluated, published, and reviewed is preserved.[101] However, if payment in cash or other liquid assets were agreed upon and other valuables are provided instead, (i.e. a contribution in kind), liability is limited to the difference in value (if any) between the provided items and the agreed upon sum.[102]

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[95] Since BGH case no. II ZR 54/80 of 3 September 1981.

[96] Sect. 9c GmbHG.

[97] Sect. 8 para. 2 sent. 3 GmbHG.

[98] Sect. 7 para. 2 will be completely eliminated.

[99] Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited-liability companies, 1989 O.J. (L 395) 40.

[100] Sect. 19 para. 5 GmbHG.

[101] Sect. 19 para. 4 GmbHG.

[102] Sect. 19 para. 4 GmbHG.

3. Capital Maintenance

Under traditional law, any distributions were prohibited without exception if they reduced the company's assets below the stated capital.[103] The reform bill relaxed that requirement significantly.
As long as there is **a valid counterclaim** or a corporate group as defined by German Law, a director may distribute assets back to the shareholder.[104] Since the sum on the balance sheet does not change, the transaction is considered irrelevant with regards to corporate assets and, therefore, legal.

The new law is meant to benefit the practice of "cash-pooling" in corporate groups: A parent company will often "pool" liquidity from subsidiaries by transferring all debt and assets to a central depository company (the "pool"). Thereby effectively reducing the available assets of the subsidiary, while retaining a claim against the "pool" in return. This allows the entire process to be cost neutral in theory. Nevertheless, the German Federal Supreme Court questioned such actions on the basis of the general prohibition of distribution to shareholders (including the parent company) or related persons if they lower the total amount of assets below the sum of the stated capital and obligations.[105]

A new level of protection, however, has been implemented. While the traditional capital maintenance system was only concerned with numbers on the balance sheet, the amended law also takes liquidity into consideration. Thus, the reform bill inflicts personal liability on the directors for any payment which will cause the inability to pay dues, unless such payments would have been made by a "reasonable businessman."[106] This is comparable to the Anglo-American Law (in)solvency test explained above,[107] but not quite a "wrongful trading rule." In case of doubt, the manager might even be required to leave office in order to evade the all but impossible choice of not following theoretically binding orders or violating the duty to protect the GmbH's assets in favor of its creditors. This conduct-

[103] Sect. 30 para. 1 GmbHG.

[104] Sect. 30 para. 1 GmbHG as amended by the reform.

[105] BGH case no. II ZR 171/01 of 24 November 2003.

[106] Seibert, *supra* note 30, at 92.

[107] However, replacing the strict formal rule of sect. 30 GmbHG, which prohibits any distribution which would lower available assets below the stated capital with a flexible solvency test, is not planned and was actually voted down by a strong majority at the 2007 meeting of legal professionals (*Deutscher Juristentag*).

oriented protection, like those used in the U.S., is supposed to complement the well-established fixed capital maintenance system.[108]

Nevertheless, the new system is not entirely consistent. If it is possible to return assets to shareholders as long as a valid claim remains, the whole process of raising and maintaining capital becomes merely an unnecessary formality. What happens behind the curtains of the seemingly intact traditional system is in fact the acceptance of capital provision by mere guarantee. Put in simple words: As long as a shareholder is actually able to provide funds, his word should be deemed sufficient; and the shareholder will remain liable for (and be able to provide) the promised amount to the company. The system implemented by the reform act complements this aspect with liability of the directors and the requirement to "show" the assets at least once. It is highly questionable whether this approach is really "future-proof."

4. Shareholder Loans[109]

As explained above, the GmbH is based on the idea of a fixed minimum capital, which is available at the sole discretion of the managers and may not be returned to the shareholders. And the shareholders are generally required to provide real funds, i.e. equity to the GmbH.

Nevertheless, it is certainly possible (and general practice) to finance a GmbH by debt - agreeing upon loans for cash or renting necessary operating assets. As long as the shareholders have performed their duties, (provided the agreed-upon contributions up to (at least) the amount of minimum capitals), it is generally possible to start a business.

However, a regulatory challenge may arise in times of crisis. If one treats shareholder loans in the exact manner as third party loans, the GmbH would be required to return the funds in full, or at least provide the full quota in case of bankruptcy. This might seem inefficient insofar as the shareholders should have known of the solvency issues and might have properly liquidated the company. Thus, the Federal Supreme Court (*Bundesgerichtshof*) considered returning loans to shareholders in times of crisis when a breach of the manager's duty to protect the stated capital may result in a loss to the shareholders.[110]

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[108] *See* Eidenmüller, *supra* note 68, at 182 (assuming two strictly alternative systems without any reason to combine the two).

[109] *See* Verse [in this issue].

[110] *Supra*.

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If the shareholders had not provided capital to the GmbH when a proper businessman would have done so, their loans are treated as part of the stated capital. In the 1980's, the legislature created special rules for such loans,[111]which were connected to the difficult-to-determine requirement of a "crisis."

The reform bill replaces these rules with a rule of subordination in bankruptcy law.[112] If a shareholder grants the company a loan, he will not be treated like a third-party-creditor in bankruptcy. Instead, the company's obligation to him will be *subordinated* to other creditors, since canceling the loans will achieve a payout *before* a move for bankruptcy, which does not actually protect the shareholders. Any payments on such loans within one year must be returned to the GmbH in case of insolvency.[113] A last minute amendment allows the insolvency administrator to require the loaned assets to remain with the company for one year in return for proper compensation.

Pulling these rules out of the specifics of GmbH-law and putting them into the general bankruptcy law will make them equally applicable to *all entities* with limited liability, including foreign companies that have their center of business in Germany.[114]

Special exceptions are provided for minority shareholders holding less than 10% of the membership rights and shareholders entering the company in order to save it ("*Sanierungsprivileg*," the *"privilege to ensure financial restructuring"*).

5. Further safeguards

Two measures complement the aforementioned changes and partially compensate for the reduction in state court review:

1. First, since review of the provision of assets by the state courts is significantly reduced, a reasonable basis for reliance upon the directors is of utmost importance. To that end, the requirements imposed upon directors increased, including

[111] Sects. 32a, 32b GmbHG.

[112] Sect. 39 para. 1 no. 5 Insolvenzordnung (bankruptcy code).

[113] Sect. 135 Insolvenzordnung as amended by the proposal.

[114] *See* Seibert, *supra* note 30, at 91.

disqualifying a potential candidate for criminal law violations on foreign soil. This rule is also applicable to subsidiaries of foreign entities as well.[115]

2. Second, the reform bill also imposed new duties upon the shareholders of a GmbH.[116] Specifically, each and every shareholder (independent of the amount of shares held) has a duty to file for bankruptcy if, and only if, there is no management available.[117] Furthermore, it is up to each shareholder to prove that he did not know of either the insolvency or the lack of a manager who could be reached. These rules are complemented by general provisions assigning the responsibility of receiving legally binding statements to the shareholders when managers are absent (Sect. 35 para. 1 sent 2 et seq. GmbHG).

D. Summary and Outlook

While it is widely accepted that competition of regulators,[118] like any kind of competition, is beneficial to the market-participants,[119] there are equally good reasons to assume that drastic changes might deter investors by eliminating the advantages of previous case law, treatises, and other literature. Recent studies suggest that small and medium sized enterprises select organizational forms solely on the basis of formation costs, ignoring both operating costs and structural advantages.[120] Thus any reform faces the challenge of endangering a well-established system, that is supported by strong case law, legal writing, and expertise.

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[115] *Id.* at 92.

[116] Since the rule is implemented in the bankruptcy code (*Insolvenzordnung*) it will similarly apply to the *Aktiengesellschaft* and any other legal entity operating in Germany.

[117] Sect. 15a Insolvenzordnung (bankruptcy code) as introduced by the reform bill.

[118] Christian Kirchner et. al., *Regulatory Competition in EU Corporate Law after Inspire Art: Unbundling Delaware's Product for Europe*, 3 ECFLR 159 (2005); Harm-Jan de Kluiver, *Inspiring a New European Company Law? – Observations on the ECJs Decision in Inspire Art from a Dutch Perspective and the Imminent Competition for Corporate Charters between EC Member States*, 2 ECFLR 121 (2004).

[119] *See* Marco Ventoruzzo, "*Cost-Based*" *And* "*Rules-Based*" *Regulatory Competition: Markets For Corporate Charters In The U.S. And In The E.U.*, 3 N.Y.U. J. L. & BUS. 91 (2006) (including detailed analysis).

[120] Marco Becht et. al., *Where Do Firms Incorporate?*, ECGI - Law Working Paper No. 70/2006 (Sept. 2006), *available at* http://ssrn.com/abstract=906066.

Germany joins other European countries in the reform of private limited companies.[121] Most recently, the European Commission introduced its own proposal into the competition: The "Societas Privata Europea" (SPE), a European Private Company.[122] The time for change seems better than ever, but can the reform bill really deliver on that promise?

While arguably not participating in a potential "race to the bottom,"[123] the *financial structure* of the GmbH will change completely.[124] Specifically, the MoMiG constitutes a visible step towards the demise of the minimum capital requirement.[125] On the other hand, while a lot of window-decorating[126] is bound to happen, the core elements of the GmbH's *organization* will remain unchanged.[127] Even after the reform, formation will remain complex and expensive. However, these deficiencies have been compensated for by the high flexibility in operation. The established system of creditor protection, combined with the planned improvements, will guarantee a certain level of trust exceeding many foreign entities. And the lowered entry "price" of limited liability might attract new small and medium enterprises.

Furthermore, the reform bill tried to ensure consistency. Thus, some changes are not limited to the GmbH, but also apply to the public corporation – and, according to the government's reasoning, also to bankruptcy of foreign entities.[128]

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[121] *See* Thomas Karst, *Die GmbH französischen Rechts*, NotBZ 119 (2006) (France, Sweden and Spain as examples); Malcolm Wiberg, *Sweden: Company Law – Reform*, 21(3) J.I.B.L.R. N19 (2006); Carl Sverniov, *Sweden: Company Law – Reform*, 15(6) I.C.C.L.R. N55-56 (2004).

[122] <http://ec.europa.eu/internal_market/company/docs/epc/proposal_de.pdf>.

[123] *See* Seibert, *supra* note 30, at 85 ("If you can't beat them – join them.").

[124] For more details on the current capital structure of the GmbH, see FRANK DORNSEIFER, CORPORATE BUSINESS FORMS IN EUROPE 311 (Frank Dornseifer, ed., 1st ed., 2005); it is only slightly more flexible than the system for public corporations under the Second Directive which was largely modeled after German public corporation law.

[125] Specifically supra * on the "*Unternehmergesellschaft (haftungsbeschränkt)*," a special type of GmbH with a minimum stated capital of 1 €; on the general debate cf. the essays in MARCUS LUTTER, LEGAL CAPITAL IN EUROPE (2006) (dealing with public corporations) and the essays in 7 EBOR (2006).

[126] Including the elimination of superfluous articles, rephrasing of certain parts of the statute and the addition of official headings.

[127] *See* Seibert, *supra* note 30, at 84.

[128] Including the incompatibility-rules regarding managers (infra *), international mobility (infra *), increased management liability for distributions to members/shareholders (infra *), and rules regarding loans by members/shareholders (infra *).

The reform is heavily debated.[129] For some, it appears "overly rushed" and "far-reaching,"[130] while others criticize the "lack of vision" and the "inconsistent compromises."[131] The "*Unternehmergesellschaft (haftungsbeschränkt)*" is a direct result of that debate.[132] Since it was politically impossible to completely eliminate the minimum capital requirement, a "re-labeling-approach" was taken. Therefore, the legislature could focus on optimizing the GmbH and avoid internal competition.[133]

Nowadays, the label "GmbH" seems to be a seal of quality - even though at the time of its inception it was called a "limited respectability company."[134] Both lawyers and the public in general know little, if anything, about foreign entities. Following their natural tendency to avoid the unknown, many parties will refuse to deal with unknown entities and lawyers will advise against "strange" organizational forms.[135]

Was the reform a success? Were the changes sufficient to put the 112 year-old GmbH on a level playing field with modern organizational forms like the proposed European Private Company (SPE)? Or was the modernization overly hampered by traditions and lobbying efforts? Only time will tell. But a closer look shows that most of the changes concern only details. The sole fundamental change is the introduction of the "*Unternehmergesellschaft (haftungsbeschränkt)*" Without any legal

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[129] *See* Marcus Lutter, *Für eine Unternehmer-Gesellschaft (UG) - Zur notwendigen Erweiterung der geplanten GmbH-Reform*, BB-Spezial Nr. 7/1006 2 (illustrating the pro side); Karsten Schmidt, *Brüderchen und Schwesterchen für die GmbH? Eine Kritik der Vorschläge zur Vermehrung der Rechtsformen*, 59 DB 1096 (2006) (illustrating the contra side).

[130] Specifically the statements at the parliamentary hearing regarding the reform bill, *supra*.

[131] *See* Triebel & Otte, *supra* note 10, at 311 (voicing skepticism).

[132] *See* Seibert, *supra* note 30, at 92 (questioning this topic).

[133] Horst Eidenmüller, *Die GmbH im Wettbewerb der Rechtsformen*, 36 ZGR 168, 181 (2007); Karsten Schmidt, *Brüderchen und Schwesterchen für die GmbH? Eine Kritik der Vorschläge zur Vermehrung der Rechtsformen*, 59 DB 1096 (2006).

[134] As translated by Ingrid Lynn Lenhardt, *The Corporate And Tax Advantages Of A Limited Liability Company: A German Perspectiv*e, 64 U. CIN. L. REV. 551, 553 (1996).

[135] This is also an often-quoted reason for the lack of importance of the CISG in legal practice. *See* John E. Murray, Jr., *The Neglect of CISG: A Workable Solution*, 17 J. L. & COM. 365 (1998): "Reflecting on the experience under CISG, we now face the reality that it suffers from neglect, as well as ignorance and even fear."

capital, its success (or failure) will probably determine the future of German, if not European, company law.

Maybe the perspective of flat-out competition among all legal forms and legislators is altogether erroneous. If the Darwinian theory of evolution prevails,[136] legislators might do best to seek specific niches for their entities, instead of trying to accommodate *everyone's* needs, by allowing the GmbH to fill t he gap between expensive, complex public entities and cheap, entry-level entities. At the current time, however, the race is on to an unknown destination.

[136] "Survival of the fittest" originally meant that the creature best suited for a certain situation will prevail under those conditions – leading to a distribution of numerous beings and not a single dominant species.