Towards an Organisational Law of the Polycorporate Enterprise?

A Comparative Analysis.

Florian Möslein, LL.M., Dipl.-Kfm., lic. en droit

Keywords:
corporate group, mergers and acquisitions, corporate governance, general meeting of shareholders, power of the board, concept of “Konzernleitungskontrolle”

Abstract

“One key element in improving economic efficiency is corporate governance which involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. […] If countries are to reap the full benefits of the global capital market, and if they are to attract long-term ‘patient’ capital, corporate governance arrangements must be credible and well understood across borders.”

One aspect of the relationship between the company’s management and its shareholders is far from being well understood: How is this relationship affected if the single company is transformed into a parent company of a corporate group? In Germany, this topic has attracted the most vivid legal interest for some decades, but it is not even considered in other countries - neither in the context of corporate governance nor in the one of corporate groups. One reason might be that provisions concerning corporate groups are not perceived as a distinct body of law in most of these countries.

Chapter I will therefore provide a framework of general legal aspects of corporate groups. It shall give an idea of this phenomenon and the main legal issues involved, focusing primarily on UK law. By summarising the German discussion, Chapter II will then focus on the relationship between the board and the general meeting of a parent company within a corporate group. This will enable us to trace the relevant issues in French, US and UK law in Chapter III.

---

1 Preamble to the OECD Principles of Corporate Governance as adopted at the meeting of OECD Ministers on 26-27 May 1999, document SG/CG (99) 1, available on http://www.oecd.org/daf/governance/principles.htm.
2 See Druey, ‘Das deutsche Konzernrecht aus der Sicht des übrigen Europa’ in: Lutter (ed.), ‘Konzernrecht im Ausland’, ZGR Sonderheft 11, 1994, 338. Within the European Union attempts of harmonisation have failed: “The draft proposal for a Ninth Directive on Groups […] has been strongly criticised and no further steps are to be taken in the foreseeable future.”, Farrar et al., ‘Farrar’s Company Law’, 4th ed. 1998, 536.
3 For a comprehensive German introduction see Emmerich/Sonnenschein, ‘Konzernrecht’, 6th ed. 1997.
4 For a comparative report see Immenga, ‘Company Systems and Affiliations’, International Encyclopaedia of Comparative Law, Ch. 7, Vol. XIII and more recently Druey, n 2 supra.
I. The framework

A. The starting point: the classical model of the company

Traditionally, company law – not only in Britain, but virtually all over the world\(^5\) - assumes any company to correspond to the model of an individual autonomous corporation\(^6\). A company (we may call it P Co) is perceived as a separate legal entity with its own economic business interests to pursue and a simple structure, composed of two constitutional organs, the board of directors and the general meeting of shareholders\(^7\).

The first of the typical features\(^8\) that we should distinguish is the separate legal entity\(^9\). P Co is in law a separate person from its shareholders and as such capable of enjoying and being subject to legal rights and duties\(^10\). This feature is the precondition for P’s very existence: “A company exists because there is a rule (usually in a statute) which says that a persona ficta shall be deemed to exist and to have certain of the powers, rights and duties of a natural person.”\(^11\)

Secondly, the limited liability. Not necessarily linked with the concept of a separate legal entity\(^12\), this concept does by no means relieve the company of its liability\(^13\). P Co’s liability for its various debts is unlimited, which may lead to a complete exhaustion of its assets in case of an insolvent liquidation. P Co’s shareholders, however, are under no obligation to its creditors beyond their obligation on the par value of their shares\(^14\).

Finally, the autonomous organisational structure. Being an artificial person, P Co’s use of its legal capacity depends on rules attributing acts of natural persons to it\(^15\). Any company law must contain such rules providing authority to bind the company externally and competence to take decisions internally. Most company laws recognise at least two organs\(^16\): the board of directors manages the company and makes business policy decisions and the general meeting of the shareholders as a body elects the board and decides on certain fundamental corporate changes\(^17\).

---

\(^{5}\) Dorrestijn et al., 'European Corporate Law', 1994, 187.

\(^{6}\) See Antunes, 'Liability of Corporate Groups', 1994, 13-20.

\(^{7}\) Farrar, n 2 supra, 9.

\(^{8}\) See Wheeler, 'The Business Enterprise: A Socio-Legal Introduction', in Wheeler (ed.), 'A Reader on the Law of the Business Enterprise', 1994, 2.

\(^{9}\) The leading UK case is *Salomon v Salomon* [1897] AC 22, HL.

\(^{10}\) This implies attributes such as the capacity to sue and to be sued in its own name, the ownership of its own assets and liabilities and the perpetual succession. See Farrar, n 2 supra, 79.

\(^{11}\) Lord Hoffmann in *Moridian Global Funds Management Asia Ltd v Securities Commission*, [1995] 3 WLR 413, 418.

\(^{12}\) See Farrar, n 2 supra, 79.

\(^{13}\) Pettet, 'Limited liability - A Principle for the 21st Century?', (1995) 48 Current Legal Problems (II), 125, 6.

\(^{14}\) The concept is often combined with a doctrine of adequate capitalisation or one of capital maintenance for creditor protection purposes, see Farrar, n 2 supra, 80.

\(^{15}\) See again Lord Hoffmann, n 11 supra, 418.

\(^{16}\) A two-tier board structure is provided in some countries. See Hueck, 'Gesellschaftsrecht', 19th ed. 1991, 201-2 for Germany and Merle, 'Droit commercial. Sociétés commerciales', 4th ed. 1994, 415-32 for France (where this structure is optional).

\(^{17}\) Compare most recently OECD Principles, n 1 supra, 11. The latter statement is more questionable than it might seem. See infra, III.
B. The recognition of the phenomenon of corporate groups

This model of the single company has to be contrasted with the economic reality characterised by the rise of corporate groups. They consist of legally independent but economically associated companies. For example, P Co may hold all (or at least the majority) of the shares in another company, S Co. The parent company P Co and its subsidiary S Co form a corporate group.

Albeit this structure is fairly simple, it gives rise to complicated legal issues: “The group enterprise has created problems for the law which have not yet been solved”.

I. The recognition of the corporate group in various branches of law

When tackling those problems, the law may recognise the corporate group by taking account not of the legally separate company, but of the economically connected group as a whole. This has been done by a variety of legal branches in a number of circumstances.

One example is tax law in many countries. There is a wide range of situations where special national rules exist for the taxation of profits of companies forming part of a group, and on the European scale the parent-subsidiary directive abolishes the withholding tax on cross-border profit distributions within a group.

This attitude of tax law is due to the idea that it should be neutral with respect to a business being conducted through a number of legally separate companies or through divisions of one company. The neutrality can be ensured by introducing reliefs for losses, dividends, gains and the like or by requiring a consolidated tax return for the group - the latter treating the corporate group more rigorously as a unit.

However, tax law does by no means recognise the corporate group under any circumstances. In many regards each group company is still regarded as a separate entity, particularly in international taxation. For instance, the Californian approach of Unitary Taxation treating the corporate group as one entity has been regarded as being in complete breach of international principles of income taxation.

Accountancy law went further: the national laws implementing the seventh company law directive of 13 June 1983 are based on the idea of the corporate group as one single unit. The obligation to draw up consolidated accounts has the purpose to show the profitability and solvency of the group without looking at the separate legal

---

18 Dorrestejin, n 5 supra, 187.
19 Farrar, n 2 supra, 9.
20 See Immenga, *The Law of Groups in the Federal Republic of Germany*, in Wymeersch (ed.), *Groups of Companies in the EEC*, 1993, 85, 7.
21 In France, relief for double taxation of dividends was introduced already in 1920, see Cozian, *Précis de fiscalité des entreprises*, 19th ed. 1995, 281. Also German tax law took the economic unity into account, by granting certain fiscal advantages to the “Organschaft” since the 1920s, see Immenga, n 20 supra, 89. Hence tax law often encouraged the group structure, contributing to its importance, Emmerich/Sonnenschein, n 20 supra, 89.
22 For Britain Tiley/Collison, *UK Tax Guide*, 16th ed 1998, 1317 et seq.; and Cozian, n 21 supra, 280 et seq. for France.
23 Council Directive (EEC) 90/435, OJ 1990 L 225. See de Hosson, *The Parent-Subsidiary Directive*, [1990] Intertax, 414-37 for an introduction.
24 Prentice, *A Survey of the Law Relating to Corporate Groups in the United Kingdom*, in Wymeersch, n 20 supra, 279, 96.
25 See n 21 supra. This is also the UK approach, see Shipwright/Keeling, *Textbook on Revenue Law*, 1997, 615 et seq.
26 As in the US, see Shipwright/Keeling, n 25 supra, 551. In France, companies can opt for this regime under certain circumstances, see Cozian, n 21 supra, 284 et seq., Guyon, *The Law on Groups of Companies in France*, in Wymeersch, n 24 supra, 141, 6. and Guyon, *Das Recht der Gesellschaftsgruppe in Frankreich*, in Lutter, n 2 supra, 77, 83.
27 See Lindencrona, *What is Wrong with Unitary Taxation?*, in Hopt (ed.), *Groups of Companies in European Laws*, 1982, 230 et seq.
28 Farrar, n 2 supra, 474, claims that this is for less need for precision and certainty in this context.
29 Emmerich/Sonnenschein, n 3 supra, 470.
entities of each of the associated undertakings. This is not a recent development: in Britain, the need for rules coping with the group enterprise was considered as early as 1904\textsuperscript{30}.

Competition law also recognises the corporate group to a large extent\textsuperscript{31}. When determining whether a merger is deemed to arise, the decisive question is - at least in the German\textsuperscript{32}, French\textsuperscript{33}, English\textsuperscript{34} and European Merger Regulation\textsuperscript{35} - whether there is common control or dominant influence. Hence little attention is paid to the legal separation, economic connection is the decisive criterion.

The recognition of the corporate group can be found in a wide variety of other branches of law such as labour law\textsuperscript{36}, insolvency law\textsuperscript{37} or even criminal law\textsuperscript{38}. The law of the corporate group defined as the sum of all those rules recognising the corporate group by ignoring the separate legal personality of its parts is hence an “atomised”\textsuperscript{39} branch of law. Its rules are spilled over the entire legal system. The scale of this recognition differs, however, not only from one country to another, and not only within the same legal system, but even within the same legal branch\textsuperscript{40}.

2. Corporate groups in UK company law

In the context of company law, the discussion of the corporate group is mainly focused on the risk that the interests of the subsidiary might be subordinated to those of the holding company or of the group as a whole. This might cause a loss of the subsidiary as a separate entity, possibly causing prejudice to minority shareholders and creditors. Company law can respond in different ways to this risk\textsuperscript{41}. It can legitimate the formation of the group and the exercise of influence thereby implemented, but offer means of compensation for the risk of injury incurred, either to the subsidiary itself or to its shareholders and creditors\textsuperscript{42}. On the other hand, it can put its emphasis on the interests of the separate entities and protect those interests, during the very formation as well as during the existence of the group. UK company law has chosen the second path\textsuperscript{43}, and it provides mechanisms of protection which will briefly be outlined.

a) The formation of the corporate group

The risk of a possible prejudice to the interests of creditors and minority shareholders arises first when a corporate group is formed. The acquisition of a substantial shareholding in the company by another company might result in their ending up in a disadvantaged position due to a possibly detrimental influence of the parent. Some mechanisms aim to prevent possible prejudice at this stage, already, particularly for minority shareholders, but to some extent also for creditors of the future subsidiary.

\textsuperscript{30} Farrar, n 2 supra, 529.
\textsuperscript{31} Guyon, n 26 supra, 148.
\textsuperscript{32} §23(2) GWB
\textsuperscript{33} Order of 1 December 1986, Art. 39. See Guyon, n 26 supra, 148.
\textsuperscript{34} s65 Fair Trading Act 1973. See Farrar, n 2 supra, 614-7.
\textsuperscript{35} Art. 3 Council Regulation 4064/69, OJ 1989 L 395.
\textsuperscript{36} For Germany see Immenga, n 20 supra, 90; for France Merle, n 16 supra, 690 and Guyon, n 26 supra, 147.
\textsuperscript{37} Guyon, n 26 supra, 149.
\textsuperscript{38} Predominantly the famous French case Rozenblum, Crim. 4 Feb 1985, Rev. soc. 1985, 648.\textsuperscript{39} Druey, n 2 supra, 345.
\textsuperscript{40} For tax law see above and for labour law Immenga, n 20 supra, 90 et seq.
\textsuperscript{41} See Immenga, n 4 supra, 7-8.
\textsuperscript{42} Ibid., 7.
\textsuperscript{43} Farrar, n 2 supra, 532.
The rules governing substantial acquisitions of shares are primarily governed by the “City Code on Mergers and Take-overs” (hereafter Code) as well as by the statutory provisions of ss428-430F Companies Act 1985 (hereafter CA). The Code is not specifically designed to prevent the mentioned risks but to provide an orderly framework within a bid may be conducted44. However, some examples illustrate that its regulations will often have a protective effect45: a fundamental principle underlying the Code is that shareholders should have the right to exit the company if control of it changes46. The Code’s attitude partial bids47 has been said to be one of suspicion48, as those bids confer voting control and leave the remaining shareholders in a powerless position49. And procedural provisions protect the shareholders by giving sufficient time and information to consider50, and the opportunity to express their views on the matter51.

The overall effect is to protect shareholders against ending up in an unwanted minority position in a corporate group where their interests might be prejudiced52, mainly by giving them an opportunity to sell their shares and by providing them with sufficient time and information to take such a decision. S430A and s430B CA have a similar effect at a later stage: if the bid was successful and the offeror owns at least 90% in value of the shares the remaining shareholders can require the offeror to acquire their shares on the terms of the offer53.

There are some shortcomings of the protection, though. The provisions will have a limited effect where shareholders are dispersed and not especially well-informed54 and they do not apply to all target companies as most private companies are excluded55. Finally, the Code by its very nature pays little attention to creditors whose interests might also be prejudiced. On a very limited scale, its provisions might nevertheless be advantageous for them: the directors of the target company are obliged to consider also the creditors’ interests when giving advice to the shareholders56. If the credit contract provides for a possibility to terminate the contract in the event of a change of control, the disclosure provisions of the Code might help the creditor to take advantage of this clause57.

Some other mechanisms having similar protective effects can only be mentioned here. The rules applicable to a scheme of arrangement, which could be used to form a group of companies, might protect potential minority shareholders58 by its disclosure and majority requirements59 and especially by the need of the court’s approval60. They might also protect the future subsidiary’s creditors by providing certain rules for disclosure and creditors’

---

44 See Introduction 1(a) of the Code.
45 More comprehensively Schuberth, ‘Konzernrelevante Regelungen im britischen Recht’, 1997, 34-54.
46 Code, General Principle 10.
47 i.e. offers to acquire something less than all the shares.
48 Prentice, ‘Groups of Companies: The English Experience’, in Hopt, n 27 supra, 99, 114.
49 Ibid. with further reference.
50 Code, General Principle 4.
51 See Prentice, n 48 supra, 115.
52 Ibid. and Wooldridge, ‘Aspects of the Regulation of Groups of Companies in European Laws’, in Drury/Xuereb, ‘European Company Laws’, 1990, 103, 14.
53 Farrar, n 2 supra, 607-9.
54 Prentice, n 48 supra, 115 and Wooldridge, n 52 supra, 114.
55 Code, Introduction 4
56 Code, General Principle 9
57 See Schuberth, n 45 supra, 93.
58 However, a typical scheme of arrangement will aim at turning the company into a wholly-owned subsidiary, so that there is by definition no risk of ending up as a minority shareholder of this subsidiary.
59 s425(2) CA.
meetings, but also by the power of the court to make an ancillary order under s 427(3)(a) to transfer their liabilities to the future parent company in the course of a reconstruction.

Another mechanism for shareholders to protect against ending up in a minority position in a subsidiary, though not a mandatory one, is to impose in the company’s articles restrictions on the transfer of shares which might turn out to be the only protection at this stage for shareholders in small private companies not falling under the Code.

b) The existence of the corporate group

Within an existing group, we should distinguish the mechanisms protecting minority shareholders and those protecting creditors, both facing the risk of detrimental influence of the parent company. The mechanisms are found in some of the most complex areas of English company law: rather than studying the details, we will illustrate some important points by looking at an example.

(1) Minority shareholders

P Co is the parent company of the subsidiary S Co, which is not wholly owned but has a minority shareholder, C. He seeks for remedies in the following situation: P Co uses its control over S to make the latter sell its products to P at a price below market value.

One remedy that C might invoke is an action on behalf of S Co in respect of the wrong done to this company. Such a derivative action, regarded as the only true exception to the rule in Foss v Harbottle, requires fraud on the minority and wrongdoer control of the subsidiary. By definition almost, the latter will easily be established, as opposed to the former. Leaving apart such difficulty, the remedy is unsatisfactory for further reasons. The costs of bringing a derivative action are discouraging, despite the courts’ attempts to provide some assistance in this respect. Perhaps most importantly, the remedy granted will be in favour of the subsidiary, which means that the value of C’s shares will raise accordingly. Depending on his stake in the company, this amount might not even cover his legal expenses. Finally, the remedy is not easily available for procedural reasons.

A more promising remedy is contained in s459 CA and provides that a member may petition the court for a remedy if the company’s affairs have been conducted in a manner unfairly prejudicial to members’ interests. C

---

60 The court will consider whether “an intelligent and honest man [...] might reasonably approve” as Maugham J has put it in Re Dorman, Long & Co Ltd, South Durham Steel and Iron Co Ltd, [1934] Ch 635 at 637. However, the courts are reluctant to interfere if a proper majority has approved the scheme, see Re Heron International NV [1994] 1 BCLC 667.

61 See Hannigan, ‘Share Transfer Problems in the Private Company’, (1990) 11 CoLaw 170.

62 For details, see Wedderburn, ‘The rule in Foss v Harbottle’, C.L.J. [1957], 194 and [1958], 93.

63 Farrar, n 2 supra, 435.

64 (1843) 2 Hare 461

65 See Prentice, n 24 supra, 279, 325.

66 An example for an extremely expensive trial is Prudential Assurance Co. Ltd v Newman Industries Ltd (No. 2) [1982] Ch 204 costing three quarters of a million pounds.

67 wallersteiner v moir (no 2) [1975] QB 373.

68 In small private companies without marketable shares, C will not be able to take any advantage of this.

69 In Prudential Assurance Co. Ltd v Newman Industries Ltd (No. 2), the Court of Appeal held that the shareholder has no locus standi if the diminution in share value was the only loss.

70 See SI 1994/1975, Rules of the Supreme Court 1965, ord. 15, r. 12A.

71 Barrett v Duckett [1995] 1 BCLC 243

72 This provision is the successor of s75 CA 1980, which in turn replaced the oppressive remedy contained in s210 CA 1948, interpreted very restrictively by the courts. See Wedderburn, ‘Oppression of Minority Shareholders’, (1966) 29 MLR 321.
could argue in accordance with *Scottish Co-operative Wholesale Society Ltd v Meyer*\(^{74}\) that the policy of the directors of S to agree the low prices for the products and their unwillingness to seek other customers constitutes such conduct\(^{75}\) unfairly prejudicial to his interests.

Those interests are not limited to strict legal rights, but might include legitimate expectations as to the conduct of the company’s affairs, arising from the nature of the company and agreements and understandings between the parties\(^{76}\). However, this flexible approach will predominantly be taken in a small, private company, as dissatisfied members of larger private and public companies can sell their shares and withdraw from the company\(^{77}\). For this reason, it might already be difficult for C to show that a relevant interest is prejudiced by the pricing agreements\(^{78}\).

Additionally, the conduct has to be unfairly prejudicial, in the sense of causing prejudice or harm to the relevant interest of the member and also unfairly so\(^{79}\). The starting point is to ask whether the conduct is in accordance with the articles and the powers conferred upon the board\(^{80}\). Even a lawful conduct may be unfair, however, and not every unlawful conduct is unfair\(^{81}\). Most of the cases fall into well-defined, but not closed\(^{82}\) categories\(^{83}\). The one that might apply here is mismanagement of the company’s affairs. However, the court will normally be very reluctant to interfere with managerial decisions for two reasons\(^{84}\): it is not the competence of the court to resolve such questions and poor management quality is a risk to be taken by the shareholder. Only “serious economic mismanagement causing real economic harm to the company’s business”\(^{85}\) constitutes unfairly prejudicial conduct. Where it is possible to point to specific acts of mismanagement repeated over many years causing financial loss to the company, this is sufficient\(^{86}\), but that might be particularly difficult in cases like the pricing agreement of our example or in highly integrated groups\(^{87}\).

The appreciation of the conduct might be influenced by the company’s affiliation to a group. In *Nicholas v Soundcraft Ltd and another*\(^{88}\), a loan given to the parent had not been repaid and caused financial difficulties for the subsidiary, but was held not to be unfairly prejudicial as it was in the subsidiary’s interest to avoid the insolvency of the parent company. Albeit Farrar is not wrong that “English law has not yet developed a concept of group interest or a coherent doctrine of fairness in respect of group transactions” and that “the emphasis is still

---

\(^{74}\) [1959] A.C. 324 based on s210 CA 1948.

\(^{75}\) In a highly integrated group, even the unwillingness of the parent company to pay its debts can constitute a conduct of the subsidiary’s affairs. See *Nicholas v Soundcraft Ltd and another* [1993] BCLC 360, CA.

\(^{76}\) See, inter alia, *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14, CA

\(^{77}\) Farrar, n 2 supra, 449-50. But the remedy is not necessarily confined to small companies, see *Re Elgindata Ltd* [1991] BCLC 959.

\(^{78}\) Since the amendment of s459 in 1989, the remedy is at least available even if the prejudice concerns the members generally.

\(^{79}\) *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14; *Re RA Noble & Sons (Clothing) Ltd* [1983] BCLC 273. The test is an objective, not a subjective one.

\(^{80}\) Farrar, n 2 supra, 452.

\(^{81}\) *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14, CA. See Farrar, ibid., for further examples.

\(^{82}\) *Re BSB Holdings Ltd (No 2)* [1996] 1 BCLC 155.

\(^{83}\) Inter alia, removal and exclusion from the board, abuse of power and self-dealing by the directors.

\(^{84}\) *Re Elgindata Ltd* [1991] BCLC 959, 993-4; *Re Sam Weller & Sons Ltd* [1990] Ch 682, 694.

\(^{85}\) *Re Five Minute Car Wash Service Ltd* [1966] 1 WLR 745; *Re Macro (Ipswich) Ltd* [1994] 2 BCLC 354.

\(^{86}\) *Re Macro (Ipswich) Ltd* [1994] 2 BCLC 354

\(^{87}\) See Prentice, n 24 supra, 327.

\(^{88}\) [1993] BCLC 360, CA.
on the interest of individual companies\textsuperscript{89}, one might respectfully add that this interest of the individual company may well be influenced by the interests of other members of the group\textsuperscript{90}.

Shareholders may have insufficient information to determine whether there has been unfairly prejudicial conduct\textsuperscript{91} and the cost barrier is an impediment to the bringing of an action for relief\textsuperscript{92}. Yet, s. 459 will apply at least in the harshest cases and is flexible as to the remedies\textsuperscript{93} which aim to give relief to the shareholder directly, not to the company\textsuperscript{94}. Thus, s. 459 will generally be the most helpful remedy for the minority shareholder of the subsidiary\textsuperscript{95}.

An indirect, not enforceable mechanism of protection applicable for listed subsidiaries is contained in the Listing Rules. Paragraph 3.13 provides that a company with a controlling shareholder\textsuperscript{96} must, inter alia, be capable at all times of operating and making decisions independently of that shareholder. Moreover, Chapter 11 provides for a competence of the general meeting to decide upon certain agreements with associated persons, the voting right of those persons being excluded. These rules have the general effect to avoid that the subsidiary’s business is conducted in the interest of the parent company or of the group rather than in the subsidiary’s own interest\textsuperscript{97}.

Particularly, a situation as in our example will not arise where these rules apply, furthermore providing that transactions with the controlling shareholder must be at arm’s length and on a normal commercial basis. Indirectly, it is the minority shareholder who benefits of the independence of the subsidiary maintained by these rules.

\textbf{(2) Creditors}

The latter mechanism will equally protect the subsidiary’s creditors. Where, however, the parent exercises detrimental influence some other mechanisms might prevent possible prejudice for them.

English courts adhere rather strictly to the principle laid down in the case \textit{Salomon v. A. Salomon and Co. Ltd}\textsuperscript{98} over 100 years ago, preventing the subsidiary’s creditor to reach the assets of the parent company: “Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities”\textsuperscript{99}. However, the courts have occasionally departed from that principle, but it seems impossible to find a general rule as to when the corporate

\textsuperscript{89} Farrar, n 2 supra, 532.
\textsuperscript{90} See also Jesner v. Jarrad Properties Ltd [1993] BCLC 1032, CS.
\textsuperscript{91} Wooldridge, n 52 supra, 115. \textit{Re Hydrosan Ltd} [1991] BCC 19, made access to the company’s documents easier for minority shareholders.
\textsuperscript{92} See Prentice, n 24 supra, 327 and Schuberth, n 45 supra, 143-5.
\textsuperscript{93} The court “may make such order as it thinks fit for giving relief”, s461(1) CA. The most common relief is a purchase order requiring the respondents to purchase the shareholders shares, see Farrar, n 2 supra, 455.
\textsuperscript{94} As opposed to the one in the derivative action, see supra, text to n 69.
\textsuperscript{95} S122(1)(g) IA, giving jurisdiction to wind up companies on the just and equitable ground can only be mentioned here. It is not redundant, though, as there may be cases where this section is applicable even if a petition on unfairly prejudicial grounds would fail. See Farrar, n 2 supra, 457.
\textsuperscript{96} The definition in paragraph 3.12. includes any person who either controls 30% or more of the voting rights or is able to control the appointment of the voting majority of directors. Parent companies will generally fall under this definition.
\textsuperscript{97} See Schuberth, n 45 supra, 167. Surprisingly, there is not any English publication to refer to.
\textsuperscript{98} [1897] AC 22, HL.
\textsuperscript{99} Slade LJ in \textit{Adams v Cape Industries plc} [1990] Ch 433, CA. The situation in France is broadly similar, see for example Com 20 oct. 1992, Rev. sociétés 1993, 449.
veil will be pierced\(^\text{100}\). There have been some decisions where the separate corporate entity has been disregarded in the context of corporate groups\(^\text{101}\), but only in very exceptional circumstances to hold one group company liable for the debts of another\(^\text{102}\). In this situation, the courts are particularly reluctant to pierce the corporate veil\(^\text{103}\) - and they certainly will not do it only because of the fact that the debtor is a subsidiary, even if it is a wholly-owned one\(^\text{104}\).

An important new means of creditor protection is provided, however, by the wrongful trading provision, s214 Insolvency Act 1986 (hereafter: IA)\(^\text{105}\). In case of an insolvent liquidation, the liquidator is enabled to obtain a court order that directors are liable for the debts of the company. A proof of dishonesty is not required\(^\text{106}\), but the liquidator must establish that there was a moment in time when the director “knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation”\(^\text{107}\).

S. 214(7) extends the liability to a shadow director defined as “a person in accordance with whose directions or instructions the directors of a company are accustomed to act”\(^\text{108}\). This might cause the liability of the parent for the subsidiary’s debts, provided that the former is a shadow director of the latter. This was first discussed in \textit{Re Hydrodam (Corby) Ltd} by Millett J\(^\text{109}\). Where it is established that the board of the parent as a collective body gave instructions to the subsidiary’s directors and that the latter were accustomed to act in accordance with those instructions, the parent company is a shadow director of the subsidiary\(^\text{110}\). Instructions are given if the directors are directed “how to act in relation to the company”\(^\text{111}\). This requires more than the majority control of the subsidiary or even holding all its shares\(^\text{112}\), but it remains to be seen whether resolutions in the subsidiary’s general meeting can be regarded as such instructions, especially where it is vested with extensive decision powers. To prove this requirement\(^\text{113}\) - and the one of “accustomed to act” - might be difficult. Single directions are not sufficient, but there must be a regular practice over a period of time and a regular course of conduct\(^\text{114}\). Even if all those requirements are established, liability under s214 IA will be excluded where the parent “took every step with a view to minimising the potential losses”\(^\text{115}\).

---

\(^{100}\) For an example of an attempt to classify see Ottolenghi, `\textit{From Peeping behind the Corporate Veil, to Ignoring it Completely}`, (1990) 53 MLR 338.

\(^{101}\) DHN Food Distributors Ltd \textit{v} London Borough of Tower Hamlets [1976] 3 AllER 462, CA, but the decision was not followed by Woolfson \textit{v} Strathclyde Regional Council 1978 SLT 159, HL. Compare Kirkbride, `\textit{Adams v Cape Industries Plc - Group Reality of Legal Reality?}`, (1991) BLR 21.

\(^{102}\) See \textit{Re Bank of Credit an Commerce International SA (No 3)} [1993] BCLC 1490, CA and No 10 [1995] 1 BCLC 362, where the court was faced to a hopeless muddle.

\(^{103}\) Farrar, n 2 supra, 74.

\(^{104}\) See Lord Keith of Kinkel in Woolfson \textit{v} Strathclyde Regional Council 1978 SLT 159, HL. Compare also Schmitthoff, `The Wholly-Owned and the Controlled Subsidiary`, J.B.L. 1978, 218-29.

\(^{105}\) See Farrar, n 2 supra, 738-40.

\(^{106}\) As opposed to the fraudulent trading provision of s213 IA. For an illustration of that provision’s shorcomings in the group context see \textit{Re Augustus Barnett & Sons Ltd} [1986] BCLC 170.

\(^{107}\) s214(2)(b) IA.

\(^{108}\) s741(2) CA.

\(^{109}\) [1994] 2 BCLC 180, 4.

\(^{110}\) The individual directors of the parent will be shadow directors of the subsidiary where the instructions were given by them individually. See ibid., 184.

\(^{111}\) n 109 supra, 183.

\(^{112}\) See Prentice, n 24 supra, 313.

\(^{113}\) There is no presumption such as Prentice, ibid., seems to assume. See \textit{Re Hydrodam (Corby) Ltd}, n 109 supra, 180.

\(^{114}\) \textit{Re Unisoft Group Ltd (No 3)} [1994] 2 BCLC 609.

\(^{115}\) s214(3) IA.
Another mechanism to protect the creditors are the disability rules enabling a company in liquidation to recover property by disallowing particular transactions to stand or certain types of claims\textsuperscript{116}. For example, transactions at an undervalue entered into by a company which is insolvent during a certain period prior to the liquidation may be challenged. The interesting feature of those rules in the context of corporate groups are the modifications that apply for connected persons\textsuperscript{117}: not only are the relevant periods prolonged, but the effectiveness of the rules is enhanced by the operation of certain presumptions. As the complex definition of connected persons\textsuperscript{118} contains not only parent companies controlling one third or more of the voting power of a subsidiary, but also other subsidiaries of the same parent company, these modifications will apply for all intra-group transactions.

C. Conclusion

All mentioned mechanisms are rules of general company law. They generally operate whenever there is detrimental influence regardless whether it origins in a parent company, a controlling shareholder or some other outsider.

This does not imply that there are no specific rules with regard to corporate groups in UK company law. Definitions of the terms “holding company” and “subsidiary” are laid down in s736 CA. Originally for accountancy purposes, they were given effect on other issues in 1948. Since the implementation of the seventh directive\textsuperscript{119}, a separate definition for accountancy purposes is laid down in s258 CA, echoing the elastic definition of dominant influence and the concept of control contracts used in German law\textsuperscript{120} - as opposed to s736 et seq., characterised by precise and detailed legal criteria and a series of supplements to avoid possible loopholes. Broadly, the latter applies where one company either controls or holds the voting rights in another company or, as a member, has the right to appoint or remove the majority of its board of directors. For the purpose of some provisions, the notion of “group” is defined as a holding company together with its subsidiaries\textsuperscript{121}.

Yet the scope of these definitions is very restricted. Leaving disclosure purposes apart their function is twofold\textsuperscript{122}: on the one hand, s23 CA prohibits a subsidiary or its nominee from being a member of its holding company. On the other hand, a number of provisions extend certain obligations of companies to certain other members of the group and their directors\textsuperscript{123} or, conversely, exempt certain transactions within a group that would otherwise be prohibited\textsuperscript{124}. Those are the only provisions where UK company law takes specifically account of the economically connected group rather than of the legally separate company. Hence, there are only rare examples of an express recognition of the corporate group in UK company law.

\textsuperscript{116} See Prentice, n 24 supra, 318.

\textsuperscript{117} See, inter alia, ss239 (6), 240 (1)(a), 241(2A)(b) IA and Prentice, n 24 supra, 319-22 for details.

\textsuperscript{118} Contained in s249 in connection with s435(6),(10) IA.

\textsuperscript{119} Its definition of the group is rather broad: mandatory tests based on legal control are accomplished by optional tests on factual control, see Farrar, n 2 supra, 472-4. Prentice, n 24 supra, 298, states for the UK implementation: “The definition of what constitutes a group […] is the first time English legislature has tried to define the phenomenon in terms of substance, or economic reality, and not form.”

\textsuperscript{120} §18(1) AktG. See Wooldridge, n 52 supra, 106 and compare also Wooldridge, ‘Groups of Companies - The Law and Practice in Britain, France and Germany’, 1981, 17-78.

\textsuperscript{121} Compare ss153(5), 319(7), 333 CA. Schuberth, n 45 supra, 23, is therefore wrong when claiming that no such term is used in English company law.

\textsuperscript{122} See Farrar, n 2 supra, 535-6.

\textsuperscript{123} For example, s151 and s330 CA.

\textsuperscript{124} Compare the exemptions in the loan prohibitions for directors in Part X, for example s333 CA.
The mechanisms described above are not specifically designed for corporate groups, and they never apply merely because of the existence of a group. As was shown above, the mechanisms are only triggered within an existing group if some element of detrimental influence is established. As a conclusion, UK company law does not react to the status of the corporate group, but only to certain patterns of behaviour within a corporate group.

This statement alone, however, does by no means imply that the law is underdeveloped and that the results are unsatisfactory\textsuperscript{125}. On the contrary, there may be good economic reasons for group companies to operate as autonomous, independent entities rather than being co-ordinated by interventions of the parent company\textsuperscript{126}. Only if the latter policy is adopted, the risk of a possible prejudice for creditors and minority shareholders increases. It is reasonable if protective mechanisms of the law are restricted to this case\textsuperscript{127}. The mentioned provisions of the Insolvency Act are a good example for such an approach: the harshest consequence, s 214, applies only if particular detrimental interventions can be positively established. More moderate mechanisms, the disability rules, can be triggered more easily because of the group structure unless it can be established that no such interventions took place, in which case the creditor is left as if he had dealt with an independent company.

But the legal mechanisms might be unsatisfactory in another respect. When focusing on the protection of creditors and minority shareholders of the subsidiary, the discussion in the UK\textsuperscript{128} largely fails to notice another impact of the corporate group that will be dealt with in the next chapter.

\textsuperscript{125} As Farrar, n 2 supra, 536 seems to conclude.

\textsuperscript{126} See Yeung, 'Corporate Groups: Legal Aspects of the Management Dilemma', [1997] LMCLQ 208, 209 et seq.

\textsuperscript{127} Yet this approach is common to most legal systems, but the necessary degree of intervention is different. See Dorrestejin, n 5 supra, 211.

\textsuperscript{128} But also in other countries, see infra, III.A.
II. The focus

A. Introduction

1. The emergence of the “new” approach

This impact is one of the main themes of recent legal discussion about corporate groups in Germany. The issue was already considered in 1902 and has been discussed by various scholars since. However, Prof. M. Lutter and his disciples are credited for the “legal discovery of the 1970s” as they drew drawing general attention to this approach. Partly followed by the Bundesgerichtshof (BGH) in the landmark “Holzmüller” decision in 1982, the wide-ranging implications are considered by countless publications. The basic principles of the decision, however, are still far from being agreed upon by courts and legal scholars.

The particular feature of this approach is the shift of attention from the subsidiary towards the parent company. A strict application of company law rules tailored to the single entity causes a disruption of the legal status of the parent’s shareholders and an enhanced scope of the legal powers of its management. To find a remedy for these shortcomings is the purpose of this approach.

2. An illustration of the approach: the hivedown of a company’s business

An example may illustrate these shortcomings.

Suppose P Co is originally a single company active in two different businesses: it trades with forest products but also runs a maritime dock. According to its articles, agreed upon by all present members, the company’s objects are to run those two businesses, but the company may also form, acquire or participate in other companies and transfer the business to such companies. To run the maritime dock represents the overwhelming part of the actual activity, whereas the trading business has significantly lost importance.

Instead of running the two independent businesses as divisions of one company, the directors of P intend to separate them into two companies. Consequently a new company, S Co, is formed and incorporated. Assets and

---

129 See Emmerich/Sonnenschein, n 3 supra, 17, 72-7 and 88-90 for a survey.
130 Decision of the Reichsgericht in HoldeimsMS 11 (1902), 266 and 12 (1903), 197 (200).
131 For example Filbinger, ‘Die Schranken der Mehrheitsherrschaft im Aktienrecht und Konzernrecht’, 1942, 30-1; Mestmäcker, ‘Verwaltung, Konzerngewalt und Rechte der Aktionäre’, 1958, 97.
132 Kropff, ‘Zur Konzernleitungspflicht’, ZGR 13 (1984), 112.
133 Particularly Lutter, ‘Zur Binnenstruktur des Konzerns’, in: Festschrift für Westermann, 1974, 347 et seq.; Hommelhoff, ‘Die Konzernleitungspflicht - Zentrale Aspekte eines Konzernverfassungsrechts’, 1982 and Timm, ‘Die Aktiengesellschaft als Konzernspitze’, 1980.
134 BGHZ 83, 122 = NJW 1982, 1703.
135 Numerous as they are, it is difficult to give exhaustive references in this paper. Compare particularly Emmerich/Sonnenschein, n 3 supra, 72, referring to the most important publications.
136 Compare, on the one hand: OLG Köln, Die AG, 86, 8, Winterthur/Nordstern; LG Frankfurt, Die AG 1993, 287 et seq.; OLG München, Die AG 1995, 232; OGH, GesRZ 1984, 217, on the other hand BGHZ 119, 1, 7 = NJW 1992, 2760, Asea/BBC; LG Mannheim, Die AG 1991, 29, 30, SEN.
137 Compare particularly Gessler, ‘Einberufung und ungeschriebene Hauptversammlungszusändigkeiten’, in: Festschrift für Stimpel, 1985, 771 et seq.; Hübner, ‘Die Ausgliederung von Unternehmensteilen in aktien- und aufsichtsrechtlicher Sicht’, ibid., 791ff.; Lutter, ‘Organzuständigkeiten im Konzern’, ibid., 825, more critical publications such as Martens, ‘Die Entscheidungsausübung des Vorstandes und die Botschaft zu dem Aktiengesellschaft - Anmerkungen zur BGHZ 83, 122 (“Holzmüller”),’ ZHR 147 (1983), 377; Werner, ‘Zuständigkeitsverlagerung in der Aktiengesellschaft durch Richterrecht?’, ZHR 147 (1983), 429 and the discussion of Westermann and Heinsius, ‘Organzuständigkeiten bei Bildung, Erweiterung und Umorganisation des Konzerns’, ZGR 1984, 352 and 385.
liabilities related to the maritime dock business are transferred from P to S in exchange for all of its shares. The result of this hivedown is a group structure where P as parent company runs the forest trading business and holds the shares in the wholly-owned subsidiary S running the maritime dock business.

X, a shareholder of P Co, is not satisfied with the hivedown by which the main profit centre of P had been transferred out of “his” company. He argues that the company’s management had no power to decide such fundamental change of the corporate structure without the consent of the general meeting.

Moreover, he claims that the new structure involves a shift of decision power from P’s general meeting to its board. X believes that the new structure enables the directors of P to circumvent the general meeting’s right to decide on certain matters. He therefore argues that all decisions requiring a general meeting’s resolution in a single company should be “passed-through” to the general meeting of the parent company if they were to be taken in the wholly-owned subsidiary.

3. The peculiarities of the approach

The arguments of X illustrate the difference to the issues related to minority shareholders in or creditors of a subsidiary who are prejudiced because of the detrimental influence of the parent.139 Here we face the impact of the group structure on the allocation of power within the (future) parent company140. This impact is not confined to its minority shareholders, but concerns the general meeting as a body. Even if X was the only shareholder of P Co, the arguments would not change - although he will then obviously have means to influence the situation to his favour.141

The example illustrates that the arising questions are twofold. First, does the management of a company have the power to transform a single company into a parent company or should the general meeting be involved in such decision? This limb of the approach focuses on the formation of the corporate group and is called “Konzernbildungskontrolle” in German.143

The second limb is concerned with the already existing group structure. Who has the power to take an important decision in the subsidiary? Provided that such decision is vested in the subsidiary’s general meeting, who decides about the vote of the parent company as shareholder? This is the second limb’s concern, referred to as “Konzernleitungskontrolle” in German, which considers managing and controlling the existing group.

---

138 The example is based on the Holzmüller decision, n 134 supra. For an English note see Buxbaum, 'Extension of Parent Company Shareholders' Rights to Participate in the Governance of Subsidiaries', AJCL 31 (1983), 511.

139 See supra, Chapter I.

140 See Galgano, 'The Allocation of Power and the Public Company in Europe.', in: Drury/Xuereb, n 52 supra, 85, for a comparative view on this allocation in the single company and, for its impact on corporate governance, Buxbaum, 'The Internal Division of Powers in Corporate Governance', 73 CalLR (1985), 1671.

141 E.g., by changing P Co’s articles or by dismissing the directors.

142 Compare Emmerich/Sonnenschein, n 3 supra, 73. and Ebenroth, 'Konzernbildungs- und Konzernleitungskontrolle', 1987.

143 Most recently Liebscher, 'Konzernbildungskontrolle', 1995, Seydel, 'Konzernbildungskontrolle bei der AG', 1995 and Wahlers, 'Konzernbildungskontrolle durch die Hauptversammlung der Obersgesellscha', 1995.

144 Particularly Timm, n 133 supra. More recently Mecke, 'Konzernstruktur und Aktienrätsentscheid', 1992, 213 et seq.; Müllert, 'Aktiengesellschaft, Unternehmensgruppe und Kapitalmarkt', 2nd ed. 1996, 417 et seq.
B. “Konzernbildungskontrolle”

Prior to examine the issues of the first limb in more detail, the basic principles of the division of power between the board of directors and the general meeting in German public limited company law require some explanation.\textsuperscript{145}

1. The principles of division of power according to the AktG

The relationship between board and meeting is governed by mandatory provisions of the Aktiengesetz (hereafter AktG) and must not be altered by the company’s articles\textsuperscript{146}. According to §119(1), the general meeting’s power to decide is restricted to cases expressly provided for\textsuperscript{147}. The board of directors, on the other hand, has extensive powers to manage the company under their own responsibility according to §76(1) and unlimited authority to bind the company\textsuperscript{148}, §78(1) and §82(1). In relation to the company, however, §82(2) imposes a duty to respect the limits set especially by the articles or the general meeting, subject to a relevant competence provided for by the Act.

Hence, the statute provides for a limited power of the general meeting, only competent to decide where such power is expressly conferred to it - and a much wider power of the board, competent in all other cases. This mandatory limitation of the power of the general meeting was introduced by the draftsmen in 1937 to guarantee the independent conduct of business and was maintained in 1965 when a new AktG came into force\textsuperscript{149}. Since 1937, the general meeting can thus not be regarded as the supreme organ of the company\textsuperscript{150}: it has no power to interfere by particular directions concerning management decisions and the board is autonomous within its own limits of power. The general meeting has no power to elect or dismiss the board\textsuperscript{151}, but it is the only body competent to alter the articles\textsuperscript{152}.

2. Is the general meeting competent to decide on the hivedown?

X’s first argument would succeed if there was a competence for the general meeting to decide on the hivedown. Such competence might arise on different grounds.

First, X might claim a violation of the object clause. Albeit such violation does not make the hivedown invalid - there is no ultra-vires doctrine in German company law - the approval of the general meeting is, according to §82(2), nonetheless required for transactions with the result of the company’s activities no longer complying with its object clause\textsuperscript{153}. The objects of P Co, however, include the forming, acquiring or participating in other

\textsuperscript{145} The third body, the supervisory board, is largely irrelevant for our purposes.

\textsuperscript{146} §23(5) and Hueck, n 16 supra, 201.

\textsuperscript{147} Particularly the power to elect the members of the supervisory board representing the shareholders, §119(1).

\textsuperscript{148} See Hueck, n 16 supra, 211-5 for details.

\textsuperscript{149} Hueck, n 16 supra, 201.

\textsuperscript{150} See Hopt, ‘Handels- und Gesellschaftsrecht’, Vol. 2, 4th. ed. 1996, 234 and von Rechenberg, ‘Die Hauptversammlung als oberstes Organ der AG’, 1996.

\textsuperscript{151} There is however, an indirect influence, see infra, III.B.1.

\textsuperscript{152} Hueck, n 16 supra, 203.

\textsuperscript{153} Supporting this approach: Hirte, ‘Bezugsrechtsausschluß und Konzernbildung’, 1986, 159; Lutter, n 137 supra, 846 et seq.; Rehbinder, ‘Ausgründung und Erwerb von Tochtergesellschaften und Rechte der Aktionäre’, 1982, 433 et seq.; Timm, n 133 supra, 89 et seq.; Westermann, n 137 supra, 360 et seq. Opposing: von Rechenberg, n 150 supra, 82; Götz, ‘Die Sicherung der Rechte des Aktionärs der Konzernobergesellschaft bei Konzernbildung und Konzernleitung’, AG 1984, 85, 90; Hommelhoff, n 133 supra, 267 et seq.
companies as well as transferring the business to such companies. Notwithstanding the mentioned discussion, at least the present hivedown does not violate P’s object clause.

X might, secondly, argue that the hivedown falls under §179a AktG requiring the general meeting’s approval for the transfer of all assets. But even if the maritime dock represents the overwhelming part of the company’s actual commercial activities, the second business of forest trading including the relevant assets remain within the company. The Bundesgerichtshof decided that the provision does not apply if the company is, after the transfer, still able to carry on the business activities as stated in the object clause, even if only on a limited scale. Therefore, a transfer of nearly all assets does not require as such the shareholders’ approval. The second argument will fail.

Thirdly, X will argue that, apart from §179a AktG, there are plenty of other provisions requiring a shareholders’ approval for decisions similarly implementing structural changes. He will enumerate the formation of a corporate group by contract (§293 AktG), the so-called integration (§319(2) AktG) and especially the hivedown of an undertaking as a whole according to §§123(2), 125 and 13(1) Umwandlungsgesetz of 1995 (Companies Restructuring Act, hereafter UmwG). But none of those provisions covers exactly the hivedown as it was carried out by the directors of P Co. Nonetheless, most authors argue that the general meeting should be competent by analogy to the mentioned provisions. According to the basic principles of German jurisprudence, however, an analogy to statutory provisions requires that there is a gap in the legislation contrary to the draftsmens’ intention - they must have “forgotten” to provide for the respective case. But the problem as arising in our example had already been discussed long before the enactment of the AktG in 1965, and a discussion thereon can even be found in preparatory materials for a statute on a related subject enacted a couple of years earlier. Even when the mentioned UmwG was enacted more than a decade after the Holzmüller decision, the legislator declined to include any provision for exactly that form of hivedown as opposed to earlier drafts of the Act. Consequently, this reluctance must have been on purpose and to draw such analogy is in breach of legal methodology. Therefore, this argument will therefore fail.

As a conclusion, the general meeting of P Co seems not to be competent to decide - bad luck for X?

3. The first limb of the Holzmüller doctrine

The provision §119(2) provides that the general meeting may only decide management decisions if they are submitted by the board. Whether or not to submit such a question had hitherto been regarded as in the discretion of the board, due to the provision’s wording, its function to enable ratifications of breaches of directors’ duties.

---

154 In the Holzmüller case, such a wide object clause was adopted only some months before the hivedown - with the consent of the complaining shareholder! See BGHZ 83, 122, 123.
155 BGHZ 83, 122, 128 et seq.
156 Formerly §361.
157 BGHZ 83, 122, 129.
158 The latter provisions were not yet in force at the time of the Holzmüller decision. They would have had no impact on the decision, because assets and liabilities were transferred - like in our example - but not the undertaking or part of it as a whole as provided for in the UmwG. For details see Feddersen/Kiem, ‘Die Ausgliederung zwischen “Holzmüller” und neuem Umwandlungsgesetz’, ZIP 1994, 1078.
159 For example Hübner, Martens and Westermann, n 137 supra.
160 Larenz, ‘Methodenlehre der Rechtswissenschaft’, 6th ed., 1991, 370.
161 See n 130 and 131 supra.
162 See the preparatory material for the Gesetz gegen Wettbewerbsbeschränkungen enacted in 1957: ‘Josten-Entwurf’, 1949, 55 et seq.
and its effect to exclude a respective directors’ liability according to §93(4) AktG. Consequently, one would suppose that P’s board has the possibility, but no obligation whatsoever to submit the hivedown decision to the general meeting.

In the famous Holzmüller case, based on similar facts, the Bundesgerichtshof ruled, however, that the board had no discretion, but was obliged to submit the decision to the shareholders. “There are, however, fundamental decisions, that, though formally within the power of the board to bind the company, within their power to manage the company’s business subject to §82(2) and within the wording of the articles, have such a thorough impact on the membership rights of the shareholders as well as on their property rights embodied in their share capital that the board of directors may not reasonably assume to be competent to take those decisions on their own responsibility without participation of the general meeting.”

This is the first limb of the Holzmüller doctrine. It is subject to the harshest criticism, less for its result, but foremost for the reasoning: most authors claim that §119(2) does not provide for any obligation of the board and argue that the result should be based on the mentioned analogy.

We will come back to the underlying concepts of those arguments. Yet two clarifications as to the scope of the decision need to be made. First this limb of the Holzmüller doctrine is not confined to corporate group issues. The above citation underlines that every fundamental decision might be subject to the doctrine, regardless whether concerning the formation of a group. Whether the rule applies to a particular decision is difficult to determine, if it is not unpredictable: what decisions are fundamental? And which fundamental decisions have a sufficient impact on shareholders’ rights to fall under the rule?

Even if the first limb of the Holzmüller rule does therefore not only apply in situations where a corporate group is formed, it does, secondly, not always apply in such situations. Obviously there is no need for the rule where the general meeting is competent on other grounds, for example where a hivedown violates the object clause, involves the transfer of all assets or is carried out by virtue of the UmwG. But even if none of those provisions is applicable, the Holzmüller rule will still not apply to all remaining measures resulting in a corporate group structure. For instance, the hivedown of the company’s canteen will hardly ever represent a fundamental decision with an important impact on shareholders’ right.

Decisions concerning the structure of corporate groups are nonetheless the foremost application of the first limb of the Holzmüller rule, regardless whether the (future) parent hives down part of its business to a subsidiary or acquires or sells the participation in a subsidiary. The fundamental character of most such decisions can only be appreciated by considering their wide-ranging consequences, subject of the second limb of the second limb of the Holzmüller doctrine.

163 Compare ‘Diskussionsentwurf zum UmwG’, 1988 and Schmidt, ’Wider eine “lex Holzmüller”‘, in: Festschrift für Heinsius, 1991, 715, 728 et seq.
164 Wahlers, n 143 supra, 168; Liebscher, ibid., 78; Martens, n 137 supra, 383 et seq.
165 BGHZ 83, 122, 131.
166 Compare the references n 137 supra.
167 Heinsius, n 137 supra, 390 et seq. and Werner, ibid., 433 et seq.
168 See particularly Wahlers, n 143 supra, 199 et seq.; Ebenroth, n 142 supra, 48 and Mecke, n 144 supra, 57.
C. “Konzernleitungskontrolle”

We remember X’s argument that such structure involves a shift of decision powers from P’s general meeting to its board and that he therefore demands a “pass-through” of all decisions in the subsidiary requiring a resolution of the latter’s general meeting.

This reasoning requires some illustration, first concerning the general idea and then in respect of a specific scenario.

1. General idea

After the hive-down, P owns all shares in S. Due to further decline in the forest products sector, all substantial economic activity is carried on in the subsidiary, whose business of running the maritime dock flourishes. Every decision that has to be taken in S Co will - according to the division of power outlined above - be taken by S’s own board, unless any provision vests the power to decide in S’s general meeting.

If such provision applies, who votes in S’s general meeting and will therefore effectively take the decision? P’s board, on the grounds of its power to manage the company, or P’s general meeting, on the grounds that it would have power to decide if the decision was taken in a single company? There is however no express provision vesting this power in P’s general meeting and voting for held shares seems to be part of the board’s competence to manage the company’s business. Consequently, all the decisions in S Co - and, the substantial activity of the group being carried on in this company, mainly all of the group’s decisions - will be taken either by the subsidiary’s own board or by the parent’s one.

Hence, the strict application of the statutory competence rules circumvents the decision power of the parent’s general meeting, weakening the legal position of its shareholders\(^{169}\) - albeit economically, the situation in this group resembles a single entity: “Important decisions are in this fashion transferred along with the transferred asset from the parent to the subsidiary.”\(^{170}\)

2. The increase of share capital

The example of an increase of S Co’s share capital reveals harsh consequences of this problem. Say S has a share capital of 500 Euro (500 shares of 1 Euro) and reserves of 500 Euro. The general meeting of S Co decides a capital increase (all the votes casted by the board of the parent) to 1000 Euro by issuing another 500 shares\(^{171}\). By special resolution it is decided that the new shares in S Co shall not be allotted to P Co, but to outside investors\(^{172}\). Such misapplication of P Co’s pre-emption rights will result in S Co no longer being a wholly owned subsidiary and in P Co’s stake dropping down to 50%. The dilution of its shareholding implies an important decrease of P Co’s influence in the subsidiary. The control over P Co’s former business activities is, by virtue of that second step, not only out of reach of P Co’s shareholders, but even out of the company’s reach - without, in principle, any involvement of P Co’s general meeting at all.

If the new shares are issued at 2 Euro (equalling the market price), the sum of share capital and reserves will amount to 2000 Euro. The value of P Co’s shareholding will remain unchanged at 1000 Euro. But if the issue had

\(^{169}\) BGHZ 83, 122, 142.

\(^{170}\) BGHZ 83, 122, 137.

\(^{171}\) See §182(1) AktG and ss80(1), 121(4) CA.

\(^{172}\) Such allotment as if the pre-emptive basis did not apply requires a special resolution, §182(1) AktG and s95(1) CA.
been made at a price below market price, the shareholders would even suffer a loss in value. For instance, an issue at par value of 1 Euro would result in a decrease in value of P Co’s main asset to 750 Euro.

Within a single company, the shareholders’ pre-emption rights prevent such detrimental share issues and can only be removed by a special resolution. The example shows that this mechanism, tailored to the single entity, does not provide protection for the shareholders of the parent in case of a capital increase in the subsidiary.\textsuperscript{173}

3. The second limb of the Holzmüller doctrine

Should therefore all decisions that would require a general meeting’s resolution in a single company be “passed through” to the general meeting of the parent company if they were to be taken in the wholly owned subsidiary?

In the Holzmüller decision, the Bundesgerichtshof answered as follows: “Where the board of directors had transferred the most valuable part of the company’s assets to a wholly owned subsidiary formed for this purpose, the parent company is under an obligation to every shareholder to obtain a resolution of its own general meeting concerning increases of the share capital of the subsidiary at a majority that would be necessary for such a measure in the parent company itself.”\textsuperscript{174} Hence, the court decided in favour of such pass-through, at least under certain circumstances. Yet two observations need to be made concerning this second limb.

First, the reasoning differs from the one in the first limb: here, the Bundesgerichtshof argues that there is a gap in the statutory competences vested in the general meeting. The general meeting is given an “unwritten competence” to decide on the matter, which presents a real departure from the hitherto mandatory division of power described above and is conceptually rather different from the approach in the first limb, based on a duty of the directors to submit the decision to the general meeting.

Secondly, many questions were left open by the court, particularly which decisions have to be passed through. The rule is not restricted to share issue decisions.\textsuperscript{176} However, it was held that not every question to be decided by the subsidiary’s general meeting had to be passed through, minor amendments of the articles for example being excepted.\textsuperscript{177} Furthermore, it was left open whether the reasoning would change had there been prior approval of the hive-down.\textsuperscript{178} Hence, the scope of the second limb is unclear.

D. The different concepts of the approach

Instead of discussing further ramifications, we will examine the judgement’s underlying concept which differs to an important extent from the one proposed by Lutter.

1. The concept of the court: a protective mechanism

Regardless of the different legal reasoning in the two limbs of the Holzmüller decision, there is one common, underlying theme. It is discernible in the first limb, where only those fundamental decisions with sufficient impact on the shareholders’ rights have to be submitted and also in the second limb where not all decisions have to be passed-through. The criterion is always a possible impact on the shareholder’s legal position, on his rights as a member of the company. In the second limb, this impact is direct and immediate: the pre-emptive right of the

\textsuperscript{173} Compare particularly Hirte, n 153 supra, 184 et seq.; Martens, n 137 supra, 412 and Westermann, ibid., 375.
\textsuperscript{174} BGHZ 83, 122.
\textsuperscript{175} Hopt, n 150 supra, 299.
\textsuperscript{176} BGHZ 83, 122, 138 et seq.
\textsuperscript{177} Ibid., 140
\textsuperscript{178} Ibid., 122.
parent’s shareholders, for example, is undermined by the share issue as such. Albeit the decisions examined in the first limb do not have such direct and immediate impact they are nonetheless the basis for a later undermining of the shareholders’ position by decisions of second-limb-type. Hence, the whole reasoning of the court is based on a possible impact on shareholders’ rights. Consequently this approach aims to provide a protective mechanism (insofar similar to the mechanisms described in Chapter I), in this case for the benefit of the parent’s shareholders.

2. The concept of Lutter: the organisational approach

A fundamentally different concept underlies the approach of the Lutter School, which the court considered but declined to comment.

The group is regarded as a functional unit of several legal entities. Such functional unit or “corporatio sui generis” is a business organisation in itself and raises similar questions as normal companies - it has to be founded, financed, managed and supervised, it has to resolve internal conflicts of interests between its members and finally it has to be dissolved. Yet the corporate group as a legal phenomenon is claimed to blast the rules of traditional company law - as, for example, but not only, in the Holzmüller scenario. Hence jurisprudence is attributed the task to prepare rules specifically tailored to the functional unit of the corporate group - instead of applying the rules of general company law that this academic school regards as unable to cope with the phenomenon.

When trying to develop such rules for the decision-making of the group, Lutter refers to general “principles of the private organisational law”, arguing that in every private organisation whatsoever, four categories of competences have to be distinguished:

- the competence to manage
- the competence to control
- the competence to account
- the competence to take fundamental decisions that “for reasons whatsoever are beyond the ‘management’ of the company”

Those categories are then applied to the corporate group, in order to furnish this functional unit with a pattern of internal organisation. The first three categories are attributed as follows: management and control are within the competence of the board of directors of the parent company. The accounting is vested in the management bodies of each subsidiary and the parent company. The question remaining is “who, within this corporate group is

---

179 See Heinsius, n 137 supra, 397, Martens, ibid., 405 and Werner, ibid., 434.
180 Lutter, n 137 supra, 834.
181 BGHZ 83, 122, 138.
182 Lutter, n 137 supra, 827.
183 Lutter, ‘The Law of Groups of Companies in Europe: A Challenge for Jurisprudence’, in: Forum Internationale, (1983) I n 1, 11.
184 Ibid., 9.
185 Ibid., 13.
186 Lutter, n 137 supra, 826 et seq.
187 Ibid., 830.
188 Ibid.
189 Ibid., 830-5.
vested with the fundamental decisions, hence who decides on its formation, enlargement, restructuration and liquidation."\(^\text{190}\)

Lutter points to the shareholder meeting of the parent as competent body\(^\text{191}\). In organisations such as the partnership or the private limited liability company - and, to some extent also the public company - the members’ meeting is considered as the competent body to decide upon such fundamental decisions. Albeit not provided by the draftsmen, it is argued that one should regard such attribution as a principle of every private organisation and therefore applicable to the corporate group as well\(^\text{192}\). Hence, the general meeting of the parent company has the function of a “supreme body” of the corporate group, responsible for all fundamental decisions within the group.

E. Why “organisational law” of the “polycorporate enterprise”?

The latter approach overcomes the protectionist concerns of the traditional law of corporate groups and has a broader, though debatable concept\(^\text{193}\). Whereas the former approach tried to protect different stakeholders in the corporate group, this concept regards the group as one functional unit and looks for an organisational, institutional framework for this unit.

That explains the title of this paper: First, the term “organisational law” is to be understood in the sense of rules providing for an internal organisation structure of the corporate group\(^\text{194}\). To determine such structure, to attribute powers to the group’s bodies becomes an end in itself, no longer aiming to provide for a protective mechanism. This approach is not restricted to the separation of powers of management and owners, but also tries to find a “group interpretation” of the functions of all the different bodies within this group\(^\text{195}\).

Secondly, the approach does no longer consider the corporate group as the sum of independent companies, but as an independent, autonomous body\(^\text{196}\), itself attracting interest as a legal phenomenon rather than the elements it is composed of. 35 years ago, Ludwig Raiser called this functional unit a “poly-corporate association”\(^\text{197}\), which is an excellent description underlining both the unity and the diversity of such a functional unit\(^\text{198}\). “Poly-corporate” stands for the diversity, due to the multiple companies - still legal entities - that it is composed of. The companies resemble atoms, capable to form a complex structure, a molecule, if grouped together\(^\text{199}\). This molecule is regarded as different from its composing atoms, revealing a uniform structure as functional unity. “Association” stands for this unity, a consequence of the economic reality that groups are being led as one business organisation\(^\text{200}\). To avoid any impression of equal partnership between its members (that might arise by using the

---

190 Ibid., 832.
191 Ibid., 833.
192 Lutter, n 183 supra, 20.
193 See Theisen, ‘Der Konzern: betriebswirtschaftliche und rechtliche Grundlagen der Konzernunternehmung’, 1991, 115 and Schneider, ‘Der Konzern als Rechtsform für Unternehmen - Zum Regulierungsgegenstand eines Konzernverfassungsrechts’, in: Mestmäcker/Behrens, ‘Das Gesellschaftsrecht der Konzerne im internationalen Vergleich’, 1991, 563 distinguishing possible conceptual approaches of a law of groups of companies.
194 For the wide-ranging policy and legal implications of such approach see Amstutz, ‘Konzernorganisationsrecht - Ordnungsfunktion, Normstruktur, Rechtssystematik’, 1993 and Ehrice, ‘Gedanken zu einem allgemeinen Konzernorganisationsrecht zwischen Markt und Regulierung’, ZGR 1996, 300.
195 See Emmerich/Sonnenschein, n 2 supra, 90 with further references.
196 Lutter, n 183 supra, 20, and Schneider, n 193 supra, 568 et seq.
197 See Raiser, ‘Die Konzernebildung als Gegenstand rechts- und wirtschaftswissenschaftlicher Untersuchung’, in: Raiser et al. (eds.), ‘Das Verhältnis der Wirtschaftswissenschaft zur Rechtswissenschaft, Soziologie und Statistik’, 1964, 51, 4.
198 See Bälz, ‘Einheit und Vielheit im Konzern’, in: Festschrift für Raiser, 1974, 287 and also Antunes, n 2 supra, 158 et seq.
199 Lutter, n 183 supra, 20.
200 See Mestmäcker, n 131 supra, 303 et seq. and, with qualifications, Yeung, n 126 supra, 209 et seq.
term “association”), which is absent within such groups, often organised like a hierarchy, the present writer chose
the term “enterprise” instead.

The time is ripe to trace such “organisational law of the polycorporate enterprise” in various legal systems - a
task that Lutter himself strongly supports: “There is barely another field of law that is better suited for a common
European development by jurisprudence than the law of groups of companies, since groups of companies are
realised to a great extent across the barriers of national borders; no national legislation has yet found a complete
system but in all of them we can find fruitful approaches, which can be put together to a Ius Commune Europae
of groups of companies”201.

201 Lutter, n 183 supra, 34.
III. In search of traces in other jurisdictions

Curious to trace those fruitful approaches, we will first look for comparable legal discussion and then focus our research on one particular, but crucial aspect of the organisational law of the polycorporate enterprise, the “Konzernbildungskontrolle”. We will consider which body of the company is competent to take what will simply be called ‘fundamental decisions’ from now on: decisions of fundamental structural changes, such as the transformation into a future holding company or the acquisition or sale of important participations.

A. In search of a comparable legal discussion

However, this search seems disappointing. Apart from Austria\(^\text{202}\) and Switzerland\(^\text{203}\), any discussion in this respect is virtually absent. In the US, an interesting article was published by Eisenberg\(^\text{204}\) as early as 1971, later included in his book “The Structure of the Corporation”\(^\text{205}\). Since then, the issue seems to be forgotten. In Britain, Prentice\(^\text{206}\) became aware of the problems and underlined the importance of dealing with them: “failure to do so would result in shareholder control being circumvented where a company carried on its business through subsidiaries”\(^\text{207}\). His discussion, hardly covering two pages, dates back to 1982 - the problems have apparently never been tackled again in the UK. In France, finally, despite some interesting approaches to the problems of corporate groups\(^\text{208}\), the distortions in the parent seem to be overlooked - with exceptions to which we will return later.

But our disappointment gives rise to new questions: why are those problems not discussed? Are they overlooked, not existing or already solved?

B. In search of the power to decide on “Konzernbildung”

We try to find answers by considering the competence to take fundamental decisions, a consideration which is, according to the Holzmüller doctrine, not necessarily confined to the group context. Determining such competence requires to examine the relationship between general meeting and the board.

1. The division of power

Under UK law the articles determine the relationship and confer certain powers of management to the board\(^\text{209}\). The conceptual difference to the German view of the company is striking: the “organisational law” even of the single entity is not governed by mandatory rules but determined by the company’s articles. The company is regarded as an organisation constituted by the contract between its members\(^\text{210}\). The conception of the company is contractual - and not institutional\(^\text{211}\).

\(^{202}\) OGH Wien, AG 1996, 382.

\(^{203}\) In great detail Amstutz, n 194 supra.

\(^{204}\) Eisenberg, ‘Megasubsidiaries: The Effect of Corporate Structure on Corporate Control’, 84 HLR (1971), 1577.

\(^{205}\) Eisenberg, 1976.

\(^{206}\) Prentice, n 48 supra, 126-8.

\(^{207}\) Ibid., 127.

\(^{208}\) See particularly Hannoun, ‘Le droit et les groupes des sociétés’, 1991 and Pariente, ‘Les groupes des sociétés’, 1993.

\(^{209}\) Automatic Self-Cleansing Filter Syndicate Co. Ltd v Cuninghame [1906] 2 Ch 34

\(^{210}\) Stokes, ‘Company Law and Legal Theory’, in: Wheeler (ed.), n 8 supra, 90.

\(^{211}\) For the wider effects of this conceptual difference, see Albert, ‘Capitalism against Capitalism’, 1993, drawing the distinction between the “neo-American” and the “Rhine” model, the latter featuring a richer institutional framework.
However, the immediate outcome is less different than one might suppose: normally, art. 70 of Table A applies, unless any other form of management article is expressly adopted\(^{212}\). It states: “Subject to the provisions of the Act, the memorandum and the articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company”. On that basis, an extensive power to manage is conferred to the board with which the general meeting can only interfere by special resolution or alteration of the articles - both requiring a 3/4 majority\(^{213}\). Despite the contractualist conception, the division of power is strict: “If powers of management are vested in the directors, they and they alone can exercise these powers”\(^{214}\).

One might argue that the general meeting is nonetheless in a better position than its German counterpart, for it has the power to dismiss its board of directors by ordinary resolution\(^{215}\), whereas in Germany this power is formally vested in the supervisory board\(^{216}\). In practical terms, however, there is not much difference: if the German general meeting resolves that the directors have lost their confidence, those will regularly be dismissed as well, given that such resolution is a statutory reason for dismissal\(^{217}\) and, particularly, that the members of the supervisory board representing the shareholders can in turn be dismissed by the general meeting\(^{218}\).

The general meeting’s competence under US company laws resemble the UK’s contractual model, but directors are normally removable only for good cause shown\(^{219}\). In France, the model is conceptually closer to the German one: the “conseil d’administration” is vested with the most extended powers to act for the company by a statutory provision\(^{220}\). However, there is also a contractualist feature: the articles can stipulate that particularly dangerous or important measures need the general meeting’s approval\(^{221}\). One should also note that the provision does not contain the specification “powers of management”, which was repealed in 1967, because of doubts whether such specification covers certain fundamental decisions\(^{222}\). This is interesting: even where doubts about the respective competence of the board had arisen in other countries, this question of wording is never considered. Under current French law, it is beyond doubt that the board of directors has, in principle, such competence.

Notwithstanding the important conceptual differences, we can conclude that X would be in a similarly unsatisfactory position had the hivedown taken place in a company with “standard” articles under the law of any of the mentioned jurisdictions - reason enough to consider his arguments.

2. Possible arguments against the board’s competence

a) Violation of the object clause

The argument that the structure did no longer comply with the company’s object clause for the business being carried on through a subsidiary did not succeed because the clause included, inter alia, the participation in other

\(^{212}\) S8(2) CA. For companies registered before 1 July 1985, art 80 of the 1948 Table A applies. The different wording has no impact on the reasoning in the present paper. For details, see Farrar, n 2 supra, 363-4.

\(^{213}\) See ss9(1), 378(2) CA.

\(^{214}\) John Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113 at 134.

\(^{215}\) s303(1) CA.

\(^{216}\) §83(3) AktG.

\(^{217}\) See again §83(3) AktG and Hueck, n 16 supra, 202.

\(^{218}\) §103(1) AktG. It should be noted that such dismissal requires a ¾ majority unless otherwise provided by the articles.

\(^{219}\) See Eisenberg, n 205 supra, 2 for further references.

\(^{220}\) Art. L. 98, Law n. 66-537 of 24 July 1966.

\(^{221}\) Merle, n 16 supra, 435-6.

\(^{222}\) Merle, n 16 supra, 383.
companies carrying on such business. In the absence of such clause, however, the hivedown would presumably violate the articles and require prior modification by the general meeting.

In the UK, such clause is equally necessary: “Were it not for the practice of conferring express powers on companies to acquire shares in other companies [...], it would not be possible for one company to be the holding company of another”. In those states of the US that have adopted the respective provision of the Model Business Corporation Act, the power to acquire shares is expressly granted. Otherwise, such authority can be derived from the implied powers of the corporation, unless for the acquisition of shares in companies pursuing different business purposes. In both countries, companies thus regularly have the power to held shares in other companies.

Strictly speaking, this is not yet a reply to the argument that the hivedown violates the object clause because the business is no longer carried on by the company itself, but by its subsidiary. This is not a question about ultra vires, but about whether not to pursue an object intra vires could be regarded as contrary to the memorandum. In spite of - or maybe because of - the long and complex history of the ultra vires doctrine in the UK, this question apparently has never given rise to any discussion. The reason might be the object clause’s traditional function to limit the company’s capacity, as opposed to countries like Germany, where the company is a priori given all powers of a natural person. A director’s act not in accordance with the clause might simply be subject of internal redress. Hence its function is similar to an “internal guideline” for the directors - and it makes little difference whether they decline to do what they are told or whether they do what they are not told to do. Given this difference, the first argument is very unlikely to succeed under UK law.

Rather different is the position under French law: having all powers of a natural person, the company’s power to held shares is beyond doubt. It was, however, quite early discussed whether the company may indirectly pursue its objects by acquiring shares in another company and no longer carrying on such business itself. This was accepted by the majority view, implying that, in case of the hivedown, the argument would not succeed. For other fundamental decisions like selling shares in a subsidiary, this might be different. In Dauphiné Libéré, it was held that the sale of all shares in the only subsidiary violated the parent’s object clause, in spite of an express clause allowing the participation in companies carrying on specified businesses. According to the court, the “real and only” object was the control of that particular subsidiary and could no longer be pursued if those shares were sold. However, in Bouygues c/ Patrimoine participations, such sale was held to be consistent with the object clause allowing the “participation of any kind and in any form”. We will return to the latter case, but can already conclude that under French law, even where a company’s articles contain such participation clause,

---

223 See n 153 supra and the text thereto.
224 German Law does not distinguish between Articles of Association and the Memorandum as opposed to UK law, where the object clause is contained in the latter, see s2(1)(c) CA.
225 Pennington, ‘Company Law’, 7th ed. 1995, 18.
226 Model B.C.A. §4(g)
227 Immenga, n 4 supra., 13.
228 Farrar, n 2 supra, 98.
229 See, for example, §1(1) AktG and Hueck, n 16 supra, 24-5.
230 Art. 5, Loi 1966
231 See, for example, Vanhaecke, ‘Les groupes des sociétés’, 1962, 38-9 and Baudeu, ‘Les sociétés liées par une participation en capital’, 1973.
232 Grenoble 31 may 1983, J.C.P. 1984, II, 20177, note Reinhard.
233 Trib. com. Paris 28 juin 1982, J.C.P. 1983, II, 20119, note Viandier.
the directors cannot automatically assume to have competence to decide on fundamental changes, due to the court’s possibly strict approach.

b) Particular statutory provisions

X’s further arguments were both linked to particular provisions vesting certain decisions in the general meeting, provisions which can also be found in other jurisdictions.

First, certain reorganisations are subject to the meeting’s approval. In the UK, such approval is required where the business is transferred to another company in the course of a liquidation (s110 IA) or by scheme of arrangement (s425 CA). The former differs from a hivedown in that it involves the winding-up of the transferor company. If the business is transferred by way of scheme of arrangement, particularly by division of a public company according to s425A CA in connection with Sch 15B, the shares of the transferee company in return of which the business is transferred are receivable by the members of the transferor company. Generally, any transfer under those provisions implies that the shareholding of the members of the transferor company changes: instead of or additional to shares in one company, they end up with shares in another company. This is the fundamental difference to structural changes such as the hivedown, where merely the assets of the company change, consequently not requiring any arrangement between the company and its members234. It is the company which ends up with shares in another company instead of its business assets.

The same reason generally prevents the French provisions about “scissions”235 (divisions) to apply. But there is one interesting peculiarity: according to Art. 387 loi 1966, the transfer of a part of the company’s assets to another company in exchange for shares of the latter receivable by the former - thus including hivedowns - can be made subject to the “scission” provisions by agreement of both companies, then requiring the approval of the transferor company’s general meeting236. But even this provision does not help X, because there is no obligation for the board to conclude such agreement.

Secondly, and perhaps to greater benefit for X, provisions require the general meeting’s approval for important changes in the company’s assets, similar to the “transfer of all assets” rule in §179a AktG.

French law contains such provision in art. 396 loi 1966. Albeit apparently only applicable to liquidations, the courts applied the provision in the absence of such liquidation237 and extended its scope considerably including the transfer of “nearly” all the assets238. In Bouygues c/ Patrimoine participations239, for example, the general meeting was held to be competent on this ground - a striking conceptual difference to the Holzmüller decision.

Many American state laws have a statutory “sale of substantially all assets” rule240, but it would not apply to a Holzmüller-type hivedown for two reasons241. The term “sale” refers to transactions resulting in the disposal of

234 Compare the wording of s425(1) CA.
235 As defined in art. 371(2) loi 1966.
236 Merle, n 16 supra, 693-4.
237 Trib. com. Paris 28 juin 1982, J.C.P. 1983, II, 20119, critically noted by Viandier.
238 T. com. Paris, 2 mai 1989, J.C.P. 1990, II, 21575, note Marteau-Petit.
239 N 233 supra.
240 For example, Cal. Corp. Code §§ 3901-3903; Del. Code Ann. ti. 8 § 271. See Hübner, n 137 supra, 802 for further references.
241 See Hübner, n 137 supra, 801-4 and Ebenroth, ibid., 75-6.
the transferor’s interest in the transferred business, whereas the (future) parent retains this interest indirectly\textsuperscript{242}. Moreover, not “substantially all” assets were hived down\textsuperscript{243}.

No such rule exists in Britain, despite several proposals. Hadden proposed to require shareholders’ approval for all “major disposals or acquisitions, whether by take-over or the purchase of assets, for major investment programmes and for ventures into entirely new spheres of activity”\textsuperscript{244} - a very wide formula indeed, reversing much of a company’s existing allocation of power. Much more restricted was the proposition of the Jenkins Committee in 1962: “Notwithstanding anything in the memorandum or articles of association the directors of a company should not be able without the specific approval of the company in general meeting to dispose of the whole or substantially the whole of the undertaking or assets of the company”\textsuperscript{245}. It was argued that the function of the board is to manage the shareholders’ business, not to dispose of it\textsuperscript{246}. Still, neither proposition would cover the hivedown, for the reasons given for the American rule - as opposed to another provision that the Jenkins Committee considered - but not recommended - for “fundamental changes (within the scope of the company’s existing objects clause)”\textsuperscript{247}. Striking is the similarity to the formula used by the Bundesgerichtshof, but also the clarity with which such proposal was rejected, mainly for the difficulty to define its boundaries: “A man who has never made anything but saddles to go on horse’s back decides one day that he wants to make seats for motor-cars; is that a fundamental change, or is it not?”\textsuperscript{248}

At least under current UK law, X’s arguments would therefore fail. There is less room for doubt about the board’s power to take a fundamental decision than under German law. We remember, however, that the Bundesgerichtshof based the requirement of the shareholders’ approval on another ground.

C. In search of restrictions on such power

It was held that even within its competence, the board must, under certain circumstances, submit a decision to the general meeting: “[...] the board of directors breaches its duty of care if it does not make use of the possibility of §119(2) AktG\textsuperscript{249}, providing that the general meeting may only decide on management questions if asked to do so by the board.

1. Directors’ duties

This argument, almost unanimously rejected in Germany\textsuperscript{250}, invites us to consider directors’ duties as a mechanism to restrict the power of the board to take fundamental decisions. This idea is supported by a distinguished French scholar strongly criticising that \textit{Bouygues c/ Patrimoine participations}\textsuperscript{251} was decided on the grounds of a lack of competence rather than on the grounds of a breach of a “duty of loyalty”\textsuperscript{252}. Courts and

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{242} Eisenberg, n 205 supra, 228.
\item \textsuperscript{243} Ebenroth, n 205 supra, 76.
\item \textsuperscript{244} Hadden, ‘\textit{Company Law}’, in Archer/Martin (eds.), ‘\textit{More Law Reform Now}’, 1983, 21, 31.
\item \textsuperscript{245} Report of the Company Law Committee (Cmnd. 1749, 1962), Recommendation 122 (e). See also para 117.
\item \textsuperscript{246} Ibid., para. 117, referring to the Institute of Chartered Accountants in England and Wales.
\item \textsuperscript{247} Ibid., para. 118.
\item \textsuperscript{248} Sir Nutcombe Hume, Chairman of the Company Law Committee of the Federation of British Industries before the Committee. See Minutes of Evidence, 17 March 1961, para. 6460.
\item \textsuperscript{249} BGHZ 83, 122, 131.
\item \textsuperscript{250} See n 168 supra and text thereto.
\item \textsuperscript{251} See n 233 supra.
\item \textsuperscript{252} Note Viandier, ibid, though his arguments relate presumably to the duty to act for proper purposes. See infra, III.C.1.
\end{itemize}
\end{footnotesize}
scholars in France and in Germany have apparently adopted reversed roles - a surprising, somewhat confusing observation.

That confusion might stem from a common lack of a doctrine of directors’ duties comparable to the British one, which gives continental lawyers “great intellectual pleasure to study its different facets and admire the skill of the judges to adjust it to our present expectations” - and perhaps also a remedy against their confusion! However, there is presumably no breach of any of the two indicated duties’ equivalents under British doctrine. Neither are we concerned with careless conduct which may give rise to a breach of their duty of care and skill, nor with any loyalty conflict such as misuse of the directors’ position for personal benefit or a conflict of duty and interest or duty and duty.

The duty to act bona fide in the interest of the company might also be considered, the relevant test being one of honesty, of whether or not the directors acted in what they - and not the court - considered to be in the interests of the company. If their intention is to circumvent shareholders’ rights like their potential pre-emption rights such breach might indeed be established, given that the interest of the company also comprises the interests of present and future shareholders. But generally, commercial or tax reasons for the decision will give rise to the directors’ honest belief it being in the best interest of the company, prohibiting any argument related to this duty.

The duty to act for proper purposes, however, provides objective grounds on which the directors’ decision might be reviewed: “[...] an exercise of such a power though formally valid, may be attacked on the ground that it was not exercised for the purpose for which it was granted”. Albeit this duty had often been synthesised with the requirement to act bona fide, recent cases establish the independence of the proper purpose doctrine for the revision of the exercise of directors’ powers. It has been said to be the least discussed and the least well understood of the directors’ fiduciary obligations, yet it might provide a mechanism to control their power to take decisions of structural change. Still, most cases related to the company’s internal composition concern share allotments. To transfer this approach to “Konzernbildungskontrolle” decisions requires some deal of speculation.

2. “Konzernbildungskontrolle” via the proper purposes doctrine?

The first consideration relates to the power on which the decision is based. Even though involving fundamental changes, such decisions are regarded as an exercise of the directors’ power to manage the company. This already differs from the share allotments, based on specific powers to allot shares. The greater width of the power makes it more difficult to restrain the directors because of the problem to define the boundaries of such power’s proper purposes.

However, it is submitted that such purpose of the power to manage can still be determined. One has to consider the ends or objects which where contemplated by those who granted the power, i.e. the incorporators and, indirectly, the legislator permitting the company to exist. The present writer’s view is that the consideration

---

253 For France, see Tunc, ‘A French Lawyer looks at British company law’, (1982) 45 MLR 1, 13.
254 Ibid.
255 As established by Re Smith & Fawcett Ltd [1942] Ch 304 at 306.
256 See generally Heydon, ‘Directors’ Duties and the Company’s Interests’, in: Finn (ed.) ‘Equity and Commercial Relationships’, 1987, 120.
257 Howard Smith Ltd v Ampol Petroleum Ltd [1974] 1 AllER 1126, 1132 per Lord Wilberforce.
258 Nolan, ‘The Proper Purpose Doctrine and Company Directors’, in: Rider (ed.), ‘The Realm of Company Law’, 1998, 1.
259 Farrar, 387
260 Worthington, ‘Directors’ Duties, Creditors’ Rights and Shareholder Intervention’, (1991) 18 Melbourne University LR 121, 4.
must not be confined to the purposes of the company as stated in the objects clause\textsuperscript{261}, but should refer to the particular power in question\textsuperscript{262}.

There is a strong argument that the reason for this wide power is to give the board great freedom to conduct the company’s business or activity externally\textsuperscript{263}. It certainly would be oversimplified to conclude that the purpose is therefore restricted to the exercise of such external powers. But different standards of review are applicable to external and internal powers and the courts are “more willing to intervene when management bothers itself with the composition of the company”\textsuperscript{264}. This might also have an impact on the appreciation of whether the purpose to reorganise the company and transform it into a holding is a proper purpose of the power to manage. Particularly where such transformation appears, from an objective viewpoint, to aim at circumventing shareholders’ rights, one could imagine that an English court will, one day, consider this to be an improper purpose.

This might be a promising avenue for future development of the doctrine of proper purposes. As the law stands, however, many questions are left open: How should the directors’ purpose be determined? What are the exact boundaries of impropriety in such cases? Who is entitled to complain? And, if such breach was established for a certain decision, might the same decision be taken with the shareholders’ approval?

Those questions are beyond the scope of this paper\textsuperscript{265}. Still it hopefully raises a new aspect of a potential application of the proper purposes doctrine, underlining the need for further discussions.

\textsuperscript{261} Ibid.
\textsuperscript{262} Nolan, n 258 supra, 4.
\textsuperscript{263} Nolan, ibid., 25
\textsuperscript{264} Ibid.
\textsuperscript{265} See generally Worthington, n 260 supra and Nolan, n 258 supra.
IV. Conclusion

A potential “Ius Commune Europae of groups of companies”\(^{266}\) is, for two reasons, not likely to develop towards an organisational law of the polycorporate enterprise.

First, even for the single company no other law provides for such a strict, mandatory institutional framework as German law. The internal division of power is instead, to varying extents, left to the incorporators’ discretion. Consequently, no fixed “principles of private organisational law”\(^{267}\) exist in respect of the attribution of powers to the company’s bodies. How and why then develop an institutional framework for the group as a whole, if contractualism reigns over the single company?

Secondly, at least the UK approach to corporate groups is “atomised”\(^{268}\) in two respects. It is an atomised branch of law because the solutions to group issues are spilled over the whole range of company law, if not even wider. And it is atomised in its approach, focusing on single atoms instead of the whole molecule, on single companies instead of the group. Arguably, it is impossible to reconcile this atomised view with the concept of Lutter, devoted to develop specific rules for the functional unit of the corporate group\(^{269}\).

Certainly, the approach of UK law has been strongly criticised: “How can poor old Salomon be expected to cope [...] We speak, teach, litigate and legislate about company law. But predominant reality is not today the company. It is the corporate group”\(^{270}\). Despite this criticism, it is submitted that the atomised view does by no means surrender to the reality of the corporate group. On the contrary, general company law offers satisfactory remedies for prejudiced creditors and minority shareholders of the subsidiary\(^{271}\).

This position does not imply that the offered solutions satisfy in every regard: no adequate answer is given to the distortions caused by the group phenomenon within the holding company. So far, this question is not even considered, which is a considerable jurisprudential shortcoming.

Nonetheless, this does not urge the need to adopt the concept of the organisational law of the polycorporate enterprise. On the contrary, general company law will be able to cope with the distortions caused by the group structure, if jurisprudence becomes aware and offers solutions by adapting provided mechanisms. As an example, this paper proposed the development of the doctrine of proper purposes to control the considerable power of the board to take the fundamental decision of the formation of a corporate group by hiving down the company’s business, a decision which might circumvent important rights of the company’s shareholders.

The issue equally has an important impact on corporate governance\(^{272}\), which will hopefully give rise to critical analysis on the matter, for simplifying policy statements are not sufficient. This brings us back to the very recent OECD report on corporate governance, already cited at the very beginning. It contains a statement “of the most basic rights of shareholders, which are recognised by law in virtually all OECD countries”, the value of which shall be left to the reader’s appreciation: “Shareholders have the right to participate in [...] decisions concerning

\(^{266}\) Lutter, n 201 supra.
\(^{267}\) Lutter, n 186 supra.
\(^{268}\) See n 39 supra.
\(^{269}\) See Teubner, ’Unitas Multiplex - Corporate Governance in Group Enterprises’, in: Sugarman/Teubner (eds.), ’Regulating Corporate Groups in Europe’, 1990, 67, 85 and 92 et seq. for further critical aspects of the functional unit approach.
\(^{270}\) Wedderburn, ’Multinationals and the Antiquities of Company Law’, (1984) 47 MLR 87, 92.
\(^{271}\) Compare particularly Ehricke, n 194 supra, 324-5.
\(^{272}\) See Buxbaum, n 140 supra.
fundamental corporate changes such as [...] extraordinary transactions that in effect result in the sale of the company"273.

273 See n 1 supra, 7.