

Jonas Steinle\*

## A selective comparison of the reforms on the British Limited and the German *GmbH* as a consequence of competitive constraints in the European Union

### Abstract

Der Beitrag untersucht die kürzlich verabschiedeten Reformen im Gesellschaftsrecht der GmbH in Deutschland durch das MoMiG und der privaten limited company im Vereinigten Königreich durch den Companies Act 2006 vor dem Hintergrund eines zunehmenden regulatorischen Wettbewerbs im europäischen Gesellschaftsrecht. Dabei wird insbesondere der Prozess der Errichtung einer Gesellschaft in beiden Ländern gegenüber gestellt und das Erfordernis eines Mindestkapitals diskutiert. In einem letzten Schritt werden die gewonnenen Erkenntnisse mit der Entwicklung in den USA unter dem Stichwort „Delaware-Effekt“ verglichen und es wird versucht einen Ausblick auf die zukünftige Entwicklung der Entwicklung des Gesellschaftsrechts in Europa zu geben.

---

\* Der Autor ist Teilnehmer am LL.M.-Programm (International Commercial) der University of Aberdeen und war vorher Student der Ruprecht-Karls-Universität in Heidelberg. Der vorliegende Beitrag wurde im Rahmen des Kurses ‚Comparative & International Perspectives on Company Law‘ erstellt und wurde mit 19 von 20 möglichen Notenpunkten bewertet.

## I. Introduction

The starting shot for a regulatory competition of company laws in Europe is fired through the jurisprudence of the *European Court of Justice*.<sup>1</sup> Nearly all the legislators in Europe have realised reform projects on company law. This enables a first evaluation of how European legislators are reacting on the fact that from now on they compete with each other with regard to company law. The objects of comparison in the following are Germany and the United Kingdom. Here, a selective comparison is drawn on two countries which each base on conceptually very different legal traditions and which have both recently passed significant reforms in their company laws. Exemplary, the two very controversial issues of the incorporating procedure of a company and the initial capital requirement are examined. Finally a comparison is drawn with the “Delaware effect” in the US in order to give an evaluation of the actual development in international company law in Europe.

## II. Regulatory competition of company laws in Europe

There are different approaches within Europe to determine the law that governs a company. Under the *real seat theory*<sup>2</sup> the company is under governed by the law of the state in which it has its effective centre of administration.<sup>3</sup> The countries<sup>4</sup> that follow the *real seat theory* allow their companies to be established only in the country of its effective administration.<sup>5</sup> Under the *theory of foundation*<sup>6</sup> the regime of the country where the company was formed applies.<sup>7</sup> This theory allows – some say even encourages<sup>8</sup> – the promoters to select the applicable law for their company.<sup>9</sup>

---

1 ECJ Case C-212/97 of 9 March 1999, *Centros*, ECR 1999, I-1459; ECJ Case C-208/00 of 5 November 2002, *Überseering*, ECR 2000, I-9919; ECJ Case C-167/01 of 30 September 2003, *Inspire Art*, ECR 2003, I-10155.

2 There is no uniform translation in English. Alternatively it is referred to the ‘theory of domicile’ or the French term ‘*siège réel*’ or the German term ‘*Sitztheorie*’, *Patrick Ryan*, ‘Will there ever be a “Delaware of Europe?”’ [2004] *Columbia Journal of European Law*, 187, 188, Footnote 9.

3 *Patrick Ryan*, ‘Will there ever be a “Delaware of Europe?”’ [2004] *Columbia Journal of European Law*, 187, 188.

4 Germany, Belgium, France, Luxembourg, Austria, Portugal and Italy. See exemplarily the decision of the *Bundesgerichtshof (BGH)* [Federal High Court of Justice] [1981] *Neue Juristische Wochenschrift (NJW)*, 522, 525.

5 *Torsten Koller*, ‘The English limited company – ready to invade Germany?’ [2004] *International Company and Commercial Law Review*, 334, 334.

6 The important representative of this theory is the United Kingdom; *Koller*, n 6, 334.

7 *Koller, supra* n 6, 334; *Paul Omar*, ‘Centros revisited: assessing the impact on corporate organisation in Europe’, [2000] *International Company and Commercial Law Review (ICCLR)*, 407, 407.

8 *Ryan, supra* n 3, 190.

9 *Koller, supra* n 6, 334.

With regard to this inconsistency the judgments *Centros*,<sup>10</sup> *Überseering*<sup>11</sup> and *Inspire Art*<sup>12</sup> have been milestones for European company law. In these decisions the ECJ established the right of a company that was validly incorporated in its European home state to register a branch in another Member State where it wants to pursue business.<sup>13</sup> Furthermore a company must not be denied legal capacity in another Member State.<sup>14</sup> Lastly there must be no legislation that makes requirements for companies that go further than those in their home state.<sup>15</sup> The breakthrough of these decisions is that one may set up a company in the Member State that offers the most favorable conditions and then pursue (even exclusively) business in another state by setting up a branch and the company must be registered and legally acknowledged without any further requirements by that state.<sup>16</sup> This jurisprudence has therefore set the Member States in a regulatory competition with regard to company law.<sup>17</sup>

### III. Selective comparison of the *British Ltd.* and the German *GmbH*

Two company forms that heavily compete with each other are the *British private limited company (British Ltd.)* and the corresponding company structure in Germany, the *Gesellschaft mit beschränkter Haftung (GmbH)*. In Germany the *British Ltd.* was praised as the new “silver bullet”.<sup>18</sup> Consulting firms offer complete service packages for incorporations of a *British Ltd.* in the United Kingdom because the *British Ltd.* is said to be more advantageous in certain respects.<sup>19</sup> These activities did not remain without consequences. The number of *Centros*-like limited liability companies that are incorporated in the United Kingdom has dramatically increased in the last few years, the majority of “foreign” incorporations is carried out by German entrepreneurs.<sup>20</sup> In 2006, 93 % of the companies could be matched to an “address

---

10 ECJ Case *Centros*, *supra* n 2.

11 ECJ Case *Überseering*, *supra* n 2.

12 ECJ Case *Inspire Art*, *supra* n 2.

13 ECJ Case *Centros*, *supra* n 2.

14 ECJ Case *Überseering*, *supra* n 2.

15 ECJ Case *Inspire Art*, *supra* n 2.

16 *Ryan*, *supra* n 3, 190.

17 *Christoph Jaehnel/Johan Henning*, ‘The European Court of Justice and the future of the German private company (Gesellschaft mit beschränkter Haftung)’ [2007] *Company Lawyer*, 33, 33.

18 *Andreas Heidinger*, ‘Der Kapitalschutz der GmbH auf dem Prüfstand’ [2005] *Deutsche Notar-Zeitschrift (DnotZ)*, 97, 99.

19 See Table 9, *Marco Becht/Colin Mayer/Hannes Wagner*, ‘Where do firms incorporate? Deregulation and the cost of entry’ [2008] *Journal of Corporate Finance*, 241, 255.

20 The number of estimations goes from 4000 to 30 000 and is finally unclear, *Ulrich Seibert*, ‘Close Corporations – Reforming Private Company Law: European and International Perspectives’ [2007] *European Business Law Review (EBOR)*, 83, 85; For an overview see Table 3, *Becht/Mayer/Wagner*, *supra* n 20, 248.

cluster" which is used by a certain number of different firms and therefore constitutes an indication for a "pseudo-foreign" incorporation.<sup>21</sup>

These figures suggest that by comparing the *British Ltd.* and the *GmbH* one examines two very different conceptual company forms which each represent either the rather liberal common law jurisdiction or respectively the stricter civil law jurisdiction.<sup>22</sup> Both jurisdictions have recently passed profound changes in their company law: The so called MoMiG<sup>23</sup> in Germany and the Companies Act 2006<sup>24</sup> in the United Kingdom. The aim in both countries was to increase the attractiveness of the company law by facilitating and rendering more effective the legal framework for companies.<sup>25</sup> The German reform can be said to be strongly influenced by the increasing number of "German Ltds."<sup>26</sup> Because of the conceptual difference of the *British Ltd.* and the *GmbH* the basis for a comparison is broad. However the following comparison is limited to the two aspects that show the greatest differences and are the most controversial issues in the current discussion: the incorporation procedure and the (absence of a) minimum capital requirement.

## 1. Incorporation Procedure

The requirements for the incorporation of a company may seem not to be the decisive part of a company law. However the speed and the costs of incorporation are proved to have a tremendous influence on the decision of entrepreneurs in which country to incorporate.<sup>27</sup> First of all there is a convergence of the United Kingdom law to the German approach which provides only one constitutional document (Satzung). The traditional "two-document" approach with the articles of asso-

21 See Table 8, *Becht/Mayer/Wagner, supra* n 20, 254.

22 *Horst Eidenmüller, Ausländische Kapitalgesellschaften im deutschen Recht 2004*, 3. Teil [part], Randnummer [paragraph] 2.

23 The Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) [Act to Modernise the Law Governing Private Limited Companies and to Combat Abuses] has come into force on 1st November 2008.

24 The Companies Act 2006 received the Royal Assent on the 8<sup>th</sup> November 2006 and is the most extensive revision of company law, cf. *Lean Sealy/Sarah Worthing, Cases and Materials in Company Law* (8<sup>th</sup> Edition, OUP, Oxford 2008), 4. Since October 2008 every provision of the Companies Act 2006 is in force.

25 Referentenentwurf, Entwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) [Researcher's draft of the Act to Modernise the Law Governing Private Limited Companies and to Combat Abuses], 33; *Sealy/Worthing, supra* n 25, p. 4.

26 The governmental draft sets out explicitly the aim to face the "increasing regulatory competition" after the jurisdiction of the *European Court of Justice*, Regierungsentwurf zum MoMiG [governmental draft for the federal council] Drucksache 354/07, 25.05.2007, p. 56; *Volker Triebel/Sabine Otte, '20 Vorschläge für eine GmbH-Reform: Welche Lektion kann der deutsche Gesetzgeber vom englischen lernen?' [2006] Zeitschrift für Wirtschaftsrecht (ZIP)*, 311.

27 *Becht/Mayer/Wagner, supra* n 20, 242; *Christoph Teichmann, 'Reform des Gläubigerschutzes im Kapitalgesellschaftsrecht' [2006] Neue Juristische Wochenschrift (NJW)*, 2444, 2449.

ciation<sup>28</sup> and the memorandum of association<sup>29</sup> has been changed under the Companies Act 2006 to a “one-document” constitution.<sup>30</sup>

In the United Kingdom the necessary forms can be agreed on in written form and sent by email<sup>31</sup> to the Companies House in Cardiff. In Germany as a basic principle the articles of association (*Satzung*) must be agreed on by means of a notarization.<sup>32</sup> However, pursuing the objective of simplification and lowering the costs for incorporation,<sup>33</sup> in the reform bill MoMiG a simplified procedure has been created.<sup>34</sup> To benefit from this facilitation the provided model articles (*Musterprotokoll*) must be used which permit only a maximum of three shareholders and one director and which do not permit any variant clauses.<sup>35</sup> Above all, even in the simplified procedure the signatures to the model articles must at least be verified by a notary public.<sup>36</sup>

The involvement of a notary public is one of the reasons why the incorporation process in Germany is, with approximately € 300 for the whole registration process,<sup>37</sup> more expensive than it is in the United Kingdom. There the fees for the registration are £ 20 or alternatively £ 50 for the registration on the same day.<sup>38</sup>

With regard to the speed of incorporation Germany cannot keep up with the United Kingdom. If all the documentation is in order and the additional fee is paid, Companies House issues a certificate of incorporation and the company comes into existence on the same day at midnight.<sup>39</sup> In Germany it takes regularly three or four weeks from the draft of the articles with the notary public to the registration in the commercial register.<sup>40</sup>

28 The articles of association are the constitution of the company; sect. 17 Companies Act 2006.

29 The memorandum of association is evidence of the subscribers to the memorandum to set up a company; sect. 7, para. 1 (a) and sect. 8 Companies Act 2006.

30 *Jessica Schmidt*, ‘The New *Unternehmergesellschaft* (Entrepreneurial Company) and the Limited – A Comparison’ Vol. 09 No. 09 [2008] *German Law Journal*, 1093, 1098.

31 Sealy/Worthing, *supra* n 25, p. 22, Footnote 24; *Nicolas Grier*, *Company Law* (2<sup>nd</sup> Edition, Thomson W. Green, Edinburgh 2005), p. 42.

32 Sect. 2 para. 1 sentence 1 *GmbHG* [German Limited Liability Companies Act].

33 *Jürgen Breitenstein/Bernhard Meyding*, ‘Der Regierungsentwurf zum MoMiG: Die Deregulierung des *GmbH*-Rechts schreitet voran.’ [2007] *Betriebs-Berater* (BB), 1457, 1457.

34 Sect. 2, para. 1a *GmbHG* [German Limited Liability Companies Act].

35 Sect. 2, para. 1a *GmbHG* [German Limited Liability Companies Act].

36 *Michael Beurskens/Ulrich Noack*, ‘The Reform of German Private Limited Company: Is the *GmbH* Ready for the 21st century?’ [2008] *German Law Journal*, 1069, 1074; *Robert Freitag/Markus Riemenschneider*, ‘Die *Unternehmergesellschaft* – “*GmbH light*” als Konkurrenz für die Limited?’ [2007] *Zeitschrift für Wirtschaftsrecht* (ZIP), 1485, 1487.

37 In a simple case; *Beurskens/Noack*, *supra* n 37, 1075.

38 See website of the Companies House: <http://www.companieshouse.gov.uk/infoAndGuide/companyRegistration.shtml> (last accessed on 23.03.2009).

39 *Nicolas Grier*, *Company Law* (2<sup>nd</sup> Edition, Thomson W. Green, Edinburgh 2005), p. 42 et seq.

40 *Volker Römermann*, ‘Die Limited in Deutschland – eine Alternative zur *GmbH*?’ [2006] *Neue Juristische Wochenschrift* (NJW), 2065, 2066; Peter Kindler, ‘Examensrelevante Aspekte der *GmbH*-Reform 2008 (MoMiG)’ [2008] *Zeitschrift für das Juristische Studium* (ZJS), 578, 580.

A significant difference during the incorporation procedure is payment of the shares. A *GmbH* may not be registered in the commercial register until half of the shares for the minimum capital have been paid up – alternatively in cash or non-cash.<sup>41</sup> In the United Kingdom a company may be registered although none of the shares have been paid up by then.<sup>42</sup> Furthermore for the *British Ltd.* shares can even be performed by providing a service.<sup>43</sup>

To summarise shortly the incorporation process by comparison: The incorporation of a *British Ltd.* is faster, cheaper and requires less formalities. Although Germany has made some considerable efforts to accelerate the duration of the incorporation and the costs for small businesses,<sup>44</sup> the United Kingdom remains more attractive for company incorporations. This may be owed to a different target group. The United Kingdom apparently wants to attract foremost standard incorporations of small businesses with a “Think-small-first” approach.<sup>45</sup> However, by comparing the mere figures one must also take into consideration that most of these differences are qualified in practice. So does the ‘standard’ promoter of an enterprise hardly have the need to incorporate within 24 hours as this is only one part of a longer planning process.<sup>46</sup> The business of the *GmbH* may even be started after the notarization in a company prior to registration (*Vorgründungsgesellschaft*), which certainly has not already limited liability.<sup>47</sup> Finally for German entrepreneurs the costs to set up and maintain a *British Ltd.* are at best equal and require additional effort with translations for the Companies House and another system of drawing up a balance sheet and the registration in the commercial register of the branch.<sup>48</sup>

---

41 Sect. 7, para. 2 GmbHG [German Limited Liability Companies Act]. For the *Unternehmergesellschaft* (*supra*) the shares must be fully paid up in cash, sect. 5a, para. 2 GmbHG [German Limited Liability Companies Act].

42 Sect. 586 of the Companies Act 2006 applies only to public companies, *argumentum e contrario*.

43 Sect. 585 of the Companies Act 2006, *argumentum e contrario*.

44 Such as e.g. the abolishment of the review of public licenses before the registration in the commercial register, sect. 8 para. 1 No. 6 GmbHG [German Limited Liability Companies Act]. In 2007 there has already been introduced the electronic commercial register to accelerate the register process, Gesetz über elektronische Handelsregister und Genossenschaftsregister sowie das Unternehmensregister (EHUG) [Act on electronic registers of trade and co-operative societies and the company registers], Bundesgesetzblatt (BGBl.) [federal law gazette] I 2006, 2553.

45 Schmidt, *supra* n 31, 1094.

46 Römermann, *supra* n 41, 2066.

47 Sect. 11, para. 2 GmbHG [German Limited Liability Companies Act].

48 The employment of a service provider and the running of a registered office in Great Britain requires cost of approximately € 260 plus annual fees of a similar amount; *Beurskens/Noack, supra* n 37, 1075; Seeing the *British Ltd.* at a disadvantage, Wolfgang Zöllner, ‘Konkurrenz für inländische Kapitalgesellschaften durch ausländische Rechtsträger, insbesondere durch die englische Private Limited Company’ [2006] *GmbH-Rundschau* (GmbHR), 1, 4.

## 2. Share capital

A significant difference between the *GmbH* and the *British Ltd.* is the amount of share capital that is necessary for the formation and the pursuance of a limited company. For the *British Ltd.* there is no minimum capital requirement.<sup>49</sup> For the *GmbH* the threshold of €25.000 even after the MoMiG has not been removed.<sup>50</sup> Clearly this is said to be an obstacle for small business to incorporate as a *GmbH*. However, the system of a minimum capital follows the basic idea that once the minimum capital is deposited, both the creditors of the company and the shareholders are protected either way.<sup>51</sup> This fact is in itself desirable. The debate is merely about whether minimum capital is the best measure to achieve such a protection. There are different reasons to justify the “burden” of a minimal capital and they differ in their target course.

### a) Sociopolitical argument

As a first argument, the minimum capital is seen as a substitute for the lack of personal liability.<sup>52</sup> The premise of this idea is that as a basic principle, businessmen bear personal responsibility for their commercial liabilities and limited liability is a ‘privilege’ that has to be bought.<sup>53</sup> Accordingly the situation shall be prevented, that businessmen collect the profits of their enterprise but do not bear any potential costs which then must be taken by the collectivity of creditors.<sup>54</sup> The minimum capital function as an “entry ticket” is that, once it is paid, it at least secures a minimal contribution by the shareholder.<sup>55</sup> This is supposed to prevent excessive risk taking from the beginning on, similar to the compulsory contribution in the case of indemnity insurance.<sup>56</sup> Clearly the establishment of such a minimal contribution is a discretionary

---

49 *Triebel/Otte, supra* n 27, 311.

50 Although the governmental draft of the MoMiG still opted for an amount of €10 000, for confer c.f. Regierungsentwurf zum MoMiG [governmental draft for the federal council] Drucksache 354/07, 25.05.2007, p. 2.

51 This bases on the assumption that once the minimum capital is paid, it cannot disburse any more to the shareholders, for confer c.f. sect. 30 para. 1 sentence 1 GmbHG [German Limited Liability Companies Act].

52 *Alexander Daebnert*, ‘The minimum capital requirement – an anachronism under conservation: Part 1’ [2009] *Company Lawyer*, 3, 8.

53 “For the privilege of the absence of personal liability, if one chooses the legal form of the *GmbH*, one has to pay the “price” that is provided by the statutes in form of to deposit and maintenance of a minimum capital and the public disclosure of the commercial register.” [translated] Decision of the Federal High Court of Justice (*BGH*) of 27.09.1997, [1999] *Neue Juristische Wochenschrift* (NJW), 3483, 3487.

54 *Tim Drygala*, ‘Stammkapital heute – Zum veränderten Verständnis vom System des festen Kapitals und seinen Konsequenzen’ [2006] *Zeitschrift für Unternehmens- und Gesellschaftsrecht* (ZGR), 587, 595 et seq.

55 *Detlef Kleindiek*, ‘Auf dem Weg zur Reform des GmbH-Rechts – Die Initiative zur Neuregelung des Mindestkapitals der GmbH (MindestkapG)’ [2005] *Deutsches Steuerrecht* (DStR), 1366, 1369.

56 *Drygala, supra* n 55, 596.

legislative decision.<sup>57</sup> In Germany limited liability is understood as a mechanism of redistribution of loss between shareholders and creditors.<sup>58</sup> Of course such a protection may only target voluntary creditors in a weak position or involuntary creditors and of course it cannot be expected that the minimum capital serves as an insurance covering the entire economic risk of an enterprise.

#### b) Creditor protection arguments

One of the key points in the discussion about a minimum capital is the protection of the creditor's interests. Sometimes the enhancement of the attractiveness of a company law form is seen as being totally opposed to the protection of creditors.<sup>59</sup> The interests of shareholders and creditors in any case sometimes run in different directions. That is why different situations must be considered with regard to creditor protection.

##### aa) Common interests in normal business times

During normal business times both, shareholders and creditors have a common interest which is their belief in the success of the undertaking they are taking part in and from which they benefit either way.<sup>60</sup> In these times, the self-interest of the shareholders in a successful business, the duty of care and the duty of loyalty as a means of indirect creditor protection may be sufficient as protection for creditors.<sup>61</sup> Minimum capital is by that time rather exposed to criticism as it is difficult to determine the exact amount that is necessary for creditor satisfaction which then lacks economic efficiency.<sup>62</sup>

##### bb) Start-up phase of the business

During the start-up phase of a limited liability company, things lie slightly different. It is a crucial difference to start a company overnight and to solve the problem where the money for that company comes from the next day or if one has to come up with a considerable amount of money first because this necessarily means that the entrepreneur has a serious business plan and is convinced of the own idea. This is what often

---

57 *Daehnert, supra* n 53, 8; However the argument of *Daehnert* that the existence of the registered association in German company law, where no minimum capital is required but limited liability is granted, is not an argument that there are both solutions in German company law. The registered association for economic purposes under sect. 22 of the BGB [Civil code] a subsidiary company form and is given only in very exceptional circumstances the necessary permission of the state to protect the ordinary company forms, *Ulrich Eisenhardt, Gesellschaftsrecht* (11. Auflage, C. H. Beck, München 2003), p. 72.

58 *Teichmann, supra* n 20, 2444.

59 *Eidenmüller* doubts that this is the case for the *GmbH*, *Eidenmüller, 'Die GmbH im Wettbewerb der Rechtsformen'* [2007] *Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR)*, 168, 179.

60 *Daehnert, supra* n 53, 9.

61 *Teichmann, supra* n 20, 2446.

62 *Eidenmüller, supra* n 20, 184; *Teichmann, supra* n 20, 2445.

is referred to as a 'seriousness threshold' with the aim to have only respectable businesses on the market.<sup>63</sup> This is economically meaningful as it restrains improvident entrepreneurs from the market which generally represent a higher risk for the creditors.<sup>64</sup> However, minimum capital is said to produce opportunity costs as there may be ideas for prospering businesses but the promoters cannot afford the minimum capital.<sup>65</sup> It is therefore very difficult to find an appropriate level for all business that combines the positive effects of the minimum capital requirement without excluding good business concepts from the market because of an initial lack of capital equipment.

Another aspect that has to be taken into account in the start-up process is the fact that in most of the cases it is simply not possible to start a business without any seed capital.<sup>66</sup> One of the functions of minimum capital is also to provide start-ups with capital for initial investments and particularly to keep the capital of the company and the private capital of the shareholders separated.<sup>67</sup> The fact that without such a minimum capital, the actors in small businesses must frequently assume personal liability<sup>68</sup> blurs the boundaries between personal and limited liability. It cannot be the intention of the legislator to achieve sufficient creditor protection of a limited liability company through personal liability of the shareholders and directors, as this is contrary to the concept of limited liability as a whole.<sup>69</sup>

The argument of the 'seriousness threshold' is not convincing. Although there are positive effects of such a threshold, the price to pay in form of unrealized profitable businesses that are excluded from the market is too high. With regard to the initial investments there is the serious concern that without a minimum capital a blurring of personal and corporate liability takes place. However it has to be acknowledged that the differences with regard to the need for capital today are much wider than they were at the time of the creation of the *GmbH* in 1892 where there was almost no services sector and nearly exclusively capital intensive producing industry. The differentiation in capital requirements for companies and with it the adequate level of a minimum capital requirement therefore remains a serious concern.

---

63 *Daehnert, supra* n 53, 8; *Eidenmüller, supra* n 60, 184.

64 *Ulrich Haas, 'Mindestkapital und Gläubigerschutz in der GmbH'* [2006] *Deutsches Steuerrecht (DStR)*, 993, 993; Pointing out the potential warning function: *Drygala, supra* n 55, 590; However minimum capital is unlikely to restrain dubious entrepreneurs from the market, *Teichmann, supra* n 20, 2446.

65 *Eidenmüller, supra* n 60, 183.

66 After No. 5 of the model contract which is provided by the MoMiG ([2008] *Bundesgesetzblatt [federal law gazette]*, I p. 2044) the company bears the expenses of the incorporation procedure up to a maximum of € 300 or alternatively the entire share capital. A company with a share capital of € 1 runs from the beginning on the risk to go insolvent or the directors face personal liability if they do not file for bankruptcy.

67 *Drygala, supra* n 55, 589.

68 *Daehnert, supra* n 53, 10.

69 *Lorenz Fastrich, 'Optimierung des Gläubigerschutzes bei der GmbH – Praktikabilität und Effizienz'* [2006] *Deutsches Steuerrecht (DStR)*, 656, 656.

cc) Distribution of corporate property to shareholders

A situation where shareholders and creditors have opposing interests is the distribution of corporate property to the shareholders. Under German law before the MoMiG, the minimum capital was seen as an absolute barrier for distributions if they would lower the company's assets below the minimum capital threshold (fix capital-based distribution).<sup>70</sup> This rule has now been relaxed significantly under the MoMiG-reform by allowing distributions against a valid counterclaim of the company which is a point of view that is geared to the balance sheet rather than the fix threshold of the minimum capital (balance sheet based distribution).<sup>71</sup> Contrary, in the German public company (Aktiengesellschaft) only the balance sheet profit of each business year can be distributed to the shareholders, which is a strict success-based distribution.<sup>72</sup> In the United Kingdom Companies Act 2006 the rules are the strictest as distributions here can be made only out of the accumulated surpluses over the years up-to-date which means, that distributions can only be paid if they are justified by the picture of the company as a whole.<sup>73</sup>

Hence there is an inverse ratio with regard to the distribution rules: In the *GmbH*, once one has arranged the minimum capital one can distribute the additional capital nearly at discretion. In contrast the United Kingdom balances the absence of a minimum capital with very rigid distribution rules. Here the *GmbH* has an advantage because it allows far more flexibility once the initial "burden" is cleared.

As a potential compromise, there is the so-called 'solvency test'. This requires the directors of the company to make a declaration, that after a potential distribution the company will still be solvent.<sup>74</sup> Most of the states in the U.S. take this approach.<sup>75</sup>

dd) Crisis of the company, insolvency

A last important situation with regard to the benefit of minimum capital for creditor protection is the crisis of a company. Again here shareholders and creditors have opposing interests: shareholders have nothing to lose any more as in times of a crisis no distributions will be made but the creditors can stand to lose a great deal of their money.<sup>76</sup> Supporters of the fix capital system argue that a minimum capital is at least a buffer against the risk of insolvency.<sup>77</sup> This is convincing insofar, as the more shareholder

70 Sect. 30 para. 1 of the former GmbHG [German Limited Liability Companies Act]; *Beurskens/Noack*, *supra* n 37, 1086.

71 The governmental statement expressly allows the switch of active positions on the balance sheet; Regierungsentwurf zum MoMiG [governmental draft for the federal council] Drucksache 354/07, 25.05.2007, p. 93 *et seq.*

72 Sect. 57 para. 3 *AktG*; The balance sheet profit is the maximum amount that can be distributed to the shareholders, *Bayer*, *Münchener Kommentar zum Aktiengesetz* (3<sup>rd</sup> Edition, Munich 2008), sect. 57, para. 131.

73 Sect. 830 para. 1 and para. 2 of the Companies Act 2006; *Sealy/Worthing*, *supra* n 25, p. 416.

74 *Teichmann*, *supra* n 20, 2447.

75 *Beurskens/Noack*, *supra* n 37, 1080; *Eidenmüller*, *supra* n 60, 182.

76 *Teichmann*, *supra* n 20, 2447.

77 *Drygala*, *supra* n 55, 591; *Daehnert*, *supra* n 53, 5.

funds a company once had, the less likely the risk of insolvency. However this view is rooted in the first episode of the *GmbH* when the minimum capital was considerably higher.<sup>78</sup> The tendency in these days goes however in the other direction: versus the lowering or abolishment of the minimum capital.<sup>79</sup> It must be clarified that a company may still have a future prospect, even if it lost its shareholder's funds or never had some.<sup>80</sup> Therefore the minimum capital can be at best a first security mechanism with regard to insolvency, particularly if one acknowledges the fact that in these days it is far more common that companies are financed to a large extent with external capital.<sup>81</sup>

As a second security mechanism there are compulsory rules for the suspension of the business if the positive prospect for the company is gone. English law provides for this case the matter of 'wrongful trading'.<sup>82</sup> Under 'wrongful trading' the management or even a 'shadow director'<sup>83</sup> of a company can be held liable when previously to the winding-up of a company payments were made out of the company's assets and he knew or ought to have known that there was no reasonable prospect to continue the business.<sup>84</sup> This rule has a very wide scope<sup>85</sup> and comes in even before the winding-up proceedings have been initiated. It applies however exactly at the point where the business should be stopped in order to protect the creditors.<sup>86</sup> Before the MoMiG, a similar liability base existed in German law with the significant difference, that the 'German wrongful trading' interfered not before the point when insolvency or excessive indebtedness was established.<sup>87</sup> This has now been changed and the management under German law must now, similar to 'wrongful trading', refrain from payments that will definitely lead to the insolvency of the company.<sup>88</sup> The reason

---

78 After the creation of the *GmbH* in 1892 the minimum capital was 20 000 Marks. At that time this was enough to pay the wages of 10 teachers for an entire year; *Daehnert, supra* n 53, 5.

79 Study of the World Bank, 'Doing Business 2009', p. 13, accessible at: [http://www.doingbusiness.org/Documents/FullReport/2009/DB\\_2009\\_English.pdf](http://www.doingbusiness.org/Documents/FullReport/2009/DB_2009_English.pdf) (last accessed on 13.03.2009).

80 *Drygala, supra* n 55, 594.

81 *Daehnert, supra* n 53, 6.

82 Sect. 214 Insolvency Act 1986; The liability out of 'fraudulent trading' is much less often used as this requires dishonesty and not only negligence; *Loose/Griffiths/Impey, The Company Director: Powers, Duties and Liabilities* (10<sup>th</sup> Edition, Jordans, Bristol 2008), 325 et seq.

83 A shadow director is "a person in accordance with whose directions or instructions the directors of the company are accustomed to act"; *Micheler/Prentice, Joint Ventures in English and German law* (Hart Publishing, Oxford 2000), 178; sect. 251 Insolvency Act 1986.

84 *Keenan/Smith, Smith & Keenan's company law with Scottish supplement* (13<sup>th</sup> Edition, Pearson/Longman, Harlow 2005), 389; *Janet Dine, Company Law* (5<sup>th</sup> Edition, Palgrave Macmillan, Basingstoke 2005), 327.

85 *Sealy/Worthing, supra* n 25, p. 665.

86 *Teichmann, supra* n 20, 2447.

87 The old liability was taken from sect. 64 para. 2 GmbHG [German Limited Liability Companies Act] in combination with sect. 823 para. 2 BGB [German Civil Code]; Schulze-Osterloh, *GmbH-Gesetz 2006*, sect. 64, para. 80.

88 Under the MoMiG the duty to file for bankruptcy has been removed from the GmbHG [German Limited Liability Companies Act] and is now to be found in sect. 15a para. 1 of the

why the interference of the ‘German wrongful trading’ has been moved forward in time is to bridge the gap that has been created with the more liberal capital maintaining system.<sup>89</sup>

It is undeniable that a company that once had a financial cushion as a start is less likely to go insolvent because of marginal and preliminary losses. An initial capital stock may even prolong a company’s life in a starting phase. However minimum capital offers no protection in cases where constant losses have wasted it. The function of minimum capital can by no means be compared to the one it had at the first years of the *GmbH*. It is therefore strongly questionable whether the minimum capital for private limited liability companies on the level it exists today, can justify itself against the existing and severe disadvantages.

c) The creation of the ‘*Unternehmergeellschaft*’ in the MoMiG

The German reform bill MoMiG has broken new grounds with regard to the minimum capital requirement of private limited liability companies. Although a lowering of the minimum capital requirement has been part of the reform until the very end,<sup>90</sup> the legislator finally decided to maintain the minimum capital requirement and the fixed capital system.<sup>91</sup> The way into limited liability with private companies has been facilitated through a new sub-company form, the *Unternehmergeellschaft*, which only requires a minimum capital of one Euro.<sup>92</sup> However the legislator imposed some additional duties on the *Unternehmergeellschaft*.<sup>93</sup> Such an *Unternehmergeellschaft* must set up a reserve equal to one quarter of the balance sheet profit of the actual year in order to increase its capital to the amount of € 25000.<sup>94</sup> Once this is achieved the *Unternehmergeellschaft* may be transformed into an adequate *GmbH* and can dispose freely of its annual profits.

The German legislator shows an interest in limiting the entrants in the market to those who have reasonable concepts and to maintain the minimum capital requirement. The criticism that good business plans cannot be realized because of a lack of

---

Insolvenzordnung [Insolvency Code]; Furthermore there has been introduced a sentence in sect. 64 of the GmbHG [German Limited Liability Companies Act] which contains the quoted obligation, sect. 64 sentence 3 of the GmbHG [German Limited Liability Companies Act].

89 *Wicke*, Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG), 2008, sect. 64, para. 1.

90 Regierungsentwurf zum MoMiG [governmental draft for the federal council] Drucksache 354/07, 25.05.2007, p. 2

91 The minimum capital of € 25 000 was not reduced, sect. 5, para. 1 GmbHG [German Limited Liability Companies Act].

92 Sect. 5a GmbHG [German Limited Liability Companies Act].

93 Such as the duty to pay up fully the share capital in cash before registration, sect. 5a, para. 2, sentence 1 GmbHG [German Limited Liability Companies Act].

94 Sect. 5a, para. 3 GmbHG [German Limited Liability Companies Act]; The balance sheet profit is to be established according to the rules of the Handelsgesetzbuch (HGB) [Commercial Code] (sect. 242, 264 HGB) and may be reduced with the deficit of the previous year.

capital has died away because of the creation of the *Unternehmergeellschaft*. However the legislator regarded the *Unternehmergeellschaft* as an “interim solution”.<sup>95</sup> The intention with the creation of a sub-company form was rather to wipe out the key argument of those who criticized the *GmbH* in the past quite heavily. The *Unternehmergeellschaft* is an innovative concept that adjusts the approved company form of the *GmbH* to altered conditions in the market. The fact that it was created by the German legislator is owed to competitive pressure – particularly through the *British Ltd.* – which is a result of the changes in conditions in international company law after the jurisprudence of the *European Court of Justice*.<sup>96</sup> The *Unternehmergeellschaft* adopts quite a few advantages of the *British Ltd.*, although leaving out the disadvantages that comes with translations, a registered office and different requirements for the balance sheet.

#### d) Evaluation

The minimum capital requirement is the crucial issue with regard to the ‘competition’ between *GmbH* and *British Ltd.* The absence of this requirement in the United Kingdom has undoubtedly enormous attraction and the “Think-small-first” campaign is quite successful. However the *British Ltd.* leaves two aspects unsolved: The first is a clear limited liability for shareholders and directors. This is achieved in the *GmbH* through a system that may seem at first glance old fashioned and inefficient, but still offers clear and reliable separation of private and business affairs, at least for the bigger part of the cases. The second issue is the protection of unsecured contract-creditors and tort-creditors. With regard to this creditor group the prior and most efficient mechanism of self protection fails. The commendation of the *GmbH* is despite some weaknesses a successful balance between limited liability and creditor protection.

### 3. Statement

In the United Kingdom it is very simple, cheap and quick to set-up a company. The German legislator made some significant improvements to catch up but is still far from matching the *British Ltd.* in this regard. The same applies to the minimum capital and the German legislator did not do more than what was necessary to meet competitive pressure. However what we see in Germany is that reforms are made with great care and all efforts are made not to abandon the core values of the *GmbH* which has offered reliable standards for a considerable period of time. The assumption that the German legislator only partially accepts the competitive constraints is therefore not remote. In German literature there even is the theory that Germany will concentrate on the “high quality segment”, as it cannot match to compete with regard to simple incorporations because this market share is already occupied by the

---

95 Schmidt, *supra* n 31, 1095.

96 Teichmann, *supra* n 20, 2445.

United Kingdom. The decision to finally remain the minimum capital requirement was also made because the existing *GmbHs* feared a loss of reputation.

#### **IV. Recent development in other European countries (France, Spain)**

France has made considerable efforts to accelerate the creation of companies. Since July 1998 it is possible to set up a company within 24 hours and since April 2007 the creation of a company by means of the internet has been enabled.<sup>97</sup> France had originally a minimum capital for the limited liability companies (*Société à Responsabilité limitée*) of 20 000 Francs (approximately € 3050) which was at first increased in 1984 to 50 000 F (approximately 7500 €) before it was reduced to € 1 since 1 August 2003.<sup>98</sup> Spain has also created a sub-form (*Sociedad Limitada Nueva Empresa*) to the traditional limited liability company (*Sociedad de Responsabilidad Limitada*) which can be created in 48 hours with a capital of € 3012.<sup>99</sup>

#### **V. Comparison of the regulatory competition in Europe and in the US**

It has been seen, that the regulatory competition of company laws in Europe has triggered some tremendous changes. This process is far from being finished. Often the situation in Europe is compared to the situation in the US where such a regulatory competition has begun much earlier and where there is now one “winner”-state which is Delaware. One may therefore assume that Europe will make a similar development.

##### **1. Situation in the US – the “Delaware effect”**

In the US, company law is a matter of the states’ governments as a result of which there are appreciable differences in the company law of the different states.<sup>100</sup> Corporations are free to choose where they want to incorporate or also to re-incorporate<sup>101</sup>

---

97 *Merle*, *Droit commercial – Sociétés commerciales* (12<sup>th</sup> Edition, Dalloz, Paris 2008), 87.

98 Art. 223-2 Code de commerce [Commercial code]; *Merle*, *Droit commercial – Sociétés commerciales* (12<sup>th</sup> Edition, Dalloz, Paris 2008), 203 *et seq.*

99 *Eidenmüller*, *supra* n 60, 180.

100 *McCahery/Vermeulen*, ‘Does the European Company Prevent the ‘Delaware Effect?’ [2005] 785, 789; *Bebchuk*, ‘Federalism and the corporation: the desirable limits on state competition in corporate law’ [1992] *Harvard Law Review*, 1435, 1438.

101 Although a change of the corporate domicile in a direct way is not possible in the US, it is a common practice to allow the change of corporate domicile nevertheless if a new company in the “target” state is founded and the other company merges into that company; *Siems*,

and the basic affairs of the company and its participants are governed by the chosen law even if there is no connection with that state at all, hence a system that follows purely the *theory of foundation*.<sup>102</sup> These conditions enabled a vital regulatory competition between the states which can be said to be finished since the 1920s.<sup>103</sup> The state of Delaware turned out to be the leading state for corporations in the US because it is said to offer the most beneficial rules for all interested parties among the competing states.<sup>104</sup> Today Delaware serves as state of corporation for 58 % of all public traded companies in the US and 59.5 % of the Fortune 500, which are the world's 500 top-selling companies.<sup>105</sup> However, if one speaks about the "Delaware effect", this is more than just the attempt to offer beneficial conditions to companies. It also means confronting the competition through lowering the standards, particularly with regard to creditor protection rules, a phenomenon that is referred to as the "race to the bottom".<sup>106</sup> Although companies in Europe have now the same choice, it is far from sure that in Europe this will open out into a "race to the bottom".

## 2. Comparability of the situation in the US and Europe

### a) Similarities

The situation in the US and Europe with regard to regulatory competition seems quite comparable at first sight. The distribution of competences is similar as it is the (Member) states that have the original competence for company law but there is also limited interference from a federal/european level.<sup>107</sup> It is conceivable that Europe will take the US as a model by liberalising the company law within the single market.<sup>108</sup> An example for this is the Directive 2005/56/EC<sup>109</sup> which facilitates cross-border

---

"The European Directive on cross-border mergers: an international model?' [2005] Columbia Journal of European Law, 167, 179.

102 Drury, 'The "Delaware syndrome": European fears and reactions' [2005] Journal of Business Law, 709, 709; *Bebchuk/Hamdani*, 'Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters' [2002] The Yale Law Journal, 553, 553; *McCahery/Vermeulen*, *supra* n 101, 789.

103 *Bebchuk*, *supra* n 101, 1443.

104 *Ryan*, *supra* n 3, 199; *Eidenmüller*, *supra* n 60, 176.

105 *Bebchuk/Hamdani*, *supra* n 130, 567.

106 "One must fear that in a in such a way opened 'competition of legal systems'" precisely the legal system with the lowest standards of protection for the interests of third parties will prevail ("race to the bottom"). Particularly the creditors of the company are in need of protection." [translated] Decision of the Federal High Court of Justice (*BGH*), [2000] Europäische Zeitschrift für Wirtschaftsrecht (*EuZW*) 412, 413; *Robert Drury*, 'The "Delaware syndrome": European fears and reactions' [2005] Journal of Business Law, 709, 734 et seq; *Daehnert*, *supra* n 53, 3; *Eidenmüller*, *supra* n 60, 178.

107 *McCahery/Vermeulen*, *supra* n 101, 787.

108 *Daehnert* regards the permission of competition through the European Court of Justice as an intentional step and regards this closely related to the development in the US; *Daehnert*, *supra* n 53, 3.

109 Directive 2005/56/EC of the European Parliament and of the council of 26 October 2005 on cross-border mergers of limited liability companies, *OJ L* 310/1.

der mergers of limited liability companies in Europe. Recently the *European Court of justice* in *SEVIC*<sup>110</sup> has clarified that there must be the possibility of cross-border mergers.<sup>111</sup> This enables re-incorporations within the *European Union* like in the US.<sup>112</sup> However one must acknowledge that such mergers may be subject to co-determination of employees if one of the companies that participate in the mergers was subject to co-determination before the merger.<sup>113</sup>

## b) Differences

If one takes a closer look at the conditions in both “markets” there emerge some significant differences. A first difference appears with regard to the incentives for the EU governments to enter heavily in competition with one another. In the US the states may raise a franchise tax on the firms incorporated within the state.<sup>114</sup> For Delaware the franchise tax revenues represent a large part of the state’s budget.<sup>115</sup> The incentives in the US therefore seem to be rather of a financial nature. Contrary in the *EU* such taxes are negligible.<sup>116</sup> There the incentive is rather not to lose jurisdictional control over a substantial part of the economy which is in Europe closely linked with social rules and political influence.<sup>117</sup>

Furthermore the freedom of establishment is not the same in Europe compared to the US. This has been clarified by the very recent jurisprudence of the *European Court of Justice* in the *Cartesio*<sup>118</sup> case. The freedom of establishment in Europe enables a company the relocation of its seat to another jurisdiction and by means of change of its statute. However the freedom of establishment does not encompass the relocation of the company’s seat without the change of its statute and Member States are free to impose restrictions on such a change.<sup>119</sup> This is however exactly the case which is relevant for the competition of company laws: The ability of companies to use the company law of a foreign state to pursue business in the home state. Germany, as an assertor of the *seat theory*, just abolished the requirement that a company

---

110 ECJ Case C-411/03 of 13.12.2005.

111 *Tilmann Frobenius*, “*Cartesio*”: Partielle Wegzugsfreiheit für Gesellschaften in Europa’ [2009] *Deutsches Steuerrecht (DStR)*, 487, 490.

112 *Mathias Siems*, ‘SEVIC: Der letzte Mosaikstein im Internationalen Gesellschaftsrecht der EU?’ [2006] *Europäische Zeitschrift für Wirtschaftsrecht (EuZW)*, 135, 139.

113 Article 16 of the Directive 2005/56/EC of 26 October 2005.

114 *Becht/Mayer/Wagner, supra* n 20, 242.

115 In 2001 the incomes of franchise tax in Delaware were about \$ 600 million with a population of 796 000 inhabitants; *Bebchuk/Hamdani, supra* n 103, 556.

116 They are even illegal if they are “not collected by the Member State where the administrative headquarters are located”, which is in principle the franchise tax as it is collected by Delaware. *Tobias Tröger*, ‘Choice of Jurisdiction in European Corporate Law – Perspectives of European Corporate Governance’ [2005] *European Business Organization Law Review (EBOR)*, 3, 19; Article 2 (1), 4 and 10 (a) of the Council Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital, *OJ* 1969 L 249/25.

117 *Becht/Mayer/Wagner, supra* n 20, 242 *et seq.*

118 ECJ Case C-210/06 of 16.12.2008.

119 *Frobenius, supra* n 112, 492.

must have an establishment in Germany or the management or the administration must be placed there.<sup>120</sup> However the Member States maintain the discretion to restrain their “own” companies from pursuing business exclusively abroad and thereby to influence the liberalisation of the incorporation market.

As a final point, Europe is not as homogenous as the US. This is reflected in different languages and different legal systems such as common law and civil law jurisdictions which cause a higher burden for the use of a foreign law and make this more inefficient.<sup>121</sup> Lastly businessmen are still sceptic to a certain extent about foreign company forms as they are not familiar with them.<sup>122</sup>

### 3. Evaluation

After the decisions of *Centros*, *Überseering* and *Inspire Art* the freedom of establishment has been advanced further for companies within Europe. Yet, it is likely that the development in Europe will be different and that there will be (at least in the near future) no “European Delaware”.<sup>123</sup> *Søndergaard Birkmose*, ‘A Market for Company Incorporations in the European Union? – Is *Überseering* the Beginning of the End?’ [2005] *Tulane Journal of International and Comparative Law*, 55, 64. This is owed to European particularities, such as co-determination and the existence of the seat theory on the one hand. On the other hand there is a stronger desire to stick to some core values of the specific company law by the Member States although one should abandon them for reasons of competitiveness.<sup>124</sup> The minimum capital requirement may serve here as an example. In Europe it seems more likely that there may be a greater disposition of a “federal” regulation in form of European company law. The creation of the *Societas Europaea (SE)* has proven that such a compromise is possible and the draft for a European Private Company is already on the way.<sup>125</sup>

120 Sect. 4a and sect. 10 GmbHG [German Limited Liability Companies Act]; The same change has been made with the MoMiG for the German public company (Aktiengesellschaft) in sect. 5 and sect. 39 AktG; However as there has been made no change for partnerships. This is why the relocation of a partnership abroad is inevitably regarded as liquidation under the ‘seat theory’; *Frobenius*, *supra* n 112, 492.

121 *Tröger*, *supra* n 117, 20 et seq; *Eidenmüller*, *Ausländische Kapitalgesellschaften im deutschen Recht* 2004, 3. Teil [part], Randnummer [paragraph] 3.

122 *Hommelhoff/Teichmann*, ‘Auf dem Weg zur Europäischen Privatgesellschaft (SPE)’ [2008] *Deutsches Steuerrecht (DStR)*, 925, 927; *Eidenmüller*, *Ausländische Kapitalgesellschaften im deutschen Recht*, München 2004), 3. Teil [part], Randnummer [paragraph] 3.

123 *Hanne Søndergaard Birkmose*, ‘A Market for Company Incorporations in the European Union? – Is *Überseering* the Beginning of the End?’ [2005] *Tulane Journal of International and Comparative Law*, 55, 64.

124 *Drury*, ‘The “Delaware syndrome”: European fears and reactions’ [2005] *Journal of Business Law*, 709, 727 et seq.

125 See [www.europeanprivatecompany.eu](http://www.europeanprivatecompany.eu).

## VI. Conclusion

The triple *Centros*, *Überseering* and *Inspire Art* marked a turning point for European company law. It seems that the *theory of foundation* has ousted the *real seat theory*. Whereas countries like France and Spain have already met competition fully by lowering their standards significantly we do not see this already to the same extent in Germany. However none of the European jurisdictions can elude the competitive pressure. It is nonetheless unlikely that there will occur anything comparable to the “Delaware effect” in Europe. The more likely it is that in Europe there will be a “federal” solution like the European Private Company which is already in the wings. Such a compromise could also entail new concepts for example a solvency test for the distribution rules which we do not already know from one of the jurisdictions. If the European jurisdictions are facing the regulatory competition in a calm and deliberate way this is likely to advance the attractiveness of the entire European Single Market and not only one of the Member States. Time will tell whether Europe will make it to find the balance between a “race to the bottom” and contemporary, reasonable reforms.