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The Liability of Corporations and Shareholders for the Capitalization and Obligations of Subsidiaries under German Law

*Maximilian Schiessl**

I. INTRODUCTION

The concept of the "corporation" as a separate legal entity is a chief principle of most nations' corporation law.¹ The owners of the corporation are allowed to conduct their business behind the corporate veil without being held liable for claims of the corporation's creditors. The German Stock Corporation Act provides that: "[t]he Stock Corporation is a company having separate legal personality. The recourse of creditors for obligations of the company is limited to the company's assets."² If the corporation goes bankrupt, its property is subject to the claims of creditors, but the shareholders' property normally will not be affected.

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¹ See, e.g., Horn, *International Rules for Multinational Enterprises: the ICC, OECD, and ILO Initiatives*, 30 AM. U. L. REV. 923, 934 (1981); Buxbaum, *The Formation of Marketable Share Companies*, in XIII INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 63 (1974).

² Aktiengesetz [AktG] § 1(1) (W. Ger.). The same rule is provided in GESETZ BETR. DIE GESELLSCHAFTEN MIT BESCHRÄNKTER HAFTUNG [GMBHG] § 13(2) (W. Ger.). The REVISED MODEL BUSINESS CORP. ACT § 6.22(b) (1985) states that: "Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct."

Such a reduction of entrepreneurial risk is neither unfair nor inequitable. This general principle is not confined to cases where management and ownership are separated. If the owners run the corporation themselves, limited liability provides an incentive to engage in the more risk-oriented types of business necessary to an advanced industrial economy.

Most legal systems, however, recognize that, under some circumstances, the separate corporate form should be disregarded in order to prevent certain inequitable results. As stated in *United States v. Milwaukee Refrigerator Transit Co.*, the corporate form is to be disregarded whenever it "is used to defeat public convenience, justify wrong, protect fraud, or defend crime."³ The equitable doctrine of "piercing the veil" is applied by United States courts in the absence of a legislative abrogation of limited liability. "In such cases, courts of equity, piercing all fictions and disguises, will deal with the substance of the action and not blindly adhere to the corporate form."⁴ This broad language makes it difficult for investors who organize their business activities in separate corporations to assess their risks. The courts achieve justice in particular cases at the expense of an overall loss of legal certainty.

Facing this problem in *Anderson v. Abbott*, the United States Supreme Court stated that: "[l]imited liability is the rule, not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted."⁵ In spite of this attempt of the United States Supreme Court to narrow the piercing the veil doctrine and safeguard shareholders relying on limited liability, courts have held shareholders personally liable for corporations' debts in a wide variety of circumstances, applying many different and even inconsistent standards. Vague and unpredictable judicial decisions have confused this area of law and have been widely criticized by commentators.⁶

In *First National City Bank v. Banco para el Comercio Exterior de*

³ *United States v. Milwaukee Refrigerator Transit Co.*, 142 F. 247, 255 (C.C.E.D. Wis. 1905).

⁴ *Bangor Punta Operations, Inc. v. Bangor & Arrostook R.R. Co.*, 417 U.S. 703, 713 (1974).

⁵ 321 U.S. 349, 362 (1944)(cited with approval in *First National City Bank v. Banco para el Comercio Exterior de Cuba*, 462 U.S. 611, 626 (1983)).

⁶ See, e.g., Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CALIF. L. REV. 12, 15 (1925)("[I]t does not seem to be possible to lay down any definite test . . . but the courts assign various grounds which to a great extent are vague and illusory."); Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589, 620 (1975)("Devoid of any consistent doctrinal basis, the cases themselves defy any attempt at rational explanation."); Easterbrook & Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985); Downs, *Piercing the Corporate Veil—Do Corporations Provide Limited Personal Liability?*, 53 UMKC L. REV. 174, 175 (1985); E. LATTY, *SUBSIDIARIES AND AFFILIATED CORPORATIONS* 6-8, 156-63 (1936); P. BLUMBERG, *THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS* 8 (1983)("[H]undreds of decisions that are irreconcilable and not entirely comprehensible").

Cuba, the United States Supreme Court demanded a more "rigorous analysis" of the piercing the veil doctrine instead of "worn epithets."⁷ The court quoted Justice Cardozo for the proposition that: "[t]he whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it."⁸

In the case of the piercing the veil doctrine, comparative analysis of other laws can be a very helpful device.⁹ Moreover, in international business transactions it is necessary for corporations and their legal advisors to know the corporate law of foreign countries in which they operate. One of the great problems which confront multinational corporations is the difference in corporate law around the world.¹⁰ Since multinationals are often subject to foreign jurisdictions and the application of foreign law, this incongruity carries with it some risk.

The Federal Republic of Germany, one of the United States' main trading partners, has a rather different approach to the liability of a parent corporation for the debts of its subsidiaries. In the United States, the affiliated enterprises doctrine is generally viewed as a subcategory of the piercing the corporate veil doctrine.¹¹ Under German law, there is a

⁷ 462 U.S. 611, 623 (1982).

⁸ *Id.* (quoting *Berkey v. Third Avenue R.R. Co.*, 244 N.Y. 84, 94, 155 N.E. 58, 61 (N.Y. 1926)).

⁹ R. DAVID & J. BRIERLEY, *MAJOR LEGAL SYSTEMS IN THE WORLD TODAY* 6 (2d ed. 1978). For the different functions and uses of comparative law, see 1 K. ZWIGERT & H. KOETZ, *EINFÜHRUNG IN DIE RECHTSVERGLEICHUNG AUF DEM GEBIETE DES PRIVATRECHTS* 14-31 (2d ed 1984); David, *The International Unification of Private Law*, in 2 *INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW* ch. 5 (1971); Dutoit, *L'importance du droit comparé dans l'enseignement juridique*, in *RECUEIL DES TRAVAUX SUISSES PRÉSENTÉS AU IXE CONGRÈS INTERNATIONAL DE DROIT COMPARÉ* 21 (1976); Kahn-Freund, *On Uses and Misuses of Comparative Law*, 37 *MOD. L. REV.* 1 (1974); Pound, *The Place of Comparative Law in the American Law School Curriculum*, 8 *TUL. L. REV.* 161 (1934).

¹⁰ See, e.g., Vagts, *The Multinational Enterprise: A New Challenge for Transnational Law*, 83 *HARV. L. REV.* 739, 741-42 (1970); Hadari, *The Structure of the Private Multinational Enterprise*, 71 *MICH. L. REV.* 729, 754 (1973); Charney, *Transnational Corporations and Developing Public International Law*, 1983 *DUKE L. J.* 748, 749 (1983); Aronofsky, *Piercing the Transnational Corporate Veil: Trends, Developments, and the Need for Widespread Adoption of Enterprise Analysis*, 10 *N.C.J. INT'L L. & COM. REG.* 31, 33 (1985). On piercing the corporate veil in transnational groups of affiliated enterprises, see Behrens, *Der Durchgriff über die Grenze*, 46 *RABELSZEITSCHRIFT [RABELSZ]* 308 (1982).

¹¹ For Landers's view of the combination of parent, subsidiary, and affiliated companies as one "business enterprise" which has far reaching consequences for the parent's liability, see Landers, *supra* note 6, at 589-652. *But see* Posner, *The Rights of Creditors of Affiliated Corporations*, 43 *U. CHI. L. REV.* 499-526 (1976), and the response of Landers in Landers, *Another Word on Parents, Subsidiaries and Affiliates in Bankruptcy*, 43 *U. CHI. L. REV.* 527-40 (1976). For the concept of a "law of corporate groups" see Blumberg, *supra* note 6.

The courts also seem to be more easily persuaded to disregard the corporate entity in such cases

sharp distinction between the general rules on piercing the corporate veil, which may also be applied to a parent-subsidiary relationship, and the special legal framework governing the *Konzernrecht* (law of affiliated enterprises). These special rules, embodied for the stock corporation in §§ 15-19 and §§ 291-318 *Aktiengesetz* ("AktG") (Stock Corporation Act),¹² purport to provide a complete system for groups of companies.¹³ The *Konzernrecht* contains, for example, provisions regarding the acquisition of a corporation, minority shareholder rights, accounting stan-

than to disregard the entity of a corporation which is owned by one or more individuals. Cf. Hackney & Benson, *Shareholder Liability for Inadequate Capital*, 43 U. PITT. L. REV. 837, 873 (1982)(citing cases supporting this proposition).

¹² There are no statutory provisions for close corporations and partnerships. These two forms, however, play an important role in the business life of West Germany. Therefore, courts and scholars have evolved rules on groups of such companies. On the close corporation, see, e.g., Judgment of June 5, 1975, Bundesgerichtshof, W. Ger., 65 Bundesgerichtshof in Zivilsachen [BGHZ] 15 ("JTT"); Judgment of Feb. 16, 1981, Bundesgerichtshof, W. Ger., 80 BGHZ 69 ("Süssen"); Judgment of Sept. 16, 1985, Bundesgerichtshof, W. Ger., 95 BGHZ 330 ("Autokran"); Barz, in M. HACHENBURG, GMBHG GROSSKOMMENTAR § 13 appendix I (7th ed. 1975); Emmerich, in F. SCHOLZ, GMBHG appendix II (6th ed. 1978); Schilling, *Grundlagen eines GmbH-Konzernrechts*, in Festschrift für Hefermehl 383 (1976); Schmidt, *Konzernrecht, Minderheitenschutz und GmbH-Innenrecht-Zu einer Bestandsaufnahme des inneren GmbH-Konzernrechts*, 1979 GESETZ BETR. DIE GESELLSCHAFTEN MIT BESCHRÄNKTER HAFTUNG RUNDschau [GMBHR] 121.

For the partnership, see, e.g., Judgment of Feb. 5, 1979, Bundesgerichtshof, W. Ger., 1980 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 231 ("Gervais"); Judgment of Oct. 5, 1981, BGH, 1982 WERTPAPIERMITTEILUNGEN [WM] 394 ("Holiday Inn"); Judgment of Dec. 5, 1983, Bundesgerichtshof, W. Ger., 89 BGHZ 162. V. EMMERICH & J. SONNENSCHNEIN, KONZERNRECHT 253-61 (2d ed. 1977); W. FLUME, DIE PERSONENGESELLSCHAFT 255-57 (1977); Raiser, *Beherrschungsvertrag im Recht der Personengesellschaften - Besprechung der Entscheidung des BGH vom 5.2.1979*, 1980 ZEITSCHRIFT FÜR UNTERNEHMENS - UND GESELLSCHAFTSRECHT [ZGR] 558; Schneider, *Konzernbildung, Konzernleitung und Verlustausgleich im Konzernrecht der Personengesellschaft - Zugleich ein Beitrag zur Bedeutung des Gervais-Urteils für die Entwicklung des Konzernrechts*, 1980 ZGR 511; Reuter, *Die Personengesellschaft als abhängiges Unternehmen*, 146 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT [ZHR] 1 (1982); M. SCHIESSL, DIE BEHERRSCHTE PERSONENGESELLSCHAFT (1985).

On the attempts to unify the corporate law and the law of affiliated enterprises in the European Community, see M. LUTTER, EUROPÄISCHES GESELLSCHAFTSRECHT (2d ed. 1984); Gyon, *Examen critique des projets européens en matière de groupes de sociétés*, in 2 LEGAL AND ECONOMIC ANALYSES ON MULTINATIONAL ENTERPRISES 155-74 (K. Hopt ed. 1982); Immenga, *Abhängige Unternehmen und Konzerne im europäischen Gesellschaftsrecht*, 48 RABELSZ 48-80 (1984); Timmermans, *Die europäische Rechtsangleichung im Gesellschaftsrecht, Eine integrations- und rechtspolitische Analyse*, 48 RABELSZ 1-47 (1984).

¹³ However, there has been a lot of criticism among legal scholars since its enactment in 1965. See, e.g., V. EMMERICH & J. SONNENSCHNEIN, *supra* note 12, at 204-205, 214-25; A. SURA, FREMDEINFLUSS UND ABHÄNGIGKEIT IM AKTIENRECHT, EINE NEURORIENTIERUNG AN DEN GRUNDLAGEN DES RECHTS DER VERBUNDENEN UNTERNEHMEN 35-62 (1980); Lutter, *Das Konzernrecht in der Bundesrepublik Deutschland: Ziel, Wirklichkeit und Bewährung*, 1976 SCHWEIZERISCHE AKTIENGESELLSCHAFT [SAG] 152. A reform commission was established by the Department of Justice which published its proposals in 1980. See BUNDESMINISTERIUM DER JUSTIZ, BERICHT ÜBER DIE VERHANDLUNGEN DER UNTERNEHMENSRECHTSKOMMISSION (1980).

dards, and shareholder liability.¹⁴ The underlying rationale is that the conduct of a dominant enterprise with business interests outside of its subsidiary may be much more dangerous to its subsidiary than the conduct of a majority shareholder who is mainly interested in the corporation's profitability since the majority shareholder has no other business interests which might conflict with the controlled corporation's interests.

German corporation law is based on the assumption that in an independent corporation there is an equilibrium and common interest among shareholders which automatically makes the corporation's best interest a guide for both management and shareholder decisions. This common interest is intended to serve as an indirect protection of the creditors. When one or several shareholders acquire a majority interest, the danger arises that they might take undue advantage of their influence. This danger is increased "if the shareholder has business interests outside of the corporation which are important enough to cause a serious concern that the shareholder might take advantage of his influence to foster them."¹⁵

Part II of this Article describes the piercing the corporate veil doctrine as it was developed by German courts and applied to parent-subsidiary relationships. Part III outlines the legal rules regarding groups of affiliated companies provided by the Stock Corporation Act for stock corporations and by the courts for close corporations and limited partnerships with respect to the liability of controlling shareholders and limited partners. Notwithstanding the difference in approach, there are many similarities in language and result between the special German laws governing groups of companies and the rules for such groups under the United States piercing the corporate veil doctrine.¹⁶

¹⁴ For a comprehensive description, see, e.g., LEGAL AND ECONOMIC ANALYSES ON MULTINATIONAL ENTERPRISES *supra* note 12, at 21-44; Oppenhoff & Verhoeven, *The Stock Corporation*, in 2 BUSINESS TRANSACTIONS IN GERMANY § 24.05 (K. Rüster ed. 1985); Bonanno, *The Protection of Minority Shareholders in a Konzern Under German and United States Law*, 18 HARV. INT'L L. J. 151, 153-63 (1977); Motomura, *Protecting Outside Shareholders in a Corporate Subsidiary: A Comparative Look at the Private and Judicial Roles in the United States and Germany*, 1980 WIS. L. REV. 61-104.

¹⁵ 80 BGHZ 69-72 (1982) ("Süssen"). See also Judgment of Oct. 13, 1977, Bundesgerichtshof, W. Ger., 69 BGHZ 334, 337-38 ("VEBA/Gelsenberg"); Judgment of May 8, 1979, Bundesgerichtshof, W. Ger., 74 BGHZ 359, 364-66. ("WAZ").

¹⁶ This article will not undertake a comparative analysis but will confine the topic to a discussion of West German law.

II. PIERCING THE CORPORATE VEIL

A. Domination of the Subsidiary

One of the most controversial issues of German corporate law and the topic of an often very ideological debate was the doctrine of "parallelism of power and liability." Its proponents,¹⁷ influenced by the "Freiburg School" of economics, argued that those who exercise power in the economic process must be held liable for their actions as a corrective for such power. Such liability was believed to lead to a more careful and responsible allocation of capital in the market. In 1966, the *Bundesgerichtshof* (Private Law Supreme Court) rejected this doctrine in *Rektor*.¹⁸ The defendant in *Rektor* had set up a limited partnership with himself as a limited partner and an unskilled worker without any capital as the general partner. In practice, however, the defendant ran the business and made all the important decisions alone. The opinion of the Court of Appeals holding the defendant liable for the debts of the insolvent partnership was reversed by the *Bundesgerichtshof*. The court said that there was no abuse of the limited liability since the statute provided for the possibility of combining limited liability and influence on management.¹⁹ Even where an insolvent person is made the only wholly liable general partner, the limited partner has no liability. Nonetheless, if "additional circumstances cause a wrong impression with a third party concerning the scope of the liability or the financial status of the partners," liability may be imposed by the court on the limited partner.²⁰

The courts have generally been very reluctant to disregard the cor-

¹⁷ See, e.g., R. MÜLLER-ERZBACH, DAS PRIVATE RECHT DER MITGLIEDSCHAFT ALS PRÜFSTEIN EINES KAUSALEN RECHTSDENKENS 116-124 (1948); R. BÖHM, DIE ORDNUNG DER WIRTSCHAFT ALS GESCHICHTLICHE AUFGABE UND RECHTSSCHÖPFERISCHE LEISTUNG 126 (1937); W. EUCKEN, GRUNDSÄTZE DER WIRTSCHAFTSPOLITIK 279-82 (1952); B. GROSSFELD, AKTIENGESELLSCHAFT, UNTERNEHMENSKONZENTRATION UND KLEINAKTIONÄR 102-12 (1968).

But see A. TEICHMANN, GESTALTUNGSFREIHEIT IN GESELLSCHAFTSVERTRÄGEN 125-26 (1970); Flume, *supra* note 12, at 244; U. KORNBLUM, DIE HAFTUNG DER GESELLSCHAFTER FÜR VERBINDLICHKEITEN VON PERSONENGESELLSCHAFTEN 262-63 (1972); E.M. KONIETZKO, ZUR HAFTUNG DES KOMMANDITISTEN 167-68 (1977).

¹⁸ See Judgment of March 17, 1966, Bundesgerichtshof, W. Ger., 45 BGHZ 204.

¹⁹ *Id.* at 207. The *Handelsgesetzbuch* (Commercial Code) does not include a "Control Rule" as provided by the Uniform Limited Partnership Act and the Revised Uniform Limited Partnership Act. See UNIFORM LIMITED PARTNERSHIP ACT § 7, 6 U.L.A. 582 (1969) and REVISED UNIFORM LIMITED PARTNERSHIP ACT § 303(a), 6 U.L.A. 241 (West Supp. 1986). HANDELSGESETZBUCH [HGB] § 171(1) provides: "The limited partner is directly liable to the creditors of the partnership up to the amount of his contribution; liability is excluded in so far as the contribution is paid in." An outright abandonment of the "control rule" under United States law is proposed by Basile, *Limited Liability for Limited Partners: An Argument for the Abolition of the Control Rule*, 38 VAND. L. REV. 1199 (1985).

²⁰ 45 BGHZ 203, 208 (1966).

porate form. In 1956, the *Bundesgerichtshof* stated that "the corporate entity can be regarded only in so far as its use is consistent with the goals of the legal system."²¹ As early as 1920, the *Reichsgericht*, the predecessor of the *Bundesgerichtshof*, had concluded that the corporation with a single shareholder "must be treated as one entity if the reality of life, the economic needs and the facts force the judge to ignore the independence of the close corporation and its sole shareholder."²² Notwithstanding this very broad language, most decisions denied liability of the single shareholder. In *Typenhaus*, the *Bundesgerichtshof* affirmed the holdings in previous cases²³ that mere domination by a sole shareholder does not make such a shareholder personally liable.²⁴ "A disregard of the corporate entity is permissible only in exceptional cases, if it is required by serious reasons of equity and good faith."²⁵ Even the complete integration of the subsidiary into the parent organization which had acquired complete control over the financially dependent subsidiary was not deemed to be sufficient to merit disregard by the court of the corporate form.²⁶ The courts recognized, but rarely applied, the following factors which might justify the disregard of the corporate entity:

—giving creditors the impression that the subsidiary is independent²⁷
or that the shareholders are personally liable;²⁸

—commingling assets with the consequence that the ownership interests of the corporation and the shareholders are indistinguishable;²⁹

²¹ Judgment of Jan. 30, 1956, *Bundesgerichtshof*, W. Ger., 20 BGHZ 4, 14. See Judgment of Nov. 29, 1956, *Bundesgerichtshof*, W. Ger., 22 BGHZ 226, 231; Judgment of Mar. 12, 1959, *Bundesgerichtshof*, W. Ger., 29 BGHZ 385, 392; Judgment of Dec. 14, 1959, *Bundesgerichtshof*, W. Ger., 31 BGHZ 258, 271; Judgment of June 4, 1974, *Bundesgerichtshof*, W. Ger., 1974 NJW 1371.

²² Judgment of June 22, 1920, *Reichsgericht*, [RG], Ger., 99 *Reichsgericht in Zivilsachen* [RGZ] 226.

²³ 22 BGHZ 226, 229 (1956); Judgment of Oct. 6, 1960, *Bundesgerichtshof*, W. Ger., 33 BGHZ 189, 191; Judgment of Nov. 13, 1973, *Bundesgerichtshof*, W. Ger., 61 BGHZ 380, 383; Judgment of Nov. 6, 1957, BGH, 1958 WM 460 (1957).

²⁴ Judgment of May 4, 1977, *Bundesgerichtshof*, W. Ger., 68 BGHZ 312, 314 ("Typenhaus"). The "alter ego" doctrine was discussed by a United States court in *Tigrett v. Pointer*, 580 S.W.2d 375, 381 (Tex. Civ. App. 1978): "Of course, domination of corporate affairs by the sole stockholder does not in itself justify the imposition of personal liability." See also, W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 41.10 (rev. perm. ed. 1983)(citing further cases).

²⁵ 68 BGHZ 312, 314-15 (1977).

²⁶ *Id.* at 320-21. After "Autokran" this case would probably be decided under the "Konzern" doctrine. See *infra* notes 123-32 and accompanying text.

²⁷ 22 BGHZ 226, 234 (1956).

²⁸ See 22 BGHZ 226, 230 (1956); 68 BGHZ 312, 315 (1977) ("Typenhaus"); F. KÜBLER, *GESELLSCHAFTSRECHT* 99 (1981); W. FLUME, *DIE JURISTISCHE PERSON* 86 (1983); Reh binder, *Zehn Jahre Rechtsprechung zum Durchgriff im Gesellschaftsrecht*, in *FESTSCHRIFT FISCHER* 579, 597 (1979).

²⁹ Judgment of July 9, 1979, *Bundesgerichtshof*, W. Ger., 1979 NJW 1823, 1828 ("Herstatt"); Judgment of Nov. 12, 1984, BGH, 1985 *ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT UND INSOLVENZ-PRAXIS* [ZIP] 29, 30-31 (1984); 95 BGHZ 330, 334 (1985) ("Autokran").

—an “absolutely unreasonable and unpractical” incorporation of a subsidiary, the legal independence of which exists only in theory from the very beginning.³⁰

B. Inadequate Capitalization

1. Loans to Corporations

It is generally accepted that a shareholder of a corporation may lend money to the corporation and be entitled to the same remedies as any other creditor. However, loans from shareholders show that the shareholders are cognizant of the corporation's need for capital. Such loans do not increase the amount of equity capital which would give such shareholders a position inferior to the corporation's creditors in the case of bankruptcy. Instead, such shareholders make a loan in order to be treated like other creditors. Other creditors' claims are thereby endangered since the company operates as if it had sufficient equity capital.³¹ Therefore, German courts treat the shareholder lender differently from other creditors if funds are lent in a situation in which the corporation would not otherwise be given a loan by a third party under usual market conditions.³² In such situations, the shareholders are not allowed to shift their business risks to the creditors.

In the case of the subsequent insolvency of such a corporation, the funds lent are treated as equity capital. “If the loan was given instead of immediately needed equity capital in order to make the corporation's survival possible and if a sufficient capitalization is pretended that way, the shareholder calling the loan back before the goals which he aimed at

³⁰ 68 BGHZ 312, 322 (1977)(“Typenhaus”).

³¹ United States courts have evolved the so-called “Deep Rock” doctrine for similar cases. This doctrine is named for the subsidiary involved in *Taylor v. Standard Gas & Electric Co.*, 306 U.S. 307 (1939) in which it was originally applied. It leads to the result that the creditor claims of a shareholder against an insolvent corporation are subordinated to those of bona fide outside creditors in bankruptcy proceedings. See, e.g., *Pepper v. Litton*, 308 U.S. 295 (1939); *Comstock v. Group of Institutional Investors*, 335 U.S. 211 (1948); *Stone v. Eacho*, 127 F.2d 284, *reh'g denied*, 128 F.2d 16 (4th Cir. 1942), *cert. denied*, 317 U.S. 635 (1942); *In re Kansas City Journal-Post Co.*, 144 F.2d 791 (8th Cir. 1944); *Arnold v. Philips*, 117 F.2d 497 (5th Cir. 1941), *cert. denied*, 313 U.S. 583 (1941); *Gannett Co. v. Larry*, 221 F.2d 269 (2d Cir. 1955); *Banker's Life and Casualty Co. v. Kirtley*, 338 F.2d 1006 (8th Cir. 1964); *Farmers Bank v. Julian*, 383 F.2d 314 (8th Cir. 1967), *cert. denied*, 389 U.S. 1021 (1967).

However, according to W. CARY & M. EISENBERG, *CASES AND MATERIALS ON CORPORATIONS* 109 (5th ed. 1980) the doctrine “has been interpreted so variously that question may be raised if there is a ‘doctrine’ at all.” For comments on the doctrine, see *Israels, The Implications and Limitations of the “Deep Rock” Doctrine*, 42 COLUM. L. REV. 376 (1942); *Stroia, Deep Rock - A Post Mortem*, 34 U. DET. L. J. 279 (1957); *Herzog & Zwiebel, The Equitable Subordination of Claims in Bankruptcy*, 15 VAND. L. REV. 83 (1961).

³² See, e.g., Judgment of Mar. 24, 1984, Bundesgerichtshof, W. Ger., 76 BGHZ 326, 326-31; Judgment of Sept. 21, 1981, Bundesgerichtshof, W. Ger., 81 BGHZ 311, 317-18.

in advancing the funds are permanently reached is inconsistent with his earlier behavior and violates the standards of equity and good faith."³³ Such a shareholder is responsible for proper financing. If the shareholder "actually intends to provide capital, he cannot avoid this responsibility by choosing a less risky form of financing instead of the increase in the equity capital which is required by objective economic standards."³⁴ This "nominal undercapitalization" doctrine was developed by the courts in cases involving *Gesellschaften mit beschränkter Haftung* ("GmbHs") (close corporations) or *Gesellschaften mit beschränkter Haftung & Co., Kommanditgesellschaften* ("GmbH & Co., KGs") (limited partnerships with close corporations as the only general partners). In the 1980 reform of the *Gesetz betr. die Gesellschaften mit beschränkter Haftung* ("GmbHG") (Close Corporation Act) and the *Handelsgesetzbuch* ("HGB") (Commercial Code) the doctrine was embodied in the statute.³⁵

Until recently, the applicability of the nominal undercapitalization doctrine to a stock corporation had for the most part been denied.³⁶ The main arguments were that the financing rules in the AktG (Stock Corporation Act) provide better safeguards for the creditors than do the safeguards in the GmbHG (Close Corporation Act). In addition, the position of the shareholder in the stock corporation is considered weaker because, in contrast to the close corporation's members, the shareholder in the stock corporation cannot give directives to the management.

Rejecting these arguments, the *Bundesgerichtshof* applied the doctrine to a stock corporation in *Beton-und Monierbau*.³⁷ In this case,

³³ Judgment of Mar. 26, 1984, Bundesgerichtshof, W. Ger., 90 BGHZ 381, 388-89 ("Beton-und Monierbau I"); See Judgment of Dec. 14, 1959, Bundesgerichtshof, W. Ger., 31 BGHZ 258, 268-72 ("Lufttaxi"); Judgment of Sept. 27, 1976, Bundesgerichtshof, W. Ger., 67 BGHZ 171, 174-75; Judgment of Nov. 26, 1979, Bundesgerichtshof, W. Ger., 75 BGHZ 334, 336-37; Judgment of Mar. 24, 1980, Bundesgerichtshof, W. Ger., 76 BGHZ 326, 329.

³⁴ 90 BGHZ 381, 389 (1984)("Beton-und Monierbau I").

³⁵ See §§ 32a, 32b GmbHG; 129a, 172a HGB. The rules provided by the statute differ from those provided by the Bundesgerichtshof. Judgment of Mar. 26, 1984, Bundesgerichtshof, W. Ger., 90 BGHZ 370, 376-81, clarified that the rules established in the precedents are not replaced by the statute and continue to be applicable.

³⁶ See, e.g., Judgment of June 30, 1983, Oberlandesgericht, [OLG], Düsseldorf, W. Ger., 1983 NJW 2887; Judgment of May 27, 1981, Landgericht, [LG], Düsseldorf, W. Ger., 1981 ZIP 601, 603; Claussen, *Kapitalersetzende Darlehen und Sanierungen durch Kreditinstitute*, 147 ZHR 195, 201-02 (1983); Westermann, *Banken als Kreditgeber und Gesellschafter*, 1982 ZIP 379, 387-88; Rümker, *Bankkredite als kapitaleretzende Gesellschafterdarlehen unter besonderer Berücksichtigung der Sanierungssituation*, 1982 ZIP 1385, 1395-96; Menzel, *Die Bedeutung der BGH-Rechtsprechung zu den Gesellschafterdarlehen für die Unternehmenssanierung*, 1982 Aktiengesellschaft [AG] 197, 205. *Contra* Schmidt, *Kapitalersetzende Bankenkredite?*, 147 ZHR 165, 171-75 (1983); Immenga, *Kapitalersetzende Aktionärsdarlehen als Haftkapital?*, 1983 ZIP 1405-12.

³⁷ 90 BGHZ 381, 385-87 (1984)("Beton-und Monierbau I").

however, shareholder liability was denied.³⁸ The differences between stock corporations and close corporations caused the court to impose “higher requirements” for stock corporation shareholder liability.³⁹ The shareholder in a stock corporation must have an “entrepreneurial interest” in the corporation which can be shown by a share of more than 25%. The justification for this threshold is that “a share of more than 25% gives the owner under certain circumstances a decisive share in decision-making on those issues which are most important for the corporation and about which the shareholders’ assembly decides with a majority qualified therefore.”⁴⁰ This influence carries with it the assumption that the shareholder is interested in the enterprise to an extent that justifies subordination.

2. Substantial Undercapitalization

In recent years, discussions have concentrated on corporations doing business without sufficient capitalization. A corporation is substantially undercapitalized if its capital, including loans made by the shareholders, does not meet the capital requirements of the business of the corporation.⁴¹ Inadequate capitalization is a much bigger problem for the German economy than for the United States economy because the percentage of equity capital in United States enterprises is more than twice as high as in comparable German enterprises.⁴² The average German debt-equity ratio mushroomed from 2.3:1 in 1967 to 4:1 in 1981.⁴³ A large number of legal scholars proposed to pierce the corporate veil in cases of substantial undercapitalization, claiming that the shareholders had a good faith duty to put at the risk of the business in question unencumbered capital reasonably adequate for the business’s prospective liabilities.⁴⁴ Most courts, however, declined to disregard the corporate

³⁸ *Id.* at 391-94.

³⁹ *Id.* at 387-91. What “higher requirements” and “entrepreneurial interest” really mean is not clear. A more detailed explanation of how the doctrine may be applied is necessary. On this issue, see Claussen, *Kapitalersatzrecht und Aktiengesellschaft*, 1985 AG 173, 176-77; Schwark, *Anmerkung zu BGH v. 26.3.1984 - II ZR 171/83*, 1984 JURISTENZEITUNG [JZ] 1036, 1037.

⁴⁰ 90 BGHZ 381, 391 (1984) (“Beton-und Monierbau I”).

⁴¹ An exact definition, however, has not been found. Those scholars who have tried, disagree. For a description of the different theories see 68 BGHZ 312, 316 (1977) (“Typenhaus”). These differences have caused a lot of legal uncertainty which is an additional argument against a shareholder’s liability in such cases.

⁴² Cf. Reuter, *Welche Massnahmen empfehlen sich, insbesondere im Gesellschafts-und Kapitalmarktrecht, um die Eigenkapitalausstattung der Unternehmen langfristig zu verbessern?*, GUTACHTEN B, VERHANDLUNGEN DES 55. DJT HAMBURG, B10 (1984).

⁴³ P. PUETZ & H. WILLGERODT, *GLEICHES RECHT FÜR BETEILIGUNGSKAPITAL* 12 (1985).

⁴⁴ See, e.g., Winkler, *Die Haftung der Gesellschafter einer unterkapitalisierten GmbH*, 1969 BETRIEBS - BERATER [BB] 1202, 1205-07; Lutter & Hommelhoff, *Nachrangiges Haftkapital und Un-*

form on this ground,⁴⁵ although, in the case of fraud, such courts would disregard the corporate form.⁴⁶ The courts stressed fixed capital requirements in the GmbHG (Close Corporation Act) to show that the lawmakers recognized the problem, had set up certain requirements, but did not want to go any further. The *Bundesgerichtshof* avoided deciding the question in most of its decisions.⁴⁷

The only case in which a court disregarded the corporate entity was *Siedlungsverein*.⁴⁸ The peculiarities of this case, however, were such that it cannot serve as a precedent.⁴⁹ The business entity in *Siedlungsverein* was not a company but an *Eingetragener Verein* (registered association; membership corporation). The defendants, who were members of the association, wanted to lease an estate from the plaintiff. The contract, however, was concluded between the plaintiff and the association to simplify the accounting. The plaintiff received the entire rent from the association which then divided the obligations among its members. This was the association's only purpose and it never possessed any capital of its own. Defendants and plaintiff were aware of these facts from the begin-

terkapitalisierung in der GmbH, 1979 ZGR 31, 57-66; U. IMMENGA, DIE PERSONALISTISCHE KAPITALGESELLSCHAFT. EINE RECHTSVERGLEICHENDE UNTERSUCHUNG NACH DEUTSCHEM GMBH-RECHT UND DEM RECHT DER CORPORATIONS IN DEN VEREINIGTEN STAATEN 403-16 (1970); Ulmer, *Gesellschafterdarlehen und Unterkapitalisierung bei GmbH und GmbH & Co. KG*, in Festschrift für Konrad Duden 661, 676-81 (1977); 1 H. WIEDEMANN, GESELLSCHAFTSRECHT 571-73 (1980). *Contra* Winter, in F. SCHOLZ, GmbHG § 13, No. 40 (1979); Herber, *Zum Entwurf einer GmbH-Novelle*, 1978 GMBHR 25, 28-29; Kahler, *Die Haftung des Gessellschafters im Falle der Unterkapitalisierung einer GmbH*, 1985 BB 1429, 1431-34; Wuest, *Unterkapitalisierung und Überschuldung bei Beschränkthaftern*, 1985 JZ 817, 822-24.

⁴⁵ Under the United States piercing the veil doctrine, undercapitalization is a major factor in seeking to hold shareholders personally liable. In almost all cases where the creditor was successful, however, the creditor has been required to show that the inadequate capitalization was coupled with other factors constituting a misuse of the corporate form. *See, e.g.*, Francis O. Day Co. v. Shapiro, 267 F.2d 669 (D.C. Cir. 1959); Bernardin, Inc. v. Midland Oil Corp., 520 F.2d 771 (7th Cir. 1975); Lurie v. Arizona Fertilizer & Chem. Co., 101 Ariz. 482, 421 P.2d 330 (1966); De Witt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681 (4th Cir. 1976); Gallagher v. Recondo Builders, Inc., 91 Ill. App. 3d 999, 415 N.E.2d 560 (Ill. App. Ct. 1980); Service Iron Foundry, Inc. v. M.A. Bell Co., 2 Kan. App. 2d 662, 588 P.2d 463 (Kan. Ct. App. 1978). Courts have repeatedly held that shareholders are not liable solely by reason of undercapitalization. *See, e.g.*, *DeWitt Truck Brokers*, 540 F.2d 681; Fisser v. Int'l Bank, 282 F.2d 231 (2d Cir. 1960); Walkovsky v. Carlton, 18 N.Y.S.2d 414, 223 N.E.2d, 276 N.Y.S.2d 585 (1966); Texas Indus., Inc. v. Dupuy & Dupuy Dev. Inc., 227 So.2d 265 (La. Ct. App. 1969); Tigrett v. Pointer, 580 S.W.2d 375 (Tex. Civ. App. 1978).

⁴⁶ *See infra* notes 58-66 and accompanying text.

⁴⁷ *See* 22 BGHZ 226, 231 (1956); 31 BGHZ 258, 271 (1959) ("Lufttaxi"); 1961 WM 1103, 1105 (1961).

⁴⁸ Judgment of July 8, 1970, Bundesgerichtshof, W. Ger., 54 BGHZ 222 ("Siedlungsverein").

⁴⁹ This view is shared by W. FLUME, *supra* note 28, at 80; *see also* J. WILHELM, RECHTSFORM UND HAFTUNG BEI DER JURISTISCHEN PERSON 317 n.125 (1981); Reh binder, *supra* note 28, at 601-02.

ning.⁵⁰ The *Bundesgerichtshof* viewed the refusal of the defendants to pay the rent as a violation of their equitable duty and of good faith and held them liable for the association's debts.⁵¹

Seven years after *Siedlungsverein*, the *Bundesgerichtshof* refused to pierce the corporate veil in the *Typenhaus* case which involved an undercapitalized close corporation.⁵² The defendant in *Typenhaus* had manufactured prefabricated houses. After some time it incorporated a subsidiary which continued the production while the parent confined its activity to the distribution of the houses.⁵³ The subsidiary was not only undercapitalized, but completely dominated by the parent which owned the equipment of the subsidiary. Nonetheless, the separate corporate form was not disregarded. The court denied any obligation of a majority shareholder to provide adequate capitalization.⁵⁴

Typenhaus was decided by the Eighth Panel of the *Bundesgerichtshof* which usually has no jurisdiction in cases involving corporation law. Some months later, the more competent Second Panel expressed a careful criticism of this holding. In dicta, the Second Panel mentioned the possibility of a disagreement with *Typenhaus* because of the panel's "tendency towards a reinforced protection of creditors."⁵⁵ Seven years later, however, the Second Panel held in *Beton-und Monierbau* that:

[t]he responsibility of a shareholder for a proper financing does not oblige him to make a subsequent payment during a crisis of the enterprise but prevents him from placing the creditors at a disadvantage by avoiding an objectively required increase in equity capital and turning to a less risky form of financing.⁵⁶

Thus, the shareholder is not liable for adequate capitalization, but if the shareholder does make some provision of capital to the corporation, the contributed payment is treated as equity capital regardless of whether the payment is arranged as a loan.

In 1980, the GmbHG (Close Corporation Act) was amended and the "nominal undercapitalization" doctrine became embodied in the statute. The lawmakers considered, but rejected, the shareholders' liability for the debts of an undercapitalized corporation. It was said that:

The draft does not contain a provision requiring a capitalization of a close corporation which is sufficient for the intended business transactions. Such a provision might be considered to enhance the protection of creditors.

⁵⁰ 54 BGHZ 222, 223-24 (1970)("Siedlungsverein").

⁵¹ *Id.* at 225-26.

⁵² 68 BGHZ 312 (1977)("Typenhaus").

⁵³ *Id.* at 313.

⁵⁴ *Id.* at 319.

⁵⁵ Judgment of June 13, 1977, Bundesgerichtshof, W. Ger., 1977 NJW 1683, 1686.

⁵⁶ 90 BGHZ 381, 389 (1984).

However, a more rigorous analysis demonstrates that such a regulation would not be feasible. When the company is incorporated it is already impossible to determine with sufficient accuracy which capitalization is adequate, measured by the nature of the corporate undertaking and its magnitude, which cannot be foreseen at the very start. Likewise, the members are unable to investigate and to control the financial needs when the business is carried on. This is especially true for members who do not have an overview over the day-to-day business and who are mainly investors and are not involved in the management. A liability which is based on an ex post assessment of an adequate capitalization is inconsistent with the principle of legal certainty and would call into question the idea of the close corporation itself.⁵⁷

C. Personal Liability Without Disregard of the Corporate Form

While the courts are reluctant to disregard the corporate form, they have sometimes achieved a similar result by granting a separate claim of a corporation's creditor against a shareholder by reason of the shareholder's own acts or conduct.

1. Tort Liability

In cases of an extremely imbalanced allocation of risks at the creditors' expense, the courts have found tort liability of shareholders pursuant to § 826 *Bürgerliches Gesetzbuch* ("BGB") (Civil Code).⁵⁸ The *Reichsgericht* held shareholders liable in tort in a case where the assessment of equity capital insufficient for the corporation's prospective business activities was part of a plan for unfavorable protection of the creditors in the event of the corporation's insolvency.⁵⁹ The *Bundesgerichtshof* concluded that § 826 BGB is violated if "a close corporation is not viable on its own and in spite of this fact the corporate entity is abused by the sole shareholder in order to continue the business operations though the shareholder is aware that the corporation is unable to satisfy its obligations."⁶⁰ The shareholders are also liable if they postpone the filing for bankruptcy by advancing funds in order to gain personal advantages at the creditors' expense even if the shareholders are aware that the bankruptcy is unavoidable.⁶¹

⁵⁷ Bundestags-Drucksache 8/1347, 38-39.

⁵⁸ BÜRGERLICHES GESETZBUCH [BGB] § 826 (W. Ger.) provides that "[a] person who willfully causes damage to another in a manner contrary to public policy is bound to compensate the other for the damage." See *infra* notes 59-61.

⁵⁹ Judgment of Nov. 16, 1937, Reichsgericht, Ger., 1938 JURISTISCHE WOCHENSCHRIFT [JW] 862, 864.

⁶⁰ Judgment of Nov. 26, 1957, Bundesgerichtshof, W. Ger., 1957 WM 460, 462.

⁶¹ See 90 BGHZ 381, 399 (1984)("Beton-und Monierbau I"); Judgment of July 9, 1979,

The most important case in this area is *Architekten*,⁶² which involved a GmbH & Co., KG (limited partnership with a close corporation as the only general partner) engaged in the construction business. The defendants were limited partners of the partnership as well as shareholders of the close corporation. Both companies were undercapitalized. Like other creditors, the plaintiff, an architect, had a claim against the partnership. The partnership, however, had sold to the defendants all the erected buildings at a price well below the market price.⁶³ The business had been organized in such a way that the undercapitalized companies bore all risks while the defendants reaped all the profits. As "their relation to the company and the creditors were arranged in a way that the creditors were automatically put at a disadvantage," the *Bundesgerichtshof* held the defendants liable in tort.⁶⁴

Architekten has shown that, under some circumstances, creditors may have a claim against the shareholder of an undercapitalized sham corporation. However, such claims are often hard to prove. The willfulness requirement in § 826 BGB is only met if the shareholder is well aware of all the facts, including the possibility of damages to the creditors.⁶⁵ That this requirement is difficult to meet is shown by the few cases in which shareholders were actually held liable for the debts of the corporation.⁶⁶

2. *The Culpa in Contrahendo Doctrine*

If a parent corporation is involved in negotiations between its subsidiary and a third party, the parent corporation may be liable on the

Bundesgerichtshof, W. Ger., 75 BGHZ 96, 114-15 ("Herstatt"); Judgment of Nov. 11, 1985, BGH, 1986 WM 2, 3 (1985) ("Beton- und Monierbau II").

⁶² Judgment of Nov. 30, 1978, Bundesgerichtshof, W. Ger., 1979 NJW 2104.

⁶³ *Id.* at 2104-05.

⁶⁴ *Id.* at 2104. This decision was unanimously approved by the commentators. See Westermann, § 826 BGB als Grundlage einer "Durchgriffhaftung" des Gesellschafters - Anmerkung zu dem Urteil des BGH vom 30.11.1978, 1980 JURA 532, 537-38; Lutter, *Die zivilrechtliche Haftung in der Unternehmensgruppe*, 1982 ZGR 244, 252-53; Schneider, *Die Personengesellschaft als Konzernunternehmen. Ein Beitrag zum Entstehen eines Sonderrechts für abhängige und konzernierte Personengesellschaften*, 1980 BB 1057, 1063.

Similar language is used by United States courts when they give the creditor the right to challenge the corporate entity by showing that the creditor has been the victim of an unfair device. See, e.g., *Bell Oil & Gas Co. v. Allied Chem. Corp.*, 431 S.W.2d 336, 340 (Tex. 1968):

The corporate arrangement must be one which is likely to be employed in achieving an inequitable result by bringing into operation a basically unfair device which in all probability will result in prejudice to those dealing with one or more of the units making up the corporate arrangement, or one which has actually resulted in the complaining party's having been placed in a position of disadvantage by the exercise of inequitable means, of which the corporate arrangement is a part.

⁶⁵ BGH, 1979 NJW 2104, 2105 (1978).

⁶⁶ See also M. HACHENBURG & P. ULMER, GMBHG Appendix § 30, No. 33-34 (7th ed. 1979).

ground of *culpa in contrahendo*.⁶⁷ One of the categories of *culpa in contrahendo* liability is that of "agency" liability.⁶⁸ Under this doctrine, an agent acting on behalf of one party in negotiations may be held liable if the agent has a strong business interest in the negotiated contract or if the third party puts its trust in the agent to a great extent. In contrast to the agency doctrine applied by some United States courts,⁶⁹ under German law, the parent corporation is held to be the subsidiary's agent. In *Lizenzvertrag*,⁷⁰ the parent corporation conducted the negotiation of a licensing agreement under which the subsidiary would be the licensee. Shortly before signing the contract, the parent broke off the negotiations without any reasonable grounds. The court held the parent liable for the damages the prospective partner had incurred in reliance upon the conclusion of the contract.⁷¹

In several recent cases, the *Bundesgerichtshof* developed a rule that the shareholder of a corporation in financial trouble must inform the other party to a potential transaction about the corporation's financial situation if such a shareholder is involved in the negotiations. If the corporation goes into bankruptcy later and the other party's claim is impaired in the bankruptcy proceeding, the other party has a claim against

⁶⁷ This doctrine, which is not contained in the Civil Code, was given its first and classic statement by von Ihering, *Culpa in Contrahendo oder Schadenersatz bei nichtigen oder nicht zur Perfection gelangten Verträgen*, 4 JHERINGS JAHRBÜCHER FÜR DOGMATIK DES BÜRGERLICHEN RECHTS [JHER JB] 1, 7 (1861).

Under this doctrine "the stage of contractual negotiations, even when they do not lead to the conclusion of a contract, engender a relationship of trust between the parties similar to that arising from a contract, so that the parties are required to observe the customary standards of care." 120 RGZ 249, 251 (1928). If these standards are not met by one party it is bound to compensate the other party for damages caused by this behavior. See, e.g., Judgment of June 20, 1952, Bundesgerichtshof, W. Ger., 6 BGHZ 330, 333; Judgment of Nov. 20, 1954, Bundesgerichtshof, W. Ger., 15 BGHZ 204, 205; Judgment of Jan. 28, 1976, Bundesgerichtshof, W. Ger., 66 BGHZ 51, 54-55; Judgment of Apr. 24, 1978, Bundesgerichtshof, W. Ger., 71 BGHZ 284, 286-87; Judgment of June 8, 1978, Bundesgerichtshof, W. Ger., 71 BGHZ 386, 395; Judgment of Feb. 23, 1983, Bundesgerichtshof, W. Ger., 87 BGHZ 27, 32-34.

⁶⁸ Judgment of Apr. 5, 1971, Bundesgerichtshof, W. Ger., 56 BGHZ 81, 83; Judgment of Jan. 21, 1975, Bundesgerichtshof, W. Ger., 63 BGHZ 382, 385-86; Judgment of July 4, 1983, Bundesgerichtshof, W. Ger., 88 BGHZ 67, 70; 87 BGHZ 27, 32-33 (1983); Judgment of Oct. 27, 1982, Bundesgerichtshof, W. Ger., 1983 NJW 676, 677.

⁶⁹ Some United States courts have held a parent company liable because the subsidiary had acted as its "agent" in concluding a contract with a third party. See, e.g., *Elvalson v. Indus. Covers*, 269 Or. 441, 453-54, 525 P.2d 105, 111 (1974); *Acme Precision Prods., Inc. v. Am. Alloys Corp.*, 422 F.2d 1395 (8th Cir. 1970), *remanded*, 347 F. Supp. 376 (W.D. Mo. 1972), *rev'd on other grounds*, 484 F.2d 1237 (8th Cir. 1973). However, if a true principal and agent relationship exists, and the corporation is acting as the agent of the shareholder-principal, the doctrine of piercing the corporate veil is unnecessary. Downs, *supra* note 6, at 191.

⁷⁰ Judgment of June 12, 1975, Bundesgerichtshof, W. Ger., 1975 WM 923.

⁷¹ *Id.* at 925.

the shareholder who has not complied with this duty.⁷² Most commentators agree with such decisions to the extent that they are based on the "special trust" the other party has in the shareholder.⁷³ However, the decisions holding the shareholder liable solely on the ground of the shareholder's "own strong business interest"⁷⁴ are widely criticized.⁷⁵ The critics allege that the *Bundesgerichtshof's* decisions are inconsistent with the underlying rationale of the *culpa in contrahendo* doctrine—to protect the creditor who has relied on the person with whom the creditor has negotiated.⁷⁶ The *Bundesgerichtshof* itself has narrowed its broad language by requiring a direct business interest, i.e., the shareholder must "act as if managing his own affairs."⁷⁷

In an October 1985 decision, the court discussed and rejected criticisms by legal scholars, but emphasized that the ownership of a large share of the corporation and the potential for controlling the corporation is not sufficient to invoke shareholder liability in such situations.⁷⁸ The scope of such liability is still far from clear. There may even be a conflict between the Eighth Panel of the *Bundesgerichtshof*, which developed the doctrine, and the Second Panel. In December 1984, the Second Panel mentioned the doubts expressed by legal scholars concerning the doctrine but did not reach this issue as the court did not find the requisite business interest in the case at bar.⁷⁹

⁷² 87 BGHZ 27, 33-35 (1983); BGH, 1983 NJW 676, 677 (1982); Judgment of Jan. 25, 1984, Bundesgerichtshof, W. Ger., 1984 NJW 2284.

⁷³ Rehbindler, *supra* note 28, at 599; Ulmer, *Volle Haftung des Gesellschafter/Geschaefstführers einer GmbH für Gläubigerschaeden aus fahrlässiger Konkursverschleppung?*, 1983 NJW 1577, 1579; Winter, *supra* note 44, at No. 34; Ballerstedt, *Zur Haftung für culpa in contrahendo bei Geschäftsabschlüssen durch Stellvertreter*, 151 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS [ACP] 501, 521 (1950/51). *Contra* Brandner, *Haftung des Gesellschafter/Geschäftsführers einer GmbH ans culpa in contrahendo?*, in Festschrift WERNER 53, 65 (1984).

⁷⁴ See, e.g., BGH, 1983 NJW 676, 677 (1982); BGH, 1984 NJW 2284, 2286 (1984); BGH, 1985 WM 1526, 1527-28 (1985).

⁷⁵ See, e.g., Ballerstedt, *supra* note 73, at 524-25; Rehbindler, *supra* note 28, at 598-99; Ulmer, *supra* note 73, at 1579; Wiedemann, *Anmerkung zu BGH v. 25.1.1984 - VIII ZR 227/82*, 1984 NJW 2286-87; Brandner, *supra* note 73, at 64-65; Canaris, *Haftung Dritter aus positiver Forderungsverletzung*, 1965 VERSICHERUNGSRECHT [VERS] 114, 118; M. SCHIESSL, *supra* note 12, at 114-16. *Contra* Winter, *supra* note 44, at No. 43; V. EMMERICH, MÜNCHENER KOMMENTAR ZUM BGB No. 82 before § 275 (2d ed. 1985); R. ALFF, REICHSGERICHTSRAETEKOMMENTAR ZUM BGB § 276, No. 108 (12th ed. 1976).

⁷⁶ See, e.g., Ballerstedt, *supra* note 73, at 506; Canaris, *Ansprüche wegen "positiver Forderungsverletzung" und "Schutzwirkung für Dritte" bei nichtigen Verträgen*, 1965 JZ 475, 476; Nirk, *Culpa in contrahendo-eine geglückte Rechtsfortbildung - Quo vadis?*, in Festschrift MÖHRING 71, 73 (1971).

⁷⁷ 56 BGHZ 81, 84 (1971); 87 BGHZ 27, 33-34 (1983); 88 BGHZ 67, 70 (1983); Judgment of Oct. 23, 1985, Bundesgerichtshof, W. Ger., 1985 WM 1526, 1528.

⁷⁸ BGH, 1985 WM 1526, 1528 (1985).

⁷⁹ Judgment of Dec. 17, 1984, Bundesgerichtshof, W. Ger., 1985 DER BETRIEB [DB] 697.

III. LIABILITY OF A PARENT COMPANY UNDER THE *KONZERN* Law

A. Scope of the Law of Affiliated Enterprises

Statutory provisions regarding affiliated enterprises only exist in the AktG (Stock Corporation Act).⁸⁰ Their direct application requires that either the parent or the subsidiary has the legal form of an *Aktiengesellschaft* ("AG") (stock corporation) or a *Kommanditgesellschaft auf Aktien* ("KGaA") (an association limited by shares). Sections 15-19 AktG, however, contain definitions which are applied to all companies regardless of their legal form.⁸¹ These four stages of a parent-subsidiary relationship must be distinguished.⁸²

a) *Majority Ownership*. An enterprise owns the majority of a company if it either holds the majority of shares or has the majority of voting rights in another company.⁸³

b) *"Control" of the Subsidiary*. A company is a "controlled enterprise" if the parent "can exert, directly or indirectly, a controlling influence."⁸⁴ A majority-owned enterprise is presumed to be controlled by the majority-owning enterprise.⁸⁵ The owning enterprise may rebut this presumption if it can prove that it is unable to exercise a significant influence on the management of the majority-owned enterprise.⁸⁶ The required control may also be based on a minority share in the subsidiary in combination with other circumstances, including a strong representation on the

⁸⁰ AktG §§ 15-19, 291-318. A reform bill proposed by the Federal government in 1973 which contained statutory provisions on affiliated close corporations never became law. See § 230 Budestags-Drucksache VII/253.

⁸¹ See, e.g., 80 BGHZ 69, 72-74 (1981) ("Süssen"); Judgment of Dec. 5, 1983, Bundesgerichtshof, W. Ger., 89 BGHZ 162, 167; Judgment of Oct. 10, 1983, Bundesgerichtshof, W. Ger., 1983 BB 2205, 2206; V. EMMERICH & J. SONNENSCHNEIN, *supra* note 12, at 232; Wiedemann, *supra* note 14, at 39; M. SCHIESSL, *supra* note 12, at 4; Schilling, *supra* note 12, at 383-84. *Contra* R. REINHARDT & D. SCHULTZ, GESELLSCHAFTSRECHT No. 613 (2d ed. 1981).

⁸² The basic requirement for the application of the law of affiliated enterprises is that the parent is an "enterprise," i.e., it has entrepreneurial interests outside the subsidiary for which it might sacrifice the subsidiary's interest. See *supra* note 15 and accompanying text. Mere investor-shareholders and holding companies with only one subsidiary are excluded. Cf. Wiedemann, *supra* note 14, at 31-32. In "VEBA/Gelsenberg" the *Bundesgerichtshof* provided that an individual shareholder who has business interests outside the corporation may be an "enterprise" within the meaning of AktG § 15-19. Judgment of Oct. 13, 1977, Bundesgerichtshof, GRSZ, W. Ger., 69 BGHZ 334, 337. Furthermore the *Bundesgerichtshof* concluded that the State or its agencies may also fall under the term "enterprise." *Id.* at 338-44.

⁸³ AktG § 16(1).

⁸⁴ *Id.* § 17(1).

⁸⁵ *Id.* § 17(2).

⁸⁶ Cf. Oppenhoff & Verhöven, *supra* note 14, § 24.05 (2)(c); Emmerich, *supra* note 12, at No. 38-40; V. EMMERICH & J. SONNENSCHNEIN, *supra* note 12, at 45.

supervisory board.⁸⁷ Merely economic dependence arising from long-term supply or loan contracts is not sufficient; there must be corporate influence and corporate control.⁸⁸

c) *Konzern*.⁸⁹ At this stage the parent company has not only the power to exert influence, but actually does so. Both enterprises are joined by the "uniform direction" of the controlling company.⁹⁰ A certain amount of independence, however, must be left to the officers of the subsidiary. The parent may only interfere from time to time. A centralized ("qualified") *Konzern* (e.g., a permanent intervention of the parent at the subsidiary's expense) is only permitted if the two companies have concluded a *Beherrschungsvertrag* (domination agreement).⁹¹

d) *Beherrschungsvertrag* (domination agreement). A domination agreement is an agreement whereby the subsidiary submits the direction of its management to the parent company.⁹² The controlling enterprise is given the right to instruct the management of the subsidiary⁹³ and the officers are obliged to abide by these instructions even if they are detrimental to the subsidiary.⁹⁴ On the other hand, by following such an instruction, the officers do not violate their fiduciary duties and cannot be held liable for damages resulting from their actions.⁹⁵ There are only two limitations: the instructions must serve the interest of the parent company or another affiliate⁹⁶ and the viability of the subsidiary must not be jeopardized.⁹⁷ Notwithstanding the two companies entering into such

⁸⁷ In "VEBA/Gelsenberg" a share of 43.74% was deemed to be sufficient to exercise control because the shares of corporations were widespread and 43.74% guaranteed a majority in the shareholders' assembly. 69 BGHZ 334, 347 (1977). In "Beton-und Monierbau I" a share of less than 25% was deemed not to be sufficient. 90 BGHZ 381, 394-97 (1984).

⁸⁸ See 90 BGHZ 381, 395-96 (1984) ("Beton-und Monierbau I").

⁸⁹ A literal translation might be "group of companies." The German term will be used hereinafter.

⁹⁰ AktG § 18(1). The definition of "uniform direction" is very controversial. See K. BIEDENKOPF & H.G. KOPPENSTEINER, KOELNER KOMMENTAR AKTG § 18, No. 6-12; E. GESSLER, W. HEFERMEHL, U. ECKHARDT & B. KROPPF, AKTG KOMMENTAR § 18, No. 25-34.

⁹¹ Cf. E. GESSLER, W. HEFERMEHL, U. ECKHARDT & B. KROPPF, *supra* note 90, at § 311 No. 27, 29, 35-45; Emmerich, *supra* note 12, at No. 136-37; V. EMMERICH & J. SONNENSCHNEIN, *supra* note 12, at 207-08, 242; Schilling, *supra* note 12, at 386, 401-03; Lutter, *supra* note 64, at 265; Schiessl, *Die Ersatzpflicht des herrschenden Unternehmens im qualifizierten faktischen Konzern*, 1985 AG 184, 187; W. FLUME, *supra* note 28, at 122-23.

⁹² AktG § 291(1). Whereas the compliance of such a contract with the law of the close corporation is generally accepted, many scholars contend that a domination agreement involving a controlled partnership is unlawful. See, e.g., Schneider, *supra* note 12, at 517-20; Reuter, *supra* note 12, at 15-16. *Contra* Raiser, *supra* note 12, at 561-63; M. SCHIESSL, *supra* note 12, at 43-53.

⁹³ AktG § 308(1).

⁹⁴ *Id.* § 308(2).

⁹⁵ *Id.* § 310(3).

⁹⁶ *Id.* § 308(1).

⁹⁷ See, e.g., K. BIEDENKOPF & H.G. KOPPENSTEINER, *supra* note 90, § 308 No. 14; Immenga,

an agreement (e.g., being negotiated by the officers), the agreement only becomes effective upon the consent of the shareholders' assembly. The resolution requires a majority comprising at least three-fourths of the share capital represented at the vote on the resolution.⁹⁸

B. Protection of Creditors Under a Domination Agreement

Under a *Beherrschungsvertrag*, the subsidiary may be exploited by the parent company.⁹⁹ The assets of the subsidiary may be impaired and the claims of its creditors endangered. Therefore, the statute provides direct and indirect protection for such creditors. The controlling company must compensate for every loss occurring during the term of the agreement.¹⁰⁰ Thus, all losses of the controlled company are balanced by potential claims against the parent. In the event of the termination of the agreement, the controlling company must provide security to the creditors of the controlled company for claims brought prior to the publication of the entry of the termination in the trade register.¹⁰¹ To obtain such security, a creditor must notify the controlling company within a period of six months following the publication.¹⁰²

C. Protection of Creditors in a *De Facto Konzern*

If a controlling enterprise exerts influence on a subsidiary's management, but no domination agreement exists between the two companies, such a combination is called a *de facto Konzern*. The AktG (Stock Corporation Act) provides that the "controlling enterprise may not use its influence to induce a controlled stock corporation or an association lim-

Bestandsschutz der beherrschten Gesellschaft im Vertragskonzern?, 140 ZHR 301, 305 (1976); Gessler, *Bestandsschutz der beherrschten Gesellschaft im Vertragskonzern?*, 140 ZHR 433, 438 (1976).

⁹⁸ AktG § 293(1). Furthermore there are safeguards for minority shareholders. The agreement must guarantee annual dividends to the shareholders as adequate compensation. *Id.* § 305. Aside from such compensation, the controlling company must offer the shareholders the option to either buy their shares for cash or to trade them for shares of the controlling company. *Id.* § 305. The reasonableness of the guaranteed dividend and the sales offer are subject to court examination. *Id.* §§ 304(3)-(4), 305(4)-(5).

⁹⁹ In addition to the domination agreement, the parties often conclude an agreement by which the controlled company obligates itself to transfer all its profits to the *Gewinnabführungsvertrag* (controlling company).

¹⁰⁰ AktG § 302. In a *Konzern* of close corporations, the parent is subject to the same obligation. See Emmerich, *supra* note 12, at No. 194; Barz, *supra* note 12, at No. 32, 41; Ulmer, *Der Gläubigerschutz im faktischen GmbH Konzern beim Fehlen von Minderheitsgesellschaftern*, 148 ZHR 391, 394-95 (1984). In the case of a controlled partnership the controlling party must compensate the general partners if they are held liable for the partnership's debts. See M. SCHIESSL, *supra* note 12, at 51-52, 53.

¹⁰¹ AktG § 303(1).

¹⁰² *Id.*

ited by shares to enter into legal transactions detrimental to it or to take or omit measures to its disadvantage, unless compensation is granted for such disadvantage."¹⁰³ Most commentators infer from this statutory statement that the centralization of management to a certain extent and limited disadvantageous instructions are permitted if compensation is granted.¹⁰⁴

If the controlling enterprise neither compensates for the disadvantage until the end of the fiscal year nor grants a legal claim to the controlled company as compensation, then the controlling enterprise is liable to the subsidiary for any resulting damage.¹⁰⁵ There is a danger, however, that the officers of the subsidiary may not sue the parent company since they are dependant upon it. Therefore, every shareholder and the creditors, to the extent they are unable to obtain satisfaction from the subsidiary, are given standing to assert the damage claim of the subsidiary against the parent company.¹⁰⁶

Since the provisions of the AktG (Stock Corporation Act) are not applicable to close corporations and partnerships, courts have had to infer a similar liability of dominating shareholders of close corporations and dominating partners from the fiduciary duties of such shareholders and partners. It is generally accepted under German law that every partner has a duty of care and loyalty to both the partnership and the other partners.¹⁰⁷ As the *Bundesgerichtshof* has refused to hold that the majority shareholder of a stock corporation owes a fiduciary duty to minor-

¹⁰³ AktG § 311(1).

¹⁰⁴ See, e.g., E. GESSLER, W. HEFERMEHL, U. ECKHARDT & B. KROPFF, *supra* note 90, § 311 No. 9-20; A. BAUMBACH & A. HUECK, AKTIENGESETZ KURZKOMMENTAR § 311 No. 5 (13th ed. 1968); Luchterhandt, *Leitungsmacht und Verantwortlichkeit im faktischen Konzern*, 133 ZHR 1, 5-13 (1969); Gessler, *Überlegungen zum faktischen Konzern*, in Festschrift für Flume 55, 56 (1978). A minority argues that the compensation is not a threshold requirement for a lawful *de facto* Konzern but the sanction for an unlawful act. See, e.g., V. EMMERICH & J. SONNENSCHNEIN, *supra* note 12, at 206-08; H. WÜRDINGER, AKTIENRECHT UND DAS RECHT DER VERBUNDENEN UNTERNEHMEN 340 (4th ed. 1981); Immenga, *Schutz abhängiger Gesellschaften durch Bindung oder Unterbindung beherrschenden Einflusses*, 1978 ZGR 269, 273-75. The published materials on the Draft Stock Corporation Act, however, show that the government favored the point of view which permits the *de facto* Konzern. See B. KROPFF, AKTIENGESETZ TEXTAUSGABE DES REGIERUNGSENTWURFS EINES AKTIENGESETZES UND EINFÜHRUNGSGESETZES ZUM AKTIENRECHT 419 (1965).

¹⁰⁵ AktG § 317(1). If the shareholders of the subsidiary suffer damage aside from the damage they have suffered by the company being damaged the parent company is held liable for these damages, too.

¹⁰⁶ AktG §§ 317(4), 309(4).

¹⁰⁷ See, e.g., Judgment of June 15, 1959, Bundesgerichtshof, W. Ger., 30 BGHZ 195, 201-02; Judgment of Oct. 18, 1976, Bundesgerichtshof, W. Ger., 68 BGHZ 81, 82; Judgment of July 2, 1973, Bundesgerichtshof, W. Ger., 1973 WM 1291, 1293; Judgment of Sept. 23, 1985, Bundesgerichtshof, W. Ger., 1985 ZIP 1482, 1483-84; BGH, 1980 NJW 231 (1979) ("Gervais"); J. STAUDINGER-KESSLER, KOMMENTAR ZUM BGB No. 38-57 before § 705 (1980); P. ULMER, MÜNCHENER KOMMENTAR ZUM BGB VOL. III/2 § 705, No. 156-70 (1980).

ity shareholders,¹⁰⁸ the question of fiduciary duties within a close corporation continued to be controversial. In *ITT*, the *Bundesgerichtshof* reversed the decision of the Court of Appeals on the ground that the parent corporation controlling a close corporation by its majority influence had a fiduciary duty to the close corporation.¹⁰⁹ The *Bundesgerichtshof* stated that:

The underlying rationale is the possibility to organize a close corporation despite its being a corporation in a way that the members are able to exert a direct and massive influence on the corporation's business activities. Thus the relations within a close corporation come close to the structure of a partnership. Moreover, the majority is able to impair the minority's interests by influencing the management. This possibility must be balanced by a fiduciary duty of loyalty.¹¹⁰

After *ITT*, the lawmakers and the *Bundesgerichtshof* seemed to have worked out a well-balanced system of safeguards for the minority shareholder and the creditors by imposing certain liabilities upon the parent company which correspond to the degree of domination which the parent company exerts on the subsidiary. If the parent company wants wide discretion in directing and integrating the subsidiary's business activities, the parent company must conclude a contract of domination by which the parent company is obliged to assume all losses and give certain guarantees to minority shareholders and creditors.¹¹¹ If the parent company wants to avoid such a commitment, it must confine itself to single directions to the subsidiary's management who are only bound

¹⁰⁸ Judgment of Feb. 16, 1976, Bundesgerichtshof, W. Ger., 1976 JZ 561, 562 ("VW/Audi-NSU"). *Accord* A. BAUMBACH & A. HUECK, *supra* note 104, at No. 11 before § 54; Reuter, *Die "Wesenselemente" der Personengesellschaft in der neueren Rechtsprechung - Bestandsaufnahme, Literarische Gegenbewegungen, Konsequenzen*-, 1981 GMBHR 129, 137. *Contra* Lutter, *Anmerkung, zu BGH, Urt. v. 16.2.1976 -II ZR 61/74*, 1976 JZ 562, 562-63; Wiedemann, *supra* note 44, at 433-34.

¹⁰⁹ Judgment of June 5, 1975, Bundesgerichtshof, W. Ger., 65 BGHZ 15 ("ITT"). This case is one of the landmark decisions of the German close corporation law and was nearly unanimously approved by legal scholars. *See, e.g.*, Brezing, *Gedanken zur internationalen Konzernumlage. Besprechung des BGH-Urteils vom 5.6.1975-II ZR 23/74*, 1976 AG 5, 9; Ulmer, *Anmerkung zu BGH, Urt. v. 5.6.1975 - II ZR 23/74*, 1976 NJW 192, 193; Schilling, *Anm. zu BGH, Urt. v. 5.6.1975 - II ZR 23/74*, 1975 BB 1451, 1451-52; Reh binder, *Treupflichten im GmbH-Konzern Besprechung der Entscheidung BGHZ 65, 15-*, 1976 ZGR 386, 391-92; Westermann, *GmbH-Konzernrecht kraft richterlicher Rechtsfortbildung? Besprechung des Urteils des BGH vom 5.6.1975 - II ZR 23/74*, 1976 GMBHR 77, 78.

¹¹⁰ *Id.* at 18-19. Since the *Bundesgerichtshof* imposes a fiduciary duty on the majority member toward both the close corporation and the minority member is given standing to bring a suit on behalf of his own (*actio pro socio*). *Id.* at 21. *Accord* Ulmer, *supra* note 109, at 193; Westermann, *supra* note 109, at 79; Lutter, *Theorie der Mitgliedschaft*, 180 ACP 84, 135-36 (1980). Other scholars reject this *actio pro socio* doctrine as not suitable in the close corporation and give the minority member standing on behalf of the corporation instead. *See also* Schmidt, *supra* note 12, at 126; Reh binder, *supra* note 109, at 394.

¹¹¹ *See supra* notes 95-98 and accompanying text.

to abide by the broad overall business strategy of the parent company. Such single directions are only lawful if the subsidiary is compensated for disadvantages incurred as a result of such directions.¹¹²

In practice, the concept of balanced safeguards did not turn out to be feasible.¹¹³ The compensation system in the *de facto Konzern* did not work when the parent company took such complete control of the subsidiary's finances, policies, and practices that the subsidiary had no direction of its own. Although the unlawfulness of such a *Konzern* in the absence of a domination agreement was obvious, litigation based on §§ 311 and 317 of the AktG (Stock Corporation Act), or on a violation of the majority shareholder's fiduciary duty in cases involving partnerships or close corporations, was very difficult.¹¹⁴ At a certain level of domination and integration of the two companies it becomes nearly impossible to insulate a single transaction and to assess the damages.¹¹⁵ The courts, however, required the subsidiary to allege a specific disadvantage caused by a single transaction or measure. The situation became more and more unsatisfactory and an increasing number of scholars proposed that the parent company have the obligation of assuming the losses of its subsidiary in a qualified *de facto Konzern* in which the parent exerted the same rights as under a domination agreement.¹¹⁶ The underlying rationale for this position is that a parent company which exercises the rights it would possess if a domination agreement existed should have the same obligations as a parent company which has entered into such an agreement.

In 1979, the *Bundesgerichtshof* in the *Gervais* case ordered a parent corporation to assume the losses of its subsidiary, the plaintiff.¹¹⁷ The plaintiff, a general partnership, had been in financial trouble while still

¹¹² See *supra* notes 101-05 and accompanying text.

¹¹³ For criticism, see Lutter, *supra* note 13, at 159-61; V. EMMERICH & J. SONNENSCHNEIN, *supra* note 12, at 217-19; K. BIEDENKOPF & H.G. KOPPENSTEINER, *supra* note 90, at § 311 No. 28-36.

¹¹⁴ Successful claims under AktG § 317 are unknown. Cf. Wiedemann, *supra* note 14, at 37.

¹¹⁵ Cf. Lutter, *Die Haftung des herrschenden Unternehmens im GmbH-Konzern*, 1985 ZIP 1425, 1429; M. SCHIESSL, *supra* note 91, at 185.

¹¹⁶ Lutter & Timm, *Betriebsrentenkürzung im Konzern. Zur Verantwortung der Konzernspitze bei der Sanierung von Tochtergesellschaften*, 1983 ZGR 269, 281-82; Schmidt, *Die konzernrechtliche Verlustübernahme pflicht als gesetzliches Dauerschuldverhältnis—Eine rechtsdogmatische Problem-skizze zu § 302 AktG*, 1983 ZGR 513, 516-17 suggest an application of AktG § 302. V. EMMERICH & J. SONNENSCHNEIN, *supra* note 12, at 219, 242-43, allege that in these situations an unwritten domination agreement exists. Reuter, *supra* note 12, at 21-22, holds the parent company liable as "principal" for the debts of the subsidiary which has acted as an "agent" for the parent. Another way to solve the problems is to ease the litigation by procedural means. See Schulze-Osterloh, *Gläubiger- und Minderheitenschutz bei der steuerlichen Betriebsaufspaltung*, 1983 ZGR 123, 153-54, 156; Schiessl, *supra* note 91, at 187-88.

¹¹⁷ BGH, 1980 NJW 231 (1979) ("Gervais").

independent. The defendant offered to assist on the condition that the defendant be given complete control over the plaintiff. The plaintiff was reorganized as a limited partnership with a newly incorporated close corporation (owned by the former general partners and the defendant) as general partner. The former general partners and the defendant became limited partners. In addition, the business of the partnership was integrated into the defendant's overall business activities "like a branch" of the defendant.¹¹⁸ An employee of the defendant managed the plaintiff's business and was to "be responsible only to the defendant."¹¹⁹

Although the parent company was given broad discretion, the planned reorganization failed and losses of the plaintiff increased. When the parent company finally terminated its support and tried to cut all remaining ties between the two corporations, the plaintiff's management brought suit, asking for the defendant to assume the subsidiary's losses amounting to DM3,500,000. The decision of the Court of Appeals, which had rejected all claims except one in the amount of DM177,000, was reversed. In its decision, the *Bundesgerichtshof* emphasized the differences between a partnership consistent with the statutory prototype and the instant case in which the partnership was only theoretically an independent entity and, in reality, was a mere branch and an integrated part of the parent company. The particular circumstances of the case had led to "conflicts which could not be solved with the same means which were worked out by the courts for partnerships which are consistent with the statutory prototype."¹²⁰

The *Bundesgerichtshof* further distinguished the case from the common parent-subsidiary situation in which the danger exists that the interests of the parent and the subsidiary may conflict. These dangers increase "if the business activities of the controlled enterprise are integrated into the business process of the controlling enterprise as an independent branch."¹²¹ As a rule, the conflict of interests produces two consequences. First, the partner will advance other business interests at the partnership's expense. Second, the relations between the two companies become opaque and uncontrollable for the other partners. Thus, the *Bundesgerichtshof* stated that it was irrelevant that the plaintiff subsidiary did not claim that single measures or directions of the defendant were specifically disadvantageous to the subsidiary. According to the court, it is nearly impossible to discover and show such single acts.

¹¹⁸ *Id.* at 231.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.* at 232.

In the end, the controlling enterprise had the uncontrollable opportunity to determine the subsidiary's management policy, especially with respect to production, distribution and investment, and to adjust and to subordinate it to its own concerns. This situation inevitably calls for the obligation to assume the losses of the controlled company during the period of the control.¹²²

While this statement appears to be clear, there was other language in *Gervais* which caused confusion among scholars commenting on the case. Two significant questions remained open. First, did *Gervais* establish a general rule or was it confined to the particular facts of the case?¹²³ Second, could the *Gervais* rule, developed in a case involving a limited partnership, be applied to corporations?

The recent decision of the court in *Autokran*¹²⁴ has answered both questions. The defendant in *Autokran* had incorporated seven close corporations of which the defendant was the only member. The defendant was the chief executive of each corporation. All seven were under the defendant's complete control; the defendant also integrated and intertwined their activities as much as possible. Another company in the group was in charge of the bookkeeping and financing for the whole group.¹²⁵ Thus, the subsidiaries were unable to build up equity capital

¹²² *Id.* The language resembles the "instrumentality" rule evolved by United States courts in cases where one corporation is so manipulated by the shareholder that it becomes a mere instrumentality or adjunct. See, e.g., *Zaist v. Olson*, 154 Conn. 563, 227 A.2d 552 (1967); *Krivo Indus. Supply Co. v. National Distillers & Chem. Corp.*, 483 F.2d 1098 (5th Cir. 1973); *Bendix Home Systems, Inc. v. Hurston Enter., Inc.*, 566 F.2d 1039 (5th Cir. 1978); *Tiger Trash v. Browning-Ferris Indus., Inc.*, 560 F.2d 818 (7th Cir. 1977), *cert. denied*, 434 U.S. 848 (1978); *Berger v. Columbia Broadcasting Sys.*, 453 F.2d 991 (5th Cir.), *cert. denied*, 409 U.S. 848 (1972). Many courts require the proof of the following three elements:

(1) Control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction, attacked so that the corporate entity as to this transaction had at the time no separate will or existence of its own; and (2) such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest or unjust act in contravention of plaintiff's legal rights; and (3) the aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.

Lowendahl v. Baltimore & Ohio R.R., 247 A.D. 144, 287 N.Y.S. 62 (N.Y.App.Div. 1936), *aff'd*, 272 N.Y. 360, 6 N.E.2d 56 (1936); *Zaist v. Olson*, 154 Conn. 563, 227 A.2d 552 (1967); *Johnson v. Warnaco, Inc.*, 426 F. Supp. 44 (S.D.Miss 1976).

¹²³ The court in "*Gervais*" used the word *Beherrschungsvertrag* labelling a set of contracts concluded by the two companies. BGH, 1980 NJW 231, 232 (1979) ("*Gervais*"). If the court had assumed such an agreement the case would not be able to serve as a precedent for cases involving a *de facto Konzern*. However, Judge A. Kellermann's speech, in *JAHRBUCH DER FACHANWÄLTE FÜR STEUERRECHT* 423 (1980/81), pointed out that by using this term the court did not imply that such an agreement existed in the case but used it to describe the extent of influence the controlling company exerted.

¹²⁴ 95 BGHZ 330, 330 (1985) ("*Autokran*"). Lutter, *supra* note 115, at 1425, pronounced this case as one of the landmark decisions of West German commercial and corporate law.

¹²⁵ 95 BGHZ 330, 331 (1985) ("*Autokran*").

and achieve financial independence. The plaintiff, who had delivered equipment to the subsidiaries, failed to obtain payment through executions against the subsidiaries' assets and, therefore, brought suit against the controlling enterprise.

In *Autokran*, the *Bundesgerichtshof* affirmed the holding of *Gervais* establishing an obligation to assume the losses of a subsidiary in a qualified *de facto Konzern* and applied the rule to corporations.¹²⁶ Since the rule is based on the concept of minority protection, the court doubted if such an obligation existed toward a wholly-owned subsidiary as in *Autokran*. The court did not decide the question but ruled that, in such cases, the controlling enterprise is directly liable to the creditors for claims exceeding the assets of the subsidiary. The *Autokran* court inferred this result from an analogous application of §§ 303(1), 322(2), and 322(3) AktG (Stock Corporation Act).¹²⁷

The underlying rationale of § 303 AktG is that the independent economic viability of the previously controlled company is doubtful even if the net losses are assumed after the termination of the domination agreement. The danger that the previously controlled close corporation is unable to pay its obligations exists after the termination of a *de facto Konzern* relationship as well.¹²⁸

The *Autokran* court modified the rule provided by § 303(1) AktG (Stock Corporation Act), stating that:

If the controlled corporation is unable to pay its obligations since they exceed its assets, it would be unreasonable to make the parent company render security to the creditors in the first place. The controlling enterprise is directly liable to the creditors instead.¹²⁹

While the consequences of a qualified *de facto Konzern* are pretty clear after *Autokran*, the requirements for such liability remain rather vague. The *Bundesgerichtshof* touched upon two basic issues but did not

¹²⁶ *Id.* at 341-45.

¹²⁷ AktG § 303(1) provides:

If a contract of domination or to transfer profits terminates, then the other party to the contract must render security to the creditors of the company for claims which were founded before the entry of the termination of the contract into the trade register is considered to be published pursuant § 10 Commercial Code, provided they report to it for this purpose within six months after the publication of the registration. The creditors shall be advised of this right in the publication of the registration.

See Schmidt, *Zum Haftungsdurchgriff wegen Sphärenvermischung und zur Haftungsverfassung im GmbH-Konzern*, 1985 BB 2074, 2079 (rejecting this analogy). Schmidt contends that there is no basis in the law for a direct liability to the creditors. Instead, he proposes an obligation to assume the losses of the wholly-owned subsidiary. The creditors shall be given the standing to claim this obligation on behalf of the corporation. Lutter, *supra* note 115, at 1431-32, agrees with the results of the *Bundesgerichtshof* but alleges that the creation of new judge-made law would be better grounds than an analogous application of AktG §§ 303, 322.

¹²⁸ 95 BGHZ 330, 346 (1985) ("Autokran").

¹²⁹ *Id.* at 347.

elaborate upon them as the case before the court was extreme. First, how much control must the parent company exercise and to what extent must the two companies be integrated to meet the formula of a qualified *de facto Konzern*?¹³⁰ Second, once the existence of a qualified *de facto Konzern* is shown, is the parent company still able to escape liability by arguing that its “*Konzern* policy” was not detrimental to the subsidiary and thus did not jeopardize the interests of the subsidiary’s creditors?

The court did not answer the first question as the *Autokran* case examined a level of *Konzern* power that exhausted even the “possibilities which would have been provided by a *Beherrschungsvertrag*.”¹³¹ The court stated that the requirements are always met if the controlling company is “permanently and extensively involved in the management” and is the sole shareholder of the subsidiary.¹³²

As to the second question, the court concluded there is a rebuttable presumption that the controlling company did not show consideration for the subsidiary’s best interests in a qualified *de facto Konzern*. The parent company must show that the “director of an independent company who abides by his fiduciary duty would not have run the business in a different way.”¹³³ According to the court, an exculpation of liability is even possible in cases where the subsidiary is managed as a dependent branch of the parent corporation and where the subsidiary’s independent vitality would be doubtful. Since it is rarely possible to show that no transactions were disadvantageous to the subsidiary, only one legal consequence can follow. Insofar as the parent company is able to prove that

¹³⁰ One of the main arguments against liability for a parent company controlling a subsidiary in a “qualified” way is that this formula is too elusive upon which to base such a far reaching liability. A violation of the principle of legal certainty has been contended by Gessler, *Neue Vorschläge zum GmbH-Konzernrecht*, 1973, DB 48, 50; Westermann, *Grundsatzfragen des GmbH-Konzerns*, in *DER GMBH-KONZERN* 25, 42 (O. Schmidt ed. 1976); Gäbelein, *Der GmbH-Konzern in der Praxis*, in *DER GMBH-KONZERN* 50, 57-58 (O. Schmidt ed. 1976); M. SCHIESSL, *supra* note 12, at 86-87.

Legal Scholars have widely differed in their attempts to find a suitable definition. *See, e.g., V. EMMERICH & J. SONNENSCHNEIN, supra* note 12, at 242 (“broad right to give orders”); Flume, *supra* note 28, at 122 (“permanently damaging the interests of the controlled company”); Schneider, *supra* note 12, at 545 (“position comparable with a dependent branch”); Lutter, *supra* note 64, at 266-67 (“organizational integration” plus “permanent and broad damages to the controlled enterprise”); L. STROHN, *DIE VERFASSUNG DER AKTIENGESELLSCHAFT IM FAKTISCHEN KONZERN* 101 (1977) (“No vitality of the controlled enterprise after the termination of the Konzern relationship”).

¹³¹ 95 BGHZ 330, 345 (1985) (“*Autokran*”).

¹³² *Id.* at 344.

¹³³ *Id.* This exculpation possibility is criticized by Schmidt, *supra* note 127, at 2078. Lutter, *supra* note 15, at 1433-35 interprets the court as follows:

The standard of comparison is not a completely independent corporation but an economically dependent one like for example a supplier of a large and powerful manufacturer which buys all or nearly all the output of the corporation. Therefore, it is sufficient if the controlling company leaves the assets and the economic autonomy of the subsidiary untouched.

the losses of the subsidiary are not caused by the *Konzern* relationship but by an external factor, such as a nationwide crisis, the parent company will not be held liable by the court.¹³⁴

IV. CONCLUSION

In theory, German law provides a variety of different ways for shareholders to be held accountable for the obligations of a corporation. German courts, however, have been reluctant to disregard the corporate form. The imposition of direct liability of the shareholder under tort law and the *culpa in contrahendo* doctrine closed some loopholes. Creditors' rights have lately been improved in the area of parent-subsidiary relations. And under the *Konzern* doctrine, which focuses particularly on affiliated enterprises, a parent company may be held liable for its subsidiary's losses and obligations if the parent company is shown to have exercised a certain degree of control over the subsidiary.

¹³⁴ A similar interpretation of *Autokran* is given by Schmidt, *supra* note 127, at 2078. The results of such an allocation of risks and liabilities comes close to a theory this author had proposed before *Autokran*. Instead of an obligation to assume losses, this author proposed to restrain the subsidiary to the claims based on AktG §§ 311, 317 and the breach of fiduciary duties. The assessment of damages, however, should take the losses into account but decrease the amount of damages if external factors could be proven by the parent company. See Schiessl, *supra* note 91 at 187-88.