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Corporate Groups

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Corporate Groups

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Abstract: This paper contrasts the recent European initiatives on regulating corporate groups with alternative approaches to the phenomenon. In doing so it pays particular regard to the German codified law on corporate groups as the polar opposite to the piecemeal approach favored by E.U. legislation.

It finds that the European Commission's proposal to submit (significant) related party transactions to enhanced transparency, outside fairness review, and ex ante shareholder approval is both flawed in its design and based on contestable assumptions on informed voting of institutional investors. In particular, the contemplated exemption for transactions with wholly owned subsidiaries allows controlling shareholders to circumvent the rule extensively. Moreover, vesting voting rights with (institutional) investors will not lead to the informed assessment that is hoped for, because these investors will rationally abstain from active monitoring and rely on proxy advisory firms instead whose competency to analyze non-routine significant related party transactions is questionable.

The paper further delineates that the proposed recognition of an overriding interest of the group requires strong counterbalances to adequately protect minority shareholders and creditors. Hence, if the Commission choses to go down this route it might end up with a comprehensive regulation that is akin to the unpopular Ninth Company Law Directive in spirit, though not in content. The latter prediction is corroborated by the pertinent parts of the proposal for a European Model Company Act.

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CORPORATE GROUPS

A GERMAN'S EUROPEAN PERSPECTIVE

- Tobias H. Tröger* -

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1 Corporate groups as subject of corporate law

Herbert Wiedemann's famous dictum „Im Konzern ist alles anders [Everything is different in a corporate group]"[1] aptly describes the essence of the German approach to groups as a subject of corporate law. It refers to the key challenge for organizational law that flows from the centralization of core economic and governance functions in a corporate group despite the affiliates' legal independence. Traditional corporate law imagines the corporation as a stand-alone entity. Hence, it is arguably not perfectly attuned to contemporary firms that integrate a multitude of incorporated subsidiaries.[2] The pursued business strategies and policies typically extend beyond the individual corporation and may thus collide systematically and permanently with the objective functions of the subsidiaries' minority shareholders and their other constituents.[3] More specifically with regard to corporate law, group integration gives rise not only to pronounced horizontal principal-agent-conflicts

[1] Herbert Wiedemann, Die Unternehmensgruppe im Privatrecht [The Corporate Group in Private Law] 9 (1988).

[2] In a recent contribution, a prominent German scholar observes Rheinisch-Westfälisches Elektrizitätswerk (RWE) AG (an energy supplier) as having more than 3.000 subsidiaries, and Deutsche Bank AG even more than 4.000, *cf.* Marcus Lutter, *Konzernphilosophie vs. Konzernweite Compliance und konzernweites Risikomanagement* [*Group Philosophy vs. Groupwide Compliance and Riskmanagement*] 289, 292 (Mathias Habersack & Peter Hommelhoff (eds.), Festschrift für Wulf Goette, 2011).

[3] A momentous description of the pivotal conflict that underpins the German approach can be found in the legislative materials of the German Stock Corporation Act, reprinted in Bruno Kropff, Aktiengesetz [Stock Corporation Act] 337 (1965).

between dominant blockholders and minority shareholders[4] but also to more severe clashes between (majority) shareholder and creditor interests.[5]

To be sure, there is considerable variation in the empirical findings on ownership concentration (in listed firms) around the world.[6] This observation makes the regulatory issues in certain jurisdictions more pressing than in others.[7] Moreover, organizational law can—and in comparative perspective does[8]—react in various

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[4] On the potential to exploit minorities and consume private benefits of control *see e.g.* Mark J. Roe, *The Institutions of Corporate Governance*, *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 371, 372-5 (Claude Ménard & Mary M. Shirley eds., 2008); John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW 35, 36 (Reinier Kraakman et al. eds., 2d ed. 2009). *See also infra* 3.1.1.

[5] A controlling shareholder has sufficient influence to induce risk-shifting at the detriment of creditors. On this incentive effect of debt-financing *see* generally Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership*, 3 J. FIN. ECON. 305, 334 -7(1976); FRANK A. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 52- (1991); John Armour, Gérard Hertig & Hideki Kanda, *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW 115, 116-21 (Reinier Kraakman et al. eds., 2d ed. 2009). However, a large blockholder's exposure also creates countervailing incentives, as the (limited) downside risk in high-volatility investments may still involve a substantial portion of the equity-holder's net wealth. Where this is not a key motivating factor, the incentive problem is exacerbated in the group context, because controlling shareholders can not only externalize much of the downside of riskier investment opportunities to creditors but also some parts of the risk born by equity to minority shareholders: they control investment decisions for all the firm's assets but bear losses only with their fractional equity stake.

[6] For the seminal survey *cf.* Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471(1999); With a special view to Europe *cf.* Marco Becht & Alisa Röell, *Blockholdings in Europe: An International Comparison*, 43 EUR. ECON. REV. 1049 (1999); Marcus Lutter, *Stand und Entwicklung des Konzernrechts in Europa* [*Status and Evolution of the Law on Corporate Groups in Europe*], 16 ZEITSCHRIFT FÜR UNTERNEHMENS UND GESELLSCHAFTSRECHT (ZGR) 324, 330-3(1987). See also Luca Enriques & Paolo Volpin, *Corporate Governance Reforms in Continental Europe*, 21 J. ECON. PERSP. 117, 122-5 (2007) (pointing to the relevance of pyramidal structures that lower the equity stake a shareholder actually has to hold in order to gain or retain control over a heavily hierarchized firm).

[7] However, an important strand of theoretical and empirical literature suggests a causal relation between confining blockholder rent-seeking and capital market development, *cf.* Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *What Works in Securities Laws*, 61 J. FIN. 1 (2006); Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 789-99 (2001); Andrei Shleifer & Daniel Wolfenzon, *Investor Protection and Equity Markets*, 66 J. FIN. ECON. 3 (2002); Lucian A. Bebchuk, *A Rent-Protection Theory of Corporate Ownership and Control* 1-37 (Nat'l Bureau of Econ. Research, Working Paper No. 7203, 1999), *available at* http://www.nber.org/papers/w7203; René M. Stulz, *Securities Laws, Disclosure, and National Capital Markets in the Age of Financial Globalization*, 47 J. ACCT. RES. 349 (2009).

[8] For a brief overview *cf.* Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM. J. COMP. L. 1, 44-45 (2011); for a more granular analysis of the legal framework in key continental European jurisdictions *see* Pierre-Henri Conac, Luca Enriques & Martin Gelter, *Constraining Dominant Shareholder Self-Dealing: The Legal Framework in France, Germany, and Italy*, 4 EUR. COMPANY & FIN. L. REV. 491 (2007).

ways to the identified substantive challenge. At the one end of the spectrum of possible institutional responses, some jurisdictions rely on fiduciary standards (duty of loyalty) that in a couple of instances are specifically adapted to the context of concentrated ownership[9] while they remain materially unaltered *vis-à-vis* dominant shareholders in others.[10] At the other end, some jurisdictions have codified a specific law of corporate groups involving stock corporations as subsidiaries, with Germany leading by example[11] and—*cum grano salis*—a handful of jurisdictions following suit.[12]

Quite importantly, the scholarly and policy debates—particularly in Germany[13]—circle around the (alleged) dichotomy between the protection of minority shareholders, creditors etc. on the one hand and the enabling function of organizational law which should permit efficiency enhancing business combinations on the other. Both strands of reasoning also resonate in prospected E.U. legislation that heavily influences the German perspective on the law of corporate groups in 2014: regardless of its merits,[14] the German approach of codifying an elaborate set of rules

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[9] For instance France and Italy recognize a specific liability where a majority shareholder abuses her power (*abus de majorité*, *abuso della maggioranza*), Conac, Enriques & Gelter, *supra* note 8, at 501.

[10] In particular Delaware case law leaves material standards unaltered within the group context, *cf.* Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); *see also infra* 3.1.2.2.1. For similar approaches in other countries *see* Hopt, *supra* note 8, at 45.

[11] Aktiengesetz [AktG] [Stock Corporation Act], Sep. 6, 1965, Bundesgesetzblatt [BGBl.] I 1089, as amended, §§ 291 et seq. For an alternative approach under German stock corporation law, primarily based on fiduciary duties of the dominant shareholder, *see* Wolfgang Zöllner, *Treupflichtgesteuertes Aktienkonzernrecht* [*Fiduciary Duty Governed Law of Groups of Stock Companies*], 162 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT [ZHR] 235-48 (1998); TOBIAS TRÖGER, TREUPFLICHT IM KONZERNRECHT [FIDUCIARY DUTIES IN THE LAW OF CORPORATE GROUPS] (2000).

[12] Among the jurisdictions that have adopted the German approach are Portugal, Brazil and Croatia, Slovenia and Albania; Hungary and the Czech Republic also had—for a little more than a decade—promulgated codifications according to the German model but recently abandoned the pertinent parts of their corporate codes, *cf.* European Model Company Act (EMCA), *Ch. 16, Introduction*, at 3-4, *available at* http://law.au.dk/fileadmin/Jura/dokumenter/CHAPTER_16_GROUPS_OF_COMPANIES.pdf (Oct. 10, 2013); Hopt, *supra* note 8, at 45.

[13] Most notably, German legal scholars have sought to transcend the limited objectives of the codified law on corporate groups and transform this body of law into a comprehensive regime that governs all organizational aspects of a group, *cf. e.g.* Lutter, *supra* note 6 at 334-8; for a survey and critique of this literature see PETER O. MÜLBERT, AKTIENGESELLSCHAFT, UNTERNEHMENSGRUPPE UND KAPITALMARKT [STOCK CORPORATION, CORPORATE GROUP, AND CAPITAL MARKET] 20-36 (2d ed., 1996).

[14] For a critical account of the effectiveness of the German law on corporate groups in the AktG *see* BERNHARD GROßFELD, AKTIENGESELLSCHAFT, UNTERNEHMENSKONZENTRATION UND KLEINAKTIONÄR [STOCK CORPORATION, CONCENTRATION OF ENTERPRISES, AND SMALL SHAREHOLDERS] 218-9 (1968); MONOPOLKOMMISSION, VII. HAUPTGUTACHTEN [VII. MAIN REPORT], BTDrucks. 11/2677, para 842 (July 19, 1988); for a more favorable view *see* Peter Hommelhoff, *Empfielt es sich, das Recht faktischer Unternehmensverbindungen neu zu regeln?, Gutachten G zum 59. Deutschen Juristentag* [*Is it advisable to amend the law on corporate groups based on share-ownership?, Report G for the 59th German Jurists' Forum*], *in* Verhandlungen des 59. Deutschen Juristentags [HEARINGS OF THE 59TH GERMAN JURISTS' FORUM] 19- (1992).

for corporate groups that serves both the protective as well as the enabling regulatory objective comprehensively, is incrementally called into question by a preference for alternative regulatory strategies in supranational lawmaking. Seen from this angle, a contemporary German perspective on the law of corporate groups has to portray the traditional approach of the AktG against the background of proposed substitutes or supplements in E.U. legislation. With this focus, the analysis yields that one peril of the piecemeal approach currently favored by supranational lawmakers lies in its disregard of the embedded character of those legal institutions that deal with the specific challenges posed by corporate groups. This result is not surprising where E.U. corporate law harmonization draws on specific examples in national law that address fractions of the broader challenge.[15] Likewise, problems occur where E.U. legislation attempts to respond to the demands of certain corporate constituents in a more innovative manner. As a consequence, a broader approach that not only avoids frictions and redundancies but also reconciles minority and creditor protection with the enabling dimension of organizational law in a consistent manner proves appropriate. Where lawmakers opt for specific rules geared towards corporate groups, a more or less full-fledged regulatory scheme seems to have merits after all, a finding that vindicates at least the spirit of the German approach with its codified law of corporate groups in the AktG.

In order to make this point, this paper proceeds by retracing the substance of the codified German law on corporate groups involving stock corporations. It also looks at the reluctant reception of this concept in European corporate law harmonization and the quest for alternatives (*infra* 2). Against this background it next addresses specific topics that have crystallized as key targets for regulatory intervention at the supranational level. On the one hand, the right of the general shareholder meeting to vote on certain related party transactions as proposed in the amended Shareholder Rights Directive[16] is based on prototypical considerations of minority protection. Although the latter are certainly not alien to the German law on corporate groups, the AktG—like most of the other Continental European jurisdictions—pursues identical goals through fundamentally diverging legal institutions. Hence, n this respect E.U. corporate law harmonization challenges not only the German approach in its center. On the other hand, the idea to create a safe harbor that allowed or even obliged the management of subsidiaries to respond to instructions from the parent corporation would impinge on the complex set of rules in the AktG that tries

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[15] The abundant literature on legal transplants starts with ALAN WATSON, LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW (1974); for a radical critique *see* Pierre Legrand, *The Impossibility of 'Legal Transplants'*, 4 MAASTRICHT J. EUR. & COMP. L. 111 (1997); for an economic approach see Ugo Mattei, *Efficiency in Legal Transplants: An Essay in Comparative Law and Economics*, 4 INT'L REV. L. ECON. 3 (1994); for a specific view on the complementarity between jurisdictions' multiple institutions of corporate governance *see* Reinhard H. Schmidt & Gerald Spindler, *Path Dependence, Corporate Governance and Complementarity*, 5 INT'L FIN. 311 (2002).

[16] *Commission Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement* [hereinafter: *Proposal Revised Shareholder Rights Directive*], art. 9c, COM (2014) 213 final (Apr. 9, 2014).

to balance the enabling dimension of corporate law with legitimate concerns of minority and creditor protection. Although the Commission's 2012 Action Plan meets the concept with a good deal of reluctance[17] and the recently proposed Single Member Company Directive[18] does not follow through on it either, its far reaching implications that call for a counterbalance to protect minority shareholders deserve attention (*infra* 3). On the grounds of this analysis, the paper evaluates the proposed amendments and concludes (*infra* 4).

2 The German law of corporate groups and its European reception

This section presents a brief outline of the main content of the law on corporate groups in the AktG (*infra* 2.1).[19] It also looks back at the dismissive reception of the German approach in European corporate law harmonization and the rationales underpinning this skepticism which are still powerful today (*infra* 2.2).

2.1 Main content

The critical distinction in Germany's codified law on corporate groups dwells on the means of control that characterize the relationship between the parent firm and the group affiliates and determine the latitude for legally permissible group integration.[20] Control can be either based on share-ownership (*infra* 2.1.1) or consoli-

[17] *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies* [hereinafter: *2012 Action Plan*], at 14-15, COM (2012) 740 final (Dec. 12, 2012) cautiously vows to take an "initiative" for a better recognition of the group interest, *i.e.* does not even commit to any specific instrument it has at hands in accordance with Treaty on the Functioning of the European Union (hereinafter: TFEU), art. 288, 2012 O.J. (C 326) 47.

[18] *Commission Proposal for a Directive of the European Parliament and of the Council on single member private limited liability companies* [hereinafter: *Proposal Single Member Company Directive*], art. 22, COM (2014) final (Apr. 9, 2014).

[19] For comprehensive accounts *see e.g.* Mathias Habersack & Volker Emmerich, Aktien- und GmbH-Konzernrecht [The Law of Corporate Groups Involving Stock Corporations and Limited Liability Corporations] 17-774 (7th ed. 2013); Hans-Georg Koppensteiner, *§§ 15-22; §§ 291-327*, *in* Kölner Kommentar zum Aktiengesetz [Cologne Commentary on The Stock Corporation Act] (Wolfgang Zöllner & Ulrich Noack eds., 3d ed., 2004); Volker Emmerich & Mathias Habersack, Konzernrecht [The Law of Corporate Groups] 26-99, 153-527 (13th ed., 2013); for a concise overview *see* Karsten Schmidt, Gesellschaftsrecht [Corporate Law] 934-70 (4th ed. 2002). For delineations in English see e.g. Herbert Wiedemann, *The German Experience with the Law of Affiliated Enterprises*, *in* Groups of Companies in European Laws 21-43 (Klaus J. Hopt ed. 1982); Klaus Böhlhoff & Julius Budde, *Company Groups – The EEC Proposal for a Ninth Directive in the Light of the Legal Situation in the Federal Republic of Germany*, 6 J. Comp. Bus. & Capital Mkt. L. 163, 164-70 (1984); Peter Hommelhoff, *Protection of Minority Shareholders, Investors and Creditors in Corporate Groups: The Strengths and Weaknesses of German Corporate Group Law*, 2 Eur. Bus. Org. L. Rev. 61-80 (2001).

[20] The pertinent definition in AktG, § 17(1) describes the parent firm (controlling firm) as exerting, directly or indirectly, controlling influence over a dependent affiliate (controlled firm).

dated by specific contracts concluded between the parent firm and the dependent stock corporation (*infra* 2.1.2).

2.1.1 Control based on share-ownership, AktG §§ 311 et seq.

If the parent firm's[21] control is based on the ownership of shares vested with voting rights,[22] an arrangement frequently referred to as *de facto*-group by German courts and commentators,[23] AktG § 311 prohibits the controlling shareholder from inducing measures that disadvantage the subsidiary without providing full compensation within a year.

First, the practical impact of the provision depends critically on the interpretation of its element 'disadvantage'. The latter is construed to encompass any decrease of or specific risk to the corporation's financial situation or earning position that occurs as a result of the controlled corporation's influence.[24] The latter requires a showing that a decent and diligent manager of an independent corporation under the circumstances had behaved differently.[25]

Second, the effectiveness of the prohibition hinges also on what constitutes an eligible compensation that has to be provided during the year. The BGH recently ruled that if the disadvantage shows on the balance sheet, the compensation has to be of a kind that *vice versa* allows its reporting in accordance with applicable ac-

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[21] The Federal Court of Justice has consistently held that a controlling firm within the meaning of the law can be any shareholder regardless of legal form who pursues economic interests also outside the controlled corporation, Bundesgerichtshof [BGH] [Federal Court of Justice] Oct 13, 1977, 69 Entscheidungen des Bundesgerichtshofs in Zivilsachen [BGHZ] 334 (335 et seq.); BGH May 8, 1979, 74 BGHZ 359 (365); BGH Apr. 22, 1991, 114 BGHZ 203 (213); BGH Mar. 19, 1993, 122 BGHZ 123 (127).

[22] A blockholder who has the majority of votes in the corporation's general meeting can fill at least one half of the seats of the supervisory board, with the other half—or, depending on co-determination laws, a smaller proportion or no seats at all—reserved for labor representatives, AktG, § 111(1). The supervisory board appoints the members of the management board, AktG, § 84(1); co-determination laws ensure that in a tied ballot shareholder representatives will prevail even under equal representation, because the chairman who will usually be a shareholder representative will have a casting vote, *cf.* Gesetz über die Mitbestimmung der Arbeitnehmer [MitbestG] [Act on Employee Co-determination], May 4, 1976, BGBl. I at 1153 as amended, § 29(1)(1). This dominant role in appointment procedures should give majority blockholders significant influence also over the corporation's operations, because board members whose fate depends in large part on the benevolence of the controlling shareholder will typically respond to her suggestions.

[23] *See* for instance BGH Feb. 15, 1982, 83 BGHZ 122 (137); Ernst Geßler, *Der Schutz vor Fremdeinflüssen im Aktienrecht* [*Protection Against External Influence in Stock Corporation Law*], 145 ZHR 457, 457 (1981). The terminology seems suggestive that controlling influence within the meaning of the law can also be based on other means than share-ownership (*e.g.* key credit or supply relationships). Yet, it only signifies that group integration is not consolidated by contract, and thus does not contradict the notion that the concept of control in AktG § 17 requires at all events an equity stake of the controlling firm, *cf.* BGH Mar. 26, 1984, 90 BGHZ 381 (395-6).

[24] BGH Mar. 1, 1999, 141 BGHZ 80 (84); BGH Dec. 12, 2008, 179 BGHZ 71 para 8; BGH May 19, 2011, 190 BGHZ 7 para 37.

[25] BGH Mar. 1, 1999, 141 BGHZ 80 (88-9); BGH Mar. 3, 2008, 175 BGHZ 365 para 9, 11; BGH Dec. 12, 2008, 179 BGHZ 71 para 9, 10.

counting standards.[26] If disadvantages are not (immediately) reflected on the balance sheet, the majority view in the literature—absent relevant case law—holds that proper compensation presupposes granting an advantage that is appraisable, though not necessarily reportable.[27] Hence, non-quantifiable advantages that may be associated with the group-affiliation as such do not qualify.

Quite importantly, if the controlling firm fails to provide for timely compensation it is liable for damages to the controlled corporation jointly and severally with its representatives that actually induced the adverse measures, AktG § 317. The claims can be brought not only by the controlled corporation's management board but also as a derivative action by its individual shareholders, AktG §§ 309(4)(1)(2), 317(5), and its creditors, although the latter can only sue if the controlled corporation is in default, AktG §§ 309(4)(3), 317(5).

The outlined regime basically takes a protective stance that seeks to limit controlling shareholder's adverse influence and mitigate agency conflicts. Although it should not be overlooked that the fundamental duty of loyalty in AktG § 311(1) is considerably modified by the elongated possibility to provide compensation for disadvantages within a year. The deferral can be understood as a privilege[28] that is provided to enable at least loose forms of group integration.[29] In any case, AktG § 311

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[26] BGH June 26, 2012, 15 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] [NEW JOURNAL FOR CORPORATE LAW]1030 para 23 (2012).

[27] Mathias Habersack, *§ 311 para 63*, *in* MATHIAS HABERSACK & VOLKER EMMERICH, AKTIEN- UND GMBH-KONZERNRECHT [THE LAW OF CORPORATE GROUPS INVOLVING STOCK CORPORATIONS AND LIMITED LIABILITY CORPORATIONS] (7th ed. 2013); Jens Koch & Uwe Hüffer, *§ 311 para 37*, *in* JENS KOCH & UWE HÜFFER, AKTIENGESETZ [STOCK CORPORATION ACT] (11th ed. 2014); Holger Altmeppen, *§ 311 para 338*, *in* MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ [MUNICH COMMENTARY ON THE STOCK CORPORATION ACT] (Wulf Goette & Mathias Habersack eds., 3d ed. 2010).

[28] Some scholars purported that this modification violates the restriction on distributions in Second Council Directive 77/91/EEC of 13 Dec. 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [hereinafter: Second Directive], arts. 15, 16, 1977 O.J. (L 26) 1 as amended, *cf.* Wolfgang Schön, *Deutsches Konzernprivileg und europäischer Kapitalschutz – Ein Widerspruch?* [*German Privilege for Corporate Groups and European Minimum Capital Safeguards – A Contradiction?*], in FESTSCHRIFT FÜR BRUNO KROPF 285 (Karl-Heinz Forster, Barbara Grunewald, Marcus Lutter & Johannes Semler eds., 1997); but *see also* TILMANN BEZZENBERGER, DAS KAPITAL DER AKTIENGESELLSCHAFT [THE LEGAL CAPITAL OF STOCK CORPORATIONS] 325 (2005) (arguing that the obligation to fully compensate any disadvantage eliminates a distribution within the meaning of the Second Directive); Mathias Habersack, *Das Konzernrecht der „deutschen" SE* [*The Group Law of the "German" SE*] 32 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT [ZGR] 724, 733-4 (2003) (arguing that the Second Directive does not apply to stock corporations within a group because the latter – according to the E.U. legislature's orginal plan – should be covered exclusively by a specific directive; *see infra* 2.2.1.1).

[29] For a discussion of the enabling dimension of AktG §§ 311 et seq. *see* e.g. MÜLBERT *supra* note 13 at 280-93; 453-5; but *see also* Karsten Schmidt, *Konzernunternehmen, Unternehmensgruppe und Konzern-Rechtsverhältnis* [*Group Affiliates, Corporate Group, and Group Legal Relationship*], *in*: FESTSCHRIFT FÜR MARKUS LUTTER ZUM 70. GEBURTSTAG [FEST-

presumes that both the exercise of influence and the individual disadvantageous act or omission that it induces can be identified. The latter is also the prerequisite if minority shareholders or creditors seek to bring derivative actions on behalf of the controlled corporation.[30] At least from the perspective of the controlled corporation—which also has standing as the original plaintiff—the task is somewhat facilitated by the management board's obligation to prepare and submit to audit a report that covers all transactions with the parent and other group affiliates as well as those transactions induced by the controlling shareholder or executed in her interest, AktG §§ 312, 313.[31]

2.1.2 Dominance consolidated by contract, AktG §§ 291 et seq.

Where the controlling shareholder strives for greater latitude to integrate the subsidiary more closely into the group, German law provides the option to conclude a contract of domination between the controlling shareholder and the controlled corporation, AktG § 291(1)(1). Such a contract—*inter alia*—grants the right to manage the controlled corporation via direct instructions issued to its management board, AktG § 308(1). These instructions may disadvantage the controlled corporation if they serve the interest of the parent or the group, AktG § 308(1)(2), as long as they do not threaten the controlled corporation's existence.[32]

The far-reaching structural change that the conclusion of such a contract of dominance entails is not only reflected in the stringent prerequisites that have to be met in drawing-up and concluding such an instrument,[33] but also in the potent safeguards that support the interests of minority shareholders and creditors once the controlling shareholder's position is consolidated. Minority shareholders are protected by a sell-out right where courts following detailed procedural rules[34] ensure that exiting shareholders receive the fair value of their equity stake in the controlled

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SCHRIFT CELEBRATING MARKUS LUTTER'S 70TH BIRTHDAY] 1167, 1179-83 (Uwe H. Schneider et al. eds., 2000).

[30] The majority view grants some alleviation when it comes to showing that the disadvantageous measure was induced by the controlling shareholder, *cf. e.g.* Altmeppen *supra* note 27, *§ 311 para 87-94*; Habersack *supra* note 27, *§ 311 para 32-36*. This implies, however, that the individual measure can be recognized in the first place.

[31] But *see infra* 3.1.2.2.1.

[32] The latter limit accords with the majority view among German commentators, e.g. Volker Emmerich, *§ 308 para 60*, *in* MATHIAS HABERSACK & VOLKER EMMERICH, AKTIEN- UND GMBH-KONZERNRECHT [THE LAW OF CORPORATE GROUPS INVOLVING STOCK CORPORATIONS AND LIMITED LIABILITY CORPORATIONS] (7th ed. 2013); Koch & Hüffer, *supra* note 27, *§ 308 para 19*. Some scholars also deem orders permissible that can wipe-out the controlled company, Koppensteiner *supra* note 19, *§ 308 para 50*.

[33] In particular, the contract of dominance has to be approved by a supermajority of ¾ of the authorized capital present at the shareholder meeting, AktG § 293(1)(2). Moreover, the management board has to prepare a detailed report on the contract and its main features, AktG § 293a(1). Finally, the contract has to be audited, § 293b(1).

[34] *Cf.* Gesetz über das gesellschaftsrechtliche Spruchverfahren [SpruchG] [Act on Appraisal Proceedings in Corporate Law] June 12, 2003 BGBl. I at 838.

company, AktG § 305.[35] Creditors are protected by the controlling firm's obligation to compensate for the controlled corporation's net loss for the year if the latter are not equalized from reserves that were created after the contract of dominance had been concluded, AktG § 302(1).

In sum, the contract of dominance emphasizes the enabling function of organizational law because it permits sweeping measures of group integration. Yet, the leeway the controlling shareholder enjoys carries a price tag, because minority shareholder and creditor interests are protected by correspondingly powerful safeguards. Hence, the legislator's intention clearly is to effectively prevent the expropriation of corporate constituents also within the context of a closely integrated group.

2.2 The European reception

Despite the widely shared policy objectives underlying the pertinent parts of the AktG, the idea to implement them by codifying a comprehensive set of rules for corporate groups never gained traction on the European level. Yet, the idea to devise at least a couple of discrete rules that address the agency conflicts associated with corporate groups was present at various stages since the beginning of corporate law harmonization (*infra* 2.2.1). The quest for alternative approaches translated into the promulgation of rules that also bear on problems that occur in, but are not limited to the group context (*infra* 2.2.2). Moreover, the idea of perceiving corporate groups as a distinct regulatory challenge[36] recently experienced a modest renaissance in some proposed or envisioned E.U. legislation (*infra* 2.2.3).

2.2.1 Specific rules for corporate groups in European corporate law

The struggle for the adequate regulatory concept that should guide law's reaction to the substantive challenges posed by corporate groups lead from a close orientation on the German model (*infra* 2.2.1.1) to less cohesive alternatives (*infra* 2.2.1.2).[37]

2.2.1.1 Duplicating the German model

The attempts to base European corporate law harmonization in pertinent part on Germany's approach and its specific institutional arrangement soon got caught in the political quagmire of supranational lawmaking because Member States' agendas varied substantially. As a result, the Ninth Company Law Directive on Corporate

[35] Usually shareholders of the controlled company receive shares of the controlling firm as compensation and only where the latter is registered outside the European Economic Area a cash settlement is mandatory, AktG § 305(2).

[36] *See supra* 1.

[37] For an overview of the European developments *see* Brigitte Haar, *Corporate Group Law*, *in* Max Planck Encyclopedia of European Private Law, Vol I, 411-5 (Jürgen Basedow, Klaus J. Hopt, Reinhard Zimmermann eds., 2012); Klaus J. Hopt, *Konzernrecht: Die europäische Perspektive* [*Corporate Group Law: The European Perspective*], 171 ZHR 199-240 (2007).

Groups never reached the stadium of an official Commission proposal. Instead it got stuck twice when fundamental opposition *vis-à-vis* advance drafts in 1974/75[38] and 1984[39] made it nonsensical to go through with the controversial initiatives that at the time required unanimous consent. Although amendments to the E.U. founding treaties for a long time have provided for majority decisions, the Commission obviously has ceded to pursue the project any further.[40]

The advocates of the German approach—who are not exclusively domiciled in Germany[41]—at least failed to impart German law's merits.[42] However, it is also plausible that the opponents—with good cause—pointed to structural shortcomings of the German example that was indeed frequently criticized as overly complex and yet largely ineffective.[43]

More fundamental, the perception that corporate groups indeed pose unique problems for organizational law that require idiosyncratic regulation can be doubted.[44] In fact, viewed from the perspective of the theory of the firm,[45] groups repre-

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[38] *Preliminary Draft of a Directive Based on article 54, 3(g) on Harmonization of the Law of Groups of Companies* (Part I - EEC Doc. XI/328/74-E, Part II - EEC Doc. XV/593/75 - E); the German version is reprinted in MARCUS LUTTER, EUROPÄISCHES GESELLSCHAFTSRECHT [EUROPEAN CORPORATE LAW] 192-230 (1979); for a critical review *see* Patrick Derom, *The EEC Approach to Groups of Companies,* 16 VA. J. INT'L L. 565-607 (1976); for a brief discussion from the perspective of a U.S. practitioner *see* Steven M. Schneebaum, *The Company Law Harmonization Program of the European Community*, 14 L. POL'Y IN INT'L BUS. 293, 317-21 (1982).

[39] *Draft of a Ninth Directive on Company Law, Doc. III/1639/84-EN* partly reprinted in Böhlhoff & Budde *supra* note 19 at 181-92; the German version is again reprinted in MARCUS LUTTER, EUROPÄISCHES GESELLSCHAFTSRECHT [EUROPEAN CORPORATE LAW] 244-56 (4th ed.,1996) and in 15 ZGR 444-65 (1985). For brief discussions *see* Ulrich Immenga, *Company Systems and Affiliation*, *in* INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, Vol. XIII/7, 9-11, 59-60 (Alfred Conard ed., 1985); Richard D. English, *Company Law in the European Single Market*, 1990 B.Y.U. L. Rev. 1413, 1494-7; Karl Hofstetter, *Parent Responsibility for Subsidiary Corporations: Evaluating European Trends*, 39 INT'L & COMP. L.Q. 576, 588-9 (1990).

[40] The Commission, following the recommendations of an expert group, has explicitly stated that it sees no need to revive the Ninth Company Law Directive, *cf. Communication from the Commission to the Council and the European Parliament – Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward*, , at 18-20 COM (2003) 284 (May 21, 2003). Coherently, the latest Action Plan only rearticulates the reservations *vis-à-vis* the project when it sets the Commission's agenda for corporate groups, *cf. 2012 Action Plan supra* note 17, at 14-5.

[41] *See* e.g. MADS ANDENAS & FRANK WOOLDRIDGE, EUROPEAN COMPARATIVE COMPANY LAW 32 (2009) (finding the Commission's „apparent abandonment of work on groups of undertakings … regrettable").

[42] For such a rationalization in the light of the Commission's preference for alternative mechanisms to protect investors e.g. Georg Sandberger, *Teilübernahmeangebote und Zwangsübernahmeangebote im Europäischen Take-over-Recht* [*Partial Bids and Mandatory Bids in European Takeover Law*], DEUTSCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (DZWIR) 319, 324 (1993).

[43] *See supra* note 14; for a summarizing discussion *see* Hommelhoff *supra* note 19. See also *infra* note 230.

[44] It is indicative that German courts have refused to apply the rules that govern a stock corporation that is controlled on the basis of share-ownership (AktG §§ 311 et seq.,

sent intermediate forms of the polar modes of resource allocation, *i.e.* they fall somewhere between market and hierarchy[46] or, in other words, short-term alliance and consolidation.[47] This observation makes it conceivable that a moderate adaptation of the general institutions of contract and corporate law would suffice or even be better suited to address the substantive problems associated with group integration.[48]

2.2.1.2 The quest for alternatives

Apart from the European institution's unsuccessful attempts to adopt a full-fledged body of rules for corporate groups, regulatory proposals were also brought forward by various expert groups that progressed with a particular view to European corporate law harmonization.

The innovative and essentially European spirit of these endeavors that left the German role model behind can be savored in the statement and recommendations of the *Forum Europaeum on Group Law*.[49] Despite an ostensible major German in-

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supra 2.1.1) to other legal forms by way of analogy, e.g. BGH Sep. 9, 1985, 95 BGHZ 330 (340) (pertaining to a Limited Liability Corporation).

[45] The literature starts with Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

[46] G.B. Richardson, *The Organisazion of Industry*, 82 ECON. J. 883 (1972); OLIVER WILLIAMSON, MARKETS, HIERARCHIES - ANALYSIS AND ANTITRUST IMPLICATIONS (1975); for a historic description of the 19th/early 20th century evolution of the modern business firm as a hybrid between the *Coasean* alternatives *see* ALFRED D. CHANDLER JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 79-376 (1977); with a particular view to divisionalized firms and specifically corporate groups (conglomerates) OLIVER WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 279-90 (1985).

[47] Mark J. Granovetter, *Coase Revisited: Business Groups in the Modern Economy*, 4 INDUS. & CORP. CHANGE 93, 95 (1994); Mark J. Granovetter, *Business Groups and Social Organization*, *in* THE HANDBOOK OF ECONOMIC SOCIOLOGY 430, 430 (Neil J. Smelser & Richard Swedberg eds., 2d ed., 2005).

[48] The proposition is not only bolstered by comparative insights (*supra* at note 9 and 10) but also by the developments in the German law of limited liability corporations (see e.g. Wolfgang Zöllner & Michael Beuerskens, *Schlussanhang Die GmbH-im Unternehmensverbund (GmbH-Konzernrecht)* [*Appendix The LLC in a Group (LLC Group Law)*], *in* ADOLF BAUMBACH & ALFRED HUECK, GESETZ BETREFFEND DIE GESELLSCHAFTEN MIT BESCHRÄNKTER HAFTUNG 2187-2256 (20th ed., 2013)) and (limited) partnerships (*see* Tobias Tröger, *§ 59 Die Personengesellchaft im Unternehmensverbund [§ 59 Partnerships in a Group*], *in* HANDBUCH PERSONENGESELLSCHAFTEN [HANDBOOK PARTNERSHIPS] I 2921-I 3000 (Harm Peter Westermann & Johannes Wertenbruch eds., loose-leaf Oct. 2012)) where group specific problems are widely submitted to the general rules and standards of corporate and partnership law. For similar concepts under German law regarding stock corporations see *supra* note 11.

[49] Forum Europaeum Konzernrecht, *Konzernrecht für Europa* [*Corporate Group Law for Europe*], ZGR 672-772 (1998). For the English version *cf.* Forum Europaeum Corporate Group Law, *Corporate Group Law for Europe*, 1 EUR. BUS. ORG. L. REV. 166-264 (2000). The text has also been published in French (117 REVUE DES SOCIÉTÉS 43-80, 285-337 (1999)), Italian (46 RIVISTA DELLE SOCIETÀ 341-448 (2001)), and Spanish (53 REVISTA DE DERECHO MERCANTIL 445-576 (1999)). For discussions of the proposal *cf.* Christine Windbichler, *"Corporate Group Law for Europe": Comments on the Forum Europaeum's Principles and Proposals for European Corporate Group Law*, 1 EUR. BUS. ORG. L. REV. 265-86 (2000); John

fluence in the group,[50] its main recommendations borrow in pivotal parts from other jurisdictions (France and the United Kingdom in particular).[51] Furthermore, the recommendations are limited to a couple of regulatory interventions that on the one hand serve to protect minority shareholders and creditors (heightened transparency of intra-group relations, right to initiate a special investigation, mandatory bid rule and sell-out right, special (shadow) directors' duties in the vicinity of insolvency (wrongful trading))[52] and on the other facilitate group integration (recognition of right to manage subsidiaries in the interest of the group, buy-out right).[53] To be sure, a fully elaborated legislative document that implemented the proposals in operational law would probably look significantly less lean. Yet, the general tendency of the Forum's approach remains clear: instead of codifying a law for corporate groups that largely supplants general corporate law, targeted modifications and additions in identified areas are preferred.

The same approach was subsequently favored by the High Level Group of Company Law Experts[54] that acted on an explicit mandate from the Commission and thus became formative for the subsequent developments as reflected in the 2003 Action Plan[55] and its implementation. In particular, the group endorsed heightened financial and non-financial disclosure for corporate groups, a prohibition to admit holding companies of pyramids to trading on regulated markets, and the right of group affiliates' managers to submit to an integrated group strategy.[56] The report also endorsed certain legislative actions that would impact on corporate groups but are not necessarily limited to the context, e.g. the right of a minority to initiate a special

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Kluver, *European and Australian proposals for Corporate Group Law: a comparative analysis*, 1 EUR. BUS. ORG. L. REV. 287-316 (2000); José Miguel Embid Irujo, *Trends and Realities in the Law of Corporate Groups*, 6 EUR. BUS. ORG. L. REV. 66 (2005).

[50] The *Forum* was financially supported by the Fritz Thyssen Foundation and its steering committee comprised of three Germans (*Klaus J. Hopt*, *Peter Hommelhoff*, *Marcus Lutter*), one Austrian (*Peter Doralt*), one Swiss (*Jean-Nicolas Druey*), and one Belgian (*Eddy Wymeersch*). The German members drafted the text of the final statement and the recommendations. The latter were prepared on the grounds of several workshops that convened participants from many European countries (Austria (1), Belgium (1), France (3), Germany (10), Italy (4), the Netherlands (2), Spain (3), Sweden (1), Switzerland (3), and the United Kingdom (2)) and were discussed with the other members of the committee and amended accordingly, *cf.* Forum Europaeum Corporate Group Law *supra* note 49 at 165 ; on the working of the Forum *see also* Windbichler, *supra* note 49, at 265-7 (2000).

[51] This is apparent for the proposed liability of shadow directors for wrongful trading (*see* Companies Act 2006, 2006, c. 46, § 214 (Eng.)) and the recognition of a group interest as legitimate guidance for affiliates' management (on the French *Rozenblum*-doctrine *see infra* 3.1.2.2.1 and 3.2.2).

[52] On this aspect in particular Thomas Bachner, *Wrongful trading - a new European model for creditor protection?*, 5 EUR. BUS. ORG. L. REV. 293, 293-6 (2004).

[53] Forum Europaeum Corporate Group Law *supra* note 49 at 260-4.

[54] The group was chaired by Dutch law professor and practicing attorney *Jaap Winter* and consisted of one distinguished expert from Denmark, France, Germany, Italy, Spain, and the United Kingdom respectively.

[55] *Communication from the Commission supra* note 40 at 18-20.

[56] For details *see* items V.2 – V.4 and the explanatory statements, High Level Group of Company Law Experts, *Report on a Modern Regulatory Framework for Company Law in Europe*, 18, 94-100 (Nov. 4, 2002) *available at* http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf.

investigation,[57] the strengthened role of directors that are independent *inter alia* from controlling shareholders,[58] the special (shadow) directors' duties near insolvency,[59] as well as the minority-protecting sell-out and integration-facilitating squeeze-out rights.[60]

Finally, the Commission appointed Reflection Group on the Future of European Company Law[61] that could draw on a broad comparative basis restricted its recommendations to the enabling prong of corporate group regulation. In doing so it apparently jumped on the bandwagon in suggesting that future legislation should recognize the interest of the group as a legitimate determinant in managerial decision making at all group affiliates.[62] Yet, it must not be overlooked that the prior proposals on the issue had gone nowhere and the debate was essentially closed at the time as far as practical supranational law making was concerned.[63] With regard to minority protection the Reflection Group only contemplated transparency issues and considered the existing framework by and large as adequate.[64]

2.2.2 Related regulatory strategies

Some of the proposed regulatory strategies that constitute alternatives to the German institutional arrangement have been subsequently promulgated by the European legislature. As a consequence, the case for additional rules that address the peculiarities of corporate groups is a good deal less urgent today.

In particular, the implementation of the 1999 Financial Services Action Plan[65] brought about the mandatory bid-rule in the Takeover Directive[66] and the comprehensive disclosure obligation regarding significant shareholdings in the Transparency

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[57] Item III.8, *ibid.* at 11, 57-9.

[58] Item III.10, *ibid.* at 11, 59-64.

[59] Items III.13 and IV.10, *ibid.* at12, 15, 68-9, 86.

[60] Items IV.9 and VI.9 *ibid.* 15, 21, 85-6, 109-10.

[61] The relevant group sessions were chaired by French law professor *Pierre-Henri Conac* and convened distinguished experts from Belgium, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, the Netherlands, Spain, and the United Kingdom who explicitly acted on their own capacity and did not represent Member States, *cf. Report of the Reflection Group on the Future of European Company Law* [hereinafter *Reflection Group Report*], at 3-4 (April 5, 2011) *available at* http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf.

[62] *Reflection Group Report supra* note 61 at 59-65.

[63] It is an important observation, that five of the thirteen members of the Reflection Group also participate in the EMCA project (José Engrácia Antunes, Theodor Baums, Blanaid Clarke, Pierre-Henri Conac, Harm-Jan de Kluiver). This group had started its deliberations that include a chapter on corporate groups already in 2007, *cf.* Theodor Baums & Paul Krüger Andersen, *The European Model Company Act Project, in:* PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 5, 5 and 16 (Michel Tison, Hans De Wulf, Christoph Van der Elst & Reinhard Steennot eds., 2009).

[64] *Reflection Group Report supra* note 61 at 68-75.

[65] *Communication of the Commission to the Council and the European Parliament – Financial Services: Implementing the Framework for Financial Markets: Action Plan*, at 4, 9, 22, 24, COM (1999) 232 final (May 11, 1999).

[66] Directive 2004/25/EC of the European Parliament and of the Council of 21 april 2004 on takeover bids [hereinafter: Takeover Directive], art. 5, 2004 O.J. (L 142) 12.

Directive.[67] The two rules taken together amount to a comprehensive European "equal opportunity rule" for listed companies. This rule aims *inter alia* at protecting minority shareholders against opportunistic control acquisitions:[68] where a bidder not only is prevented from sneaking in by building-up a substantial equity stake prior to announcing her intention[69] but also faces a sell-out right of all other shareholders,[70] any redistributive strategy that requires the expropriation of a remaining minority to yield profits is effectively precluded.[71] Following the example of the City Code on Takeovers and Mergers[72] the Takeover Directive introduces strong protections at the time a corporate group evolves and thus in principle allows corporate law to be somewhat more lenient later down the road.[73]

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[67] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC [hereinafter: Transparency Directive], arts. 9-15, 2004 O.J. (L 390) 38.

[68] For a critical assessment of the mandatory bid's function to address collective action problems of dispersed shareholders *see* Mike Burkhart & Fausto Panunzi, *Mandatory Bids, Squeeze Outs an Similar Transactions, in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 737, 748-53 (Guido Ferrarini, Klaus J. Hopt, Jaap Winter & Eddy Wymeersch eds., 2004).

[69] Transparency Directive, art. 9(1) requires the disclosure of equity-ownership once a shareholder hits a 5%-threshold. As a consequence, minority shareholders benefit from the rise in share prices that result from the emerging control transaction. To be sure, there may be loopholes in the Directive that allow to structure deals around the disclosure requirements using derivatives. For the basic analysis of the problem *see* Henry T.C. Hu & Bernard S. Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006); Henry T.C. Hu & Bernard S. Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 BUS. LAW. 1011 (2006); for the specific European angle *see* Dirk A. Zetzsche, *Hidden Ownership in Europe: BAFin's Decisionin Schaeffler v. Continental*, 10 EUR. BUS. ORG. L. REV. 115 (2009). Yet, the rule's rationale is unfettered despite flaws in its design.

[70] Takeover Directive, art. 5(1) and (2) require a voluntary takeover bid either to be addressed to all shareholders for all their shares or—in the case of a partial bid—to be followed by a comprehensive mandatory bid.

[71] In practice, the protection may not be that effective after all, *cf.* Jeremy Grant, Tom Kirchmaier & Jodie A. Kirshner, *Financial Tunnelling and the Mandatory Bid Rule*, 10 EUR. BUS. ORG. L. REV. (2009) (presenting case studies of "creative compliance" with the mandatory bid rule that allowed dominant shareholders to appropriate wealth form minority shareholders).

[72] THE PANEL ON TAKEOVERS AND MERGERS, THE TAKEOVER CODE (11th ed., 2013).

[73] Apart from the practical deficiencies of the Takeover Directive's mandatory bid rule (*supra* note 71), it is worth noting that even the protection afforded by a well-functioning regime comes at a cost. The equal opportunity rule has the latent effect that bidders are not fully compensated for their search and monitoring costs, i.e. the identification of sub-optimally managed targets and the subsequent implementation of efficient strategies. Hence, it potentially also impedes effective control transactions. For the seminal analyses *see* Frank H. Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 705-11 (1981); Lucian A. Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q. J. ECON. 957 (1994) (showing that in a jurisdiction with high private benefits of control the equal opportunity rule may be optimal whereas it is inefficient in jurisdictions that effectively confine majority shareholder rent-seeking in other ways); *see also* Ronald J. Gilson & Jeffrey N. Gordon, Controlling Controlling Shareholders, 152 U. PA. L. REV. 785, 785-6 (2003). On this analytical basis ALESSIO M. PACCESS, FEATURING CONTROL POWER 683-8 (2008) thus argues

However, the E.U. did not rely on the mandatory bid alone to minimize dominant shareholder rent-seeking. Instead it undertook to bolster the institutional preconditions that limit blockholders' ability to consume private benefits of control in an existing group. In particular, with its Independent Director Recommendation for listed corporations,[74] the Commission moved in line with the emerging global paradigm for investor protection following the U.S. example.[75] At the margin, mandating director independence *inter alia* from dominant shareholders[76] should yield significant improvements in minority protection if the existing arrangements in this regard prove insufficient. *Vice versa*, if the established institutions already constrain dominant shareholders' rent-seeking in a meaningful way, the additional benefit of compelling director independence seems limited and the costs of such a regime (lack of firm-specific knowledge, impediment to effective blockholder monitoring etc.) carry more weight.[77] Regardless of the merits and shortcomings of filling the boardroom with outside directors, suffice it to say for the purposes of this paper that the Commission with its pertinent Recommendation again opted for a regulatory strategy to attenuate the agency conflict between dominant and minority shareholders that diverges conceptually from the German codified law on corporate groups. Recently, the Commission attempted to push this agenda further in a manner specifically meaningful for intra-group transactions. It sought mandating that the majority of the members of a listed firm's audit committee be independent within the meaning

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for the reliance on fiduciary duties instead of the mandatory bid rule to control private benefits of control; but *see also* CAROLINE BOLLE, A COMPARATIVE OVERVIEW OF THE MANDATORY BID RULE IN BELGIUM, FRANCE, GERMANY, AND THE UNITED KINGDOM 279-80 (2008) (arguing that the mandatory bid is optimal in the European context).

[74] Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board [hereinafter: Independent Director Recommendation], 2005 O.J. (L 52) 51. It also impacts

[75] In the U.S. context of dispersed ownership structures, independent directors mainly constitute an ambiguous counterweight to managerial opportunism, *see* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: of Shareholder Value and Stock Market Prices*, 59 Stan. L. Rev. 1465, 1510-40 (2007) (describing the rise and refinement of board member independence as a function of shareholder value orientation). For a survey of the economic effects of board composition (and size) *see* Benjamin E. Hermalin & Michael S. Weisbach, *Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature*, 9 ECON. POL'Y REV. 7-23 (2003).

[76] *Cf.* Independent Director Recommendation, item 13.1.

[77] In line with theory, an empirical survey that scrutinizes a sample of 800 firms with concentrated ownership from 22 jurisdictions finds a positive correlation between the number of independent directors and firm value, the statistically significant effect being larger in jurisdictions with weak minority protection according to the anti-director rights-index presented in Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W. Vishny, *Law and Finance*, 106 J. POL. ECON. 1113-1155 (1998), see Jay Dahya, Orlin Dimitrov & John J. McConnell, *Dominant shareholders, corporate boards, and corporate value: A cross-country analysis*, 87 J. FIN. ECON. 73-100 (2008).

of the Recommendation, *i.e.* independent of the controlling shareholder,[78] but could not prevail with its position in the legislative process.[79]

2.2.3 The 2012 Action Plan, the revised Shareholder Rights Directive, and other recent regulatory advances

During recent years, the Commission has again devoted its legislative attention to issues that pertain to corporate groups. In its 2012 Action plan, the Commission announced to propose regulation that would submit related party transactions—a foremost method of extracting private benefits of control—to heightened transparency, expert review and disinterested shareholder approval.[80] This intention has translated into an elaborate legislative proposal[81] that traces closely the more granular prequel of the European Corporate Governance Forum (ECGF).[82] Moreover, the 2012 Action Plan seized the suggestion various expert groups had consistently championed[83] to recognize the "interest of the group" as a legitimate and overriding determinant in the decisions of subsidiaries' managers. It did so, however, only with visible caution, because it stopped short of vowing to propose legislation and only pledged to "come with an initiative to improve … the … recognition of the concept of 'group interest'".[84] This very concept is not limited by nature to wholly-owned subsidiaries.[85] Thus it could not be fully realized with the recent proposal for a single member company. This holds true regardless of the observation that the right of the single shareholder to instruct the management of a *Societas Unius Personae (SUP)* in its present shape will have tighter limits than envisioned by those commentators who advocate a strong-form recognition of group interest.[86]

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[78] *Commission Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities*, art. 31 and recital 23, COM (2011) 779 final (Nov. 11, 2011).

[79] The relevant rule was ultimately promulgated in Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, art. 1(32), 2014 O.J. (L 158) 196 as an amendment to Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, art. 39(1)(4), 2006 O.J. (L 157) 87. The key difference is that the effective rule in pertinent part only mandates independence "of the audited entity".

[80] *2012 Action Plan supra* note 17, at 9-10 (para 3.2).

[81] *Proposal Revised Shareholder Rights Directive*, art. 9c.

[82] *Statement of the European Corporate Governance Forum on Related Party Transactions for Listed Entities* (Mar. 10, 2011) *available at* http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf_related_party_transactions_en.pdf.

[83] See *supra* 2.2.1.2. For a discussion of the substantive arguments against or in favor of such a rule *cf.* Pierre-Henri Conac, *Director's Duties in Groups of Companies – Legalizing the Interest of the Group at the European Level*, 10 Eur. Comp. & Fin. L. Rev. 194, 205-12 (2013).

[84] *2012 Action Plan*, *supra* note 17, at 14-5 (para 4.6). For a discussion of the various instruments E.U. bodies could use Conac *supra* note 83 at 213-7.

[85] *Reflection Group Report supra* note 61, at 61; Conac *supra* note 83, at 221-25.

[86] *Proposal Single-Member Companies Directive*, art. 23. *See infra* 3.2.2.

Despite this modest renaissance of group specific legislative advances, the unmoved cornerstone remains that the Commission will not revive the Ninth Directive. Instead of codifying a comprehensive set of rules it will only target specific issues that it has identified as insufficiently addressed in European corporate law so far.[87] The remainder of this paper will scrutinize the prospective regulation in these areas of current legislative initiatives.

3 Specific topics of current regulatory initiatives

Following a functional approach, this paper will first analyze the proposed rules for related party transactions that aim at minimizing controlling shareholder rent-seeking. It does so by comparing the new rules to the existing legal framework, both supranational and national (*infra* 3.1). The paper then turns to the projected enabling rule that seeks to facilitate reaping the benefits from efficient group integration (*infra* 3.2).

3.1 Private benefits of control

Restraining dominant shareholder rent-seeking is one of the key challenges for any regulation of corporate groups and thus is anything but new to European corporate law. This observation makes it worthwhile to look briefly at the background of the proposed regulation (*infra* 3.1.1) and the existing legal framework both supranational and national (*infra* 3.1.2) before gauging the specific rule's merits (*infra* 3.1.3).

3.1.1 General background

From the perspective of agency theory,[88] related party transactions constitute one of the key areas where dominant shareholders (agents) can take hidden action to exploit minority shareholders (principals). In other words, related party transactions constitute a broad avenue for tunneling, i.e. "the transfer of assets and profits

[87] The expert group that works on a European Model Company Act (EMCA) to be adopted by national legislatures seems to revert to a more comprehensive approach. It has proposed a set of uniform rules for corporate groups that deals with the management of the group and the protection of shareholders in both the parent and the subsidiary. Hence, its proposal covers the key areas of group regulation, although less extensively and ponderously than the AktG, *cf. European Model Company Act, Chapter 16: Groups of Companies* (Oct. 1, 2013) *available at* http://law.au.dk/fileadmin/Jura/dokumenter/CHAPTER_16_GROUPS_OF_COMPANIES.pdf. In fact, the consolidation seems to be at least in part a consequence of the group's objective to prepare a concise code that—alongside some innovations—brings together those rules that mainly apply in the context of corporate groups but are currently scattered across European law. On the general goals of the group *see* Baums & Krüger Andersen *supra* note 63; Paul Krüger Andersen, *The European Model Company Act (EMCA): A new way forward*, in: Company Law and Economic Protectionism - New Challenges to European Integration 303-325 (Ulf Bernitz & Wolf-Georg Ringe eds., 2010).

[88] *Supra* 1.

out of firms for the benefit of those who control them".[89] The empirical evidence suggests that there is indeed room for improvement in continental Europe,[90] although the periods surveyed naturally fail to reflect the considerable improvements in corporate governance that occurred over the last fifteen years.[91]

Rather surprisingly, the Commission now favors a counter-strategy that was in key parts not recommended by any of the private or officially mandated expert groups concerned with the future of European corporate law.[92] Yet, the commission could dwell on the spadework of the ECGF,[93] a standing high-level group of experts that was established following the 2003 Action Plan to advice the Commission in its quest for convergence in Member States' corporate laws. As a result, E.U. legislation seeks to submit related party transactions that do not occur exclusively but substantially within corporate groups, to heightened transparency, and—depending on specific thresholds—an independent fairness assessment as well as a disinterested shareholder approval of the most significant transactions.[94] Particularly the direct shareholder involvement represents a largely unprecedented innovation that raises the question of how it fits into or relates to the existing legal regimes that impact on related party transactions.

3.1.2 The existing legal framework

While European legislation thus far submits related party transactions only to transparency requirements in the pertinent accounting rules (*infra* 3.1.2.1), national corporate laws provide a wide variety of institutional approaches to minimize the consumption of private benefits of control in these transactions (*infra* 3.1.2.2).

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[89] Simon Johnston, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Schleifer, *Tunneling*, 90 Am. Econ. Rev. 22 (2000). For a more granular taxonomy of pertinent transactions *see* Vladimir Atanasov, Bernard S. Black & Conrad S. Ciccotello, *Law and Tunneling*, 37 J. Corp. L. 1, 5-9 (2011) (distinguishing the misappropriation of cash flow, asset and equity entitlements).

[90] Tatiana Nenova, *The value of corporate voting rights and control: A cross-county analysis*, 68 J. Fin. Econ. 325 (2003) (finding in 1997 the value of voting blocks that conferred control in a cross-country sample of 661 firms with dual-class stock to be positive and above the value of the U.S. observations (near zero) in the surveyed continental European jurisdictions, with the notable exceptions of Denmark and Finland); Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. Fin. 537, 551 (2004) (showing in a sample of 393 sale of control transactions that occurred in 39 countries between 1990 and 2000 control premiums in continental Europe to be generally positive, frequently above the sample-median—although not in Germany—and in all surveyed jurisdictions higher than the U.S.-median).

[91] On the other hand, though, the data points collected for Germany corroborate to a certain degree the critique leveled against the German codified group law (*supra* 14): at a time when investor protection through securities regulation was largely inexistent, neither corporate law, *i.e.* the codified law of corporate groups, nor Germany's informal institutions minimized private benefits of control as effectively as the institutional framework did in other jurisdictions.

[92] *Supra* 2.2.1.2.

[93] *Supra* note 82

[94] For details *see infra* 3.1.3.1

3.1.2.1 E.U. REGIME

Both the Fourth Directive on annual accounts and the Seventh Directive on consolidated accounts required the notes on (consolidated) accounts to report related party transactions, "including the amount of such transactions, the nature of the related party relationship as well as other information about the transaction necessary for an understanding of the financial position of the company/undertakings included in the consolidation if such transactions are material and have not been concluded under normal market conditions."[95] Quite obviously, the latter precondition already lowered the probability dramatically that tunneling transactions with a dominant shareholder would indeed be disclosed: reporting would amount to little less than the self-accusation of the affiliate's board members. Moreover, Consolidated Accounts Directive art. 34(7b) explicitly exempted intra-group transactions form the reporting requirements. Recent law reform tightened the reporting requirements, providing only an option to Member States to exempt transactions from disclosure that were concluded under normal market conditions or with wholly owned subsidiaries.[96]

Yet, E.U. corporations with securities admitted to trading on a regulated market are subject to International Accounting Standards (IAS),[97] and thus have to report all relevant information on related party transactions under IAS 24(18) regardless of materiality, deviation from market conditions or intra-group exceptions – in fact, the definition of what constitutes a related party relationship explicitly comprises any affiliation within a corporate group.[98] With regard to this set of corporations, at least *ex post*-transparency seems comprehensive.[99] However, in addition to the fact that reporting obligations on the books are only as good as their enforcement in

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[95] Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies [hereinafter: Annual Accounts Directive], art. 43(1)(7b), 1978 O.J. (L 222) 11; Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts [hereinafter: Consolidated Accounts Directive], art. 34(7b), 1983 O.J. (L 193) 1 as amended.

[96] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, art. 17(1)(r), 2013 O.J. (L 182) 19.

[97] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, art. 4, 2002 O.J. (L 243) 1.

[98] IAS 24(9)(b)(i). The relevant definition of a group was thus far provided in IAS 27(4) and comprises a parent and all its subsidiaries, the latter being controlled by the parent in their financial and operating policies so as to obtain benefits from their activities. With effective date January 1, 2014 this definition was superseded by International Financial Reporting Standard (IFRS) 10, Appendix A which likewise subsumes the parent and its subsidiaries and also adheres to the concept of control as described in IFRS 10(5)-(7).

[99] The latter observation made the Reflection Group conclude that the existing legal framework ensures a transparent and broad yearly picture of the intra-group relations and that thus no legislative action is required in this regard, *Reflection Group Report supra* note 61, at 74.

practice, annual disclosure is only a viable mechanism to control rent-seeking where corporate law places shareholders in a position to obtain effective redress if related party transactions serve as tunneling-devices. It is thus the (un-harmonized) law of the Member States that has to provide the essential complements to comprehensive disclosure.

3.1.2.2 Member States

Broadly speaking, the law of the Member States and other important jurisdictions falls into two categories. Most jurisdictions seek to control the consumption of private benefits of control by holding dominant shareholders liable *ex post* under substantive (fiduciary) standards of loyalty. These corporate law regimes aspire to make this liability effective by mandatory reporting requirements – the latter being at least partly obsolete where IAS govern the corporations' financial reporting (*infra* 3.1.2.2.1). Others, particularly the United Kingdom, rely additionally on *ex ante* shareholder involvement in material related party transactions (*infra* 3.1.2.2.2).

3.1.2.2.1 STANDARD BASED LIABILITY COUPLED WITH REPORTING OBLIGATIONS

Typical examples of the first approach can not only be found in Germany, where AktG §§ 311, 317(1) provide the statutory grounds for a standard based liability regime which affords standing for individual minority shareholders in derivative actions, AktG §§ 309(4)(1), 317(4).[100] Italian law also knows a similar liability regime that allows individual shareholders to bring the action against the parent corporation and its managers if the parent's directions and its coordination *in sum* result in damages to the affiliate corporation that are not properly compensated.[101] In France dominant shareholders are not subject to civil liability under corporate law even if they *de facto* determine the subsidiaries' management, because the general rules on directors' liability[102] do not apply.[103] Yet, dominant shareholders can be held accountable as a *dirigeant de fait* under general tort law[104] and in the corporation's

[100] *Supra* 2.1.1.

[101] Codice civile [C.c.] [Civil code], Mar. 16, 1942, Gazzetto Ufficiale [Gazz. Uff.] No. 79, Apr. 4, 1942 as amended, art. 2497.

[102] Code de commerce [C.com.] [Commercial code], Journal Officiel de la République Française [J.O.] [Official Gazette of France], June 22, 2000, art. L.225-251 (directors' liability in one tier *société anonyme* [SA]), art. L.225-256 (liability of management-board members in two-tier SA).

[103] C.com., art. L-246-2 extends directors' criminal liability to de facto directors, i.e. dominant shareholders.

[104] Code civile [C.civ.] [Civil code], art. 1382; on the construction of the specific rule *see* Court de cassation Chambre commercial [Cass. com.] [Supreme Court Commercial Chamber], 21 March, 123 Rev. Soc. 501 (2005), note *Bernard Saintourens*. As a consequence, C.com., art. R.225-169 that affords only collective standing to minority shareholders that possess at least 0.5% of the equity if the corporation has more than € 15 million capital outstanding—higher relative thresholds apply if the SA's capital is lower—does not govern.

insolvency.[105] English company law also subjects controlling shareholders—in their capacity as shadow directors[106]—to fiduciary duties (of loyalty)[107] and has recently invigorated minority shareholders' right to bring derivative actions.[108] Finally, it is noteworthy that the legal regime governing U.S. corporations registered in Delaware also falls into this category because dominant shareholders in principle are subject to a fiduciary duty of loyalty and thus—if sued in a derivative action—have to prove the entire fairness of any related party transaction they are involved in.[109] This burden of proof only shifts if the transaction was approved by an uncoerced and informed majority-of-the-minority vote.[110] The leading decision thus has to be read in a way that minority shareholder approval alone does never shield related party transactions (mergers) from a judicial fairness review, i.e. it does not alter the substantive standards of conduct.[111]

Quite importantly, even where individual shareholders can bring suit, the nonexistence of corporate class actions and the consequential absence of a plaintiffs' bar whose financial self-interest could drive litigation, substantially devaluates a duty-based system. The essential private enforcement mechanism hinges on individual cost-benefit-calculations that deviate from the social optimum.[112]

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[105] C.com, art. L 652-1.

[106] Companies Act 2006, 2006, ch. 46, § 251(1) defines the latter as "persons in accordance with whose directions or instructions the directors of the company are accustomed to act".

[107] The substantive duty is now codified in Companies Act 2006, 2006, ch. 46, § 172 which, however, does not merely repeat the common law standard, *cf.* PAUL L. DAVIES & SARAH E. WORTHINGTON, GOWER & DAVIES' PRINCIPLES OF MODERN COMPANY LAW 540-3 (9th ed., 2012). For a profound doctrinal analysis see John Lowry, *The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure*, 68 CAMBRIDGE L.J. 607-22 (2009).

[108] Companies Act 2006, §§ 260-269. The leading precedent of *Foss v Harbottle*, (1843) 67 Eng.Rep. 189 established a "proper plaintiff rule" that left minority shareholders *in grosso modo* without standing to sue. For a detailed policy analysis of the traditional rule *cf.* ARAD REISBERG, DERIVATIVE ACTIONS AND CORPORATE GOVERNANCE 88-120 (2007).

[109] *See already supra* note 10. For a discussion of the rule *cf. e.g.* Gilson & Gordon *supra* note 73, at 789-93.

[110] *Kahn v. Lynch Commc'n Sys.* (*Lynch I*), 638 A.2d 1110, 1117 (Del. 1994); see also *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 846 (Del. 1987); *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 937 (Del. 1985).

[111] Besides *Lynch see also Kahn v. Tremont Corp.*, 694 A.2d 422 (Del. 1997); *Emerald Partners v. Berlin*, 726 A.2d 1215 (Del. 1999); *Americas Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012). The Chancery Court time and again has deviated from this view, *cf. In re Wheelabrator Techs., Inc. S'holders Litig.*, 663 A.2d 1194, 1196 (Del. Ch. 1995) (ruling that the vote causes a duty of loyalty claim to be reviewed under the business judgment standard); very recently it held that the business judgment standard applies to a merger with the controlling shareholder if the transaction was approved by both an independent special board committee and a majority-of-the minority vote *In re MFS S'holders Litig.*, C.A. No. 6566-CS (Del. Ch. May 29, 2013). Yet, a closer reading of the case suggests that the court assumes an important role in reviewing the conduct of the special committee, which does not accord with the general hands-off deference under the business judgment rule. This observation implies that cases can't be dismissed on motions at early stages.

[112] For the standard analysis that compares different rules for recouping litigation costs cf. Kathryn E. Spier, *Litigation*, *in* HANDBOOK OF LAW AND ECONOMICS 259, 264-5 (A.

Notable differences among jurisdictions exist, when it comes to the institutional framework that allows minority shareholders to identify tainted related party transactions, the natural precondition for bringing actions to reverse any expropriation. Italian shareholders seem to be in the most comfortable position, because the annual management report mandated by C.c. art. 2428(1) has to contain key information on any management decisions induced by the controlling parent. In particular it serves as a means to disclose a detailed delineation of the reasons for taking the decision and a description of the interests that influenced decision taking.[113] Under just reformed French law,[114] minority shareholders receive a special audited report that delineates any non-routine related party transaction[115] that was approved by the competent administrative body of the corporation.[116] Quite importantly, recent amendments will bolster the significance of this report because boards will have to explain their motives for approving pertinent transactions with a view to their corporation's interest.[117] In light of these comprehensive disclosure requirements, it seems subordinate that disclosure of background information on related party transactions occurs also incidentally where controlling shareholders as (criminal) defendants invoke the safe harbor of the *Rozenblum*-doctrine.[118] The latter requires *inter alia* a showing that the transaction was in line with the "interest of the group", *i.e.* some assertions on its conditions and main motivations.[119] Delaware corporate law does not provide for any group-specific disclosure duties, but is complemented by reporting requirements under Federal securities laws and U.S. Generally Accepted Accounting Principles (GAAP).[120] Similarly, the generally far reaching disclosure du-

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Mitchell Polinsky & Steven Shavell eds., 2007). For an explanation of the situation with regard to shareholder derivative suits in Europe *see* Martin Gelter, *Why do Shareholder Derivative Suits Remain Rare in Continental Europe?*, 37 BROOKLYN J. INT'L L. 843 (2012). For enlightening and disenchanting empirical data on shareholder litigation in the U.K. see John Armour, Bernhard Black, Brian Cheffins & Richard Nolan, *Private Enforcement of Corporate Law: An Empirical Comparison on the US and UK*, 6. J. EMPIRICAL L. STUD. 687, 696-700 (2009) (observing that between 2004 and 2006 zero claims were brought against U.K company directors).

[113] C.c., art. 2497 ter.

[114] The amendments were promulgated in Ordonnance no 2014-863 du 31 juillet 2014 relative au droit des sociétés, prise en application de l'article 3 de la loi no 2014-1 du 2 janvier 2014 habilitant le Gouvernement à simplifier et sécuriser la vie des entreprises, J.O., Aug. 2, 2014, p. ■■■.

[115] The latter include those involving shareholders holding at least 10% of the voting rights, C.com, art. L. 225-38(1) (one tier SA); art. L. 225-86(1) (two tier SA).

[116] C.com., arts. L. 225-38 – L. 225-40-1 (one tier SA), arts. L. 225-86 – L. 225-88-1 (two tier SA). After the reform, the regime does no longer apply to transactions involving wholly owned affiliates, *cf.* C.com., art. L. 225-39 (one tier SA) and art. L. 225-87 (two tier SA) as amended.

[117] C.com., art. L. 225-38 (one tier SA) and art. L. 225-86 (two tier SA) as amended.

[118] Cour de cassation Chambre criminelle [Cass. crim.] [Supreme Court Criminal Chamber], 4 Feb., 1985, 103 REV. SOC. 648 (1985).

[119] *See also infra* 3.2.2.

[120] Any transaction with a value of more than USD 120.000 in which a shareholder who holds more than 5% of any class of securities that carry voting rights has a material interest has to be reported for the past fiscal year under SEC Regulation S-K, Item 404, 17 C.F.R. 229.404(a). According to Statement of Financial Accounting Standards (SFAS) 57,

ties covering related party transactions in English corporate law,[121] do not apply in the group context,[122] but comprehensive information is provided to the shareholders of a corporation that entertains a Premium Listing on the London Stock Exchange.[123] Finally, the codified German law on corporate groups seeks to bolster the duty-based accountability of dominant shareholders by prescribing that the management board of the controlled corporation draws-up a special report ("*Abhängigkeitsbericht*") that does not only specify any intra-group transaction but also any transaction or other activity that was induced by the controlling parent, AktG § 312.[124] The report is reviewed by both independent auditors, AktG § 313, and the supervisory board, AktG § 314(2)(1). However, only the overall assessments of the involved agents have to be disclosed to shareholders.[125] Hence, the byzantine reporting and auditing duties do little to help shareholders in identifying critical transactions that could be tackled with shareholder litigation.[126] Against this background, the right to information that individual shareholders can exercise in the general meeting, AktG § 131, largely remains a blunt tool, because its constructive use would require the prior identification of potentially foul transactions or activities.

3.1.2.2.2 EX ANTE SHAREHOLDER INVOLVEMENT

Although English company law also subjects controlling shareholders to substantive duties (of loyalty)[127] and in principle affords standing to individual shareholders,[128] it relies primarily on shareholder involvement as a check against rent-seeking where (horizontal) principal-agent-conflicts loom large.[129]

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annual disclosure encompasses any material transaction between the reporting entity and a controlling shareholder.

[121] *Cf.* Companies Act 2006, §§ 188-226.

[122] *Infra* note 131 and accompanying text.

[123] FIN. SERVS. AUTH., LISTING RULES, RULE 11.1.7(2) and (3) (2014).

[124] AktG § 312(1)(2) mandates that the report includes performance and consideration of the transactions, the advantages and disadvantages of the other activities and the reasons for engaging in them. AktG § 312(1)(3) requires reporting of any paid or pledged compensation for the disadvantages incurred.

[125] The assessment of the management board is part of annual financial reporting, AktG § 312(3). The auditor's final assessment is conveyed to the shareholder meeting in conjunction with the supervisory board's communication of its own results, AktG §§ 313(5), 314(2).

[126] It is one of the key criticisms of the German codified law on corporate groups that the special reporting system is both costly and largely ineffective due to its adamant secrecy, *e.g.* Wolfgang Zöllner, *Qualifizierte Konzernierung im Aktienrecht* [*Intensified Group Integration in Stock Corporation Law*], *in* GEDÄCHTNISSCHRIFT FÜR BRIGITTE KNOBBE-KEUK 369, 371 (Wolfgang Schön, ed., 2007). But see also Hommelhoff *supra* note 14 at G 23 (arguing that the system works well without shareholder litigation, because the controlled corporation's management can fend off disadvantageous influence by alluding to the reporting and auditing duties).

[127] *Supra* 3.1.2.2.1.

[128] *ibid.*

[129] It is indicative that Companies Act 2006, § 175(3) exempts self-dealing transactions from the substantive duty to avoid conflicts of interests and thus makes it utterly clear that other institutions of corporate law are invoked to avoid rent-seeking.

Under the Companies Act 2006 shareholder approval is required in non-routine substantial property (involving assets of more than GBP 100.000 in value) and loan transactions with "shadow directors".[130] Yet, a pivotal exemption is granted with a view to the parent company in a corporate group[131] which renders the provisions inapt to constrain controlling shareholders in the group context.[132] No such group privilege is conceded under the Financial Services Authority (FSA) Listing Rules. The latter require in pertinent part, that any material transaction[133] with *inter alia* a substantial shareholder[134] is approved or ratified by disinterested shareholders before it becomes legally binding and after its key features have been disclosed.[135]

In this important respect of *ex ante* shareholder involvement, the FSA Listing rules go much further than the French ratification requirement that allows shareholders only to resolve *ex post* on related party transactions that were approved by the competent administrative body of the corporation during the preceding 12 months.[136] The difference matters, because empirical findings suggest that a stringent regime of *ex ante* shareholder approval is a key component in constraining controlling shareholders' rent-seeking.[137]

3.1.3 Related party transactions in the proposed Revised Shareholder Rights Directive

Given the strong policy implications of these empirical observations, it is not entirely baffling that the European Commission picked up the ECGF proposal[138] and introduced a new rule in its proposal for a revised Shareholder Rights directive that would combine enhanced *ex ante* transparency of related party transactions with an independent fairness review and a mandatory disinterested shareholder approval requirement (*infra* 3.1.3.1). The contemplated rule raises several questions. They relate on the one hand to the disruptive effect a quite radical deviation from the traditional regulatory strategies would have in those jurisdictions that so far address the problems of corporate groups following alternative approaches. In this regard, Germany certainly finds itself in the front row with its codified group law, yet with the underlying concept of a standard based *ex post* accountability it is far from isolat-

[130] Companies Act 2006, §§ 190, 197, 223.

[131] Companies Act 2006, § 251(3).

[132] On the policy rationale behind such a group-exception in decision rights strategies *infra* 3.1.3.1.

[133] Fin. Servs. Auth., Listing Rules, Rule 11.1.10 (2014) relieves minor transactions from the approval requirement.

[134] The latter is defined in Fin. Servs. Auth., Listing Rules, Rule 11.1.4A (1) (2014) as any person controlling more than 10% of the votes at general meetings.

[135] Fin. Servs. Auth., Listing Rules, Rule 11.1.7(2) and (3) (2014).

[136] C.com., art. L. 225-40 (one tier SA) and C.com., art. L. 225-88 (two tier SA).

[137] Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing*, 88 J. Fin. Econ. 430, 447-9 (2008) (showing a statistically significant correlation between a high score on their ex ante private control of self-dealing index and stock-market development)

[138] *Supra* 2.2.3.

ed.[139] On the other hand, the general efficiency of shareholder involvement warrants scrutiny with a particular view to the typical characteristics of outside shareholders in European listed firms (*infra* 3.1.3.2).

3.1.3.1 Enhanced transparency and shareholder involvement under the proposal for a Revised Shareholder Rights Directive

The proposed Directive's definition of related party transactions[140] tallies with that of IAS 24(9).[141] In its substance the proposal follows a two-step approach that is limited in its scope in two important respects.

First, the proposal requires not only that related party transactions that represent more than 1% of the company's assets are publicly and comprehensibly announced at the time of their conclusion but also that their conformity with market terms and their fairness and reasonableness *vis-à-vis* (minority) shareholders is assessed by an independent third party whose report has to accompany the public announcement.[142] Member States may provide that the latter requirement to obtain and publish an independent third-party assessment can be waived by the company's disinterested shareholders for a period of up to 12 months with regard to clearly specified recurring standard transactions.[143]

Second the proposed rule requires related party transactions that represent more than 5% of the company's assets[144] or potentially impact significantly on the company's profits or turnover to be submitted to a vote of disinterested shareholders in the general meeting prior to their binding conclusion.[145] Once again, Member States may provide for loosened preconditions regarding clearly specified, recurring standard transactions within a 12 months period: Member States' corporate law may allow that these transactions are approved in advance by disinterested shareholders.[146]

The scope of the proposed rule will be limited to European corporations whose shares are admitted to trading on a regulated market that is situated or operates within the E.U. This follows from the Commission's intention to promulgate the rule as an amendment to the Shareholder Rights Directive.[147] This approach is com-

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[139] *Supra* 3.1.2.2.1.

[140] *Proposal Revised Shareholder Rights Directive*, art. 2(j).

[141] *Supra* note 98 and accompanying text.

[142] *Proposal Revised Shareholder Rights Directive*, art. 9c(1) subpara. 1.

[143] *Proposal Revised Shareholder Rights Directive*, art. 9c(1) subpara. 2.

[144] In order to prevent a circumvention of the rule by artificially splitting up transactions, those that occur with the same related party during a period of 12 months are aggregated in calculating the 5% threshold, *Proposal Revised Shareholder Rights Directive*, art. 9c(3).

[145] *Proposal Revised Shareholder Rights Directive*, art. 9c(2) subpara. 1.

[146] *Proposal Revised Shareholder Rights Directive*, art. 9c(2) subpara. 2.

[147] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies [hereinafter: Shareholder Rights Directive], art. 1(1), 2007 O.J. (L 184) 17.

prehensible as a consequence of limited legislative competences,[148] but is not immediately intuitive on the merits. If, as the Commission presumes, heightened transparency, outside review and particularly shareholder approval requirements constituted indeed an eligible route to less tunneling in related party transactions, this confinement seems unfortunate for two reasons. First, public corporations with a dominant shareholder are arguably becoming increasingly rare animals in the European corporate landscape, because both the mandatory bid rule and the accompanying squeeze out and appraisal rights[149] work in favor of going private transactions after the consummation of takeovers and mergers. Second, the rationale of the shareholder decision rights strategy[150] is not limited to public corporations. To the contrary, in privately held firms where viable exit options frequently don't exist, there may be a dire need for voice.[151]

Furthermore and arguably even more doubtful with regard to the fundamental policy rationale behind the Commission's decision rights strategy, Member States can exempt transactions with wholly-owned subsidiaries from all the requirements outlined above.[152] The relief-option that allows for a restricted version of the English exemption in the Companies Act 2006[153] in Member States' laws may make life considerably easier for large corporate groups that aim at integrating a host of wholly owned subsidiaries tightly.[154] Yet, it also rips a huge hole in the scope of application of the general rule that fundamentally calls its efficacy in the group context into question. This is all the more problematic, as the proposed rule stipulates that routine intra-group transactions can be authorized in general for a period of 12 months.[155] Hence, it already serves the legitimate interests a parent has in facilitating an efficiency enhancing centralized group management.[156] Certainly, the proposed rule is a mechanism to protect the interests of minority shareholders not those of creditors.[157] In fact, a shareholder vote may do nothing to cure the principal-agent

[148] The legal basis for the Directive can be found in TFEU arts. 50(2)(g), 114. The Commission delineates the harmonization goal it pursues in pertinent respect with a particular view to E.U. firms' transnational investor base and thus perceives the principle of subsidiarity as limiting legitimate supranational intervention to firms that attract these types of investors through public capital markets*, cf. Proposal Revised Shareholder Rights Directive, Explanatory Memorandum*, at 6.

[149] *Supra* 2.2.2.

[150] For a taxonomy of governance strategies that react to agency problems *cf.* Armour, Hansmann & Kraakman *supra* note 4 at 42.

[151] The catch phrase follows the seminal analysis of ALBERT O. HIRSHMAN, EXIT, VOICE, AND LOYALTY (1970). For the typical situation in a closed corporation *cf.* GREGOR BACHMANN, HORST EIDENMÜLLER, ANDREAS ENGERT, HOLGER FLEISCHER & WOLFGANG SCHÖN, REGULATING THE CLOSED CORPORATION 35 (2013).

[152] *Proposal Revised Shareholder Rights Directive*, art. 9c (4). The exemption is mirrored also in just reformed French law within the alternative regime of *ex post* shareholder resolutions on board approved related party transactions, *supra* note 116.

[153] *Supra* 3.1.2.2.2.

[154] *Cf. supra* note 2.

[155] *Supra* note 146 and accompanying text and *infra* 3.1.3.2.1.

[156] It is far from clear why putting non-standard transactions up for a specific shareholder vote at the parent level would impede efficient group integration across the board.

[157] It is an important empirical observation that voluntary (adjusting) creditors can and indeed do fend for themselves against equity-holders' incentives to shift assets within

conflict between equity and debt,[158] because shareholders (residual claimants) face incentives as a class to speculate at the expense of creditors with fixed interest and redemption claims.[159] Yet, it is precisely the interest of minority shareholders at the parent level that militates in favor of a vote also on transactions that involve wholly owned subsidiaries. If the latter were exempt from any approval requirements without qualification, controlling shareholders could happily stick to their tunneling habits. In a first step they would simply induce the corporation's management to shift those significant assets they wish to misappropriate to the wholly owned affiliate. In a second step controlling shareholders would induce the subsidiary's management—that will certainly be responsive to the group's ultimate center of power—to engage in the actual tunneling transaction. Where the envisaged exception for wholly owned subsidiaries applies and the approval requirement is limited to listed corporations, neither step requires minority shareholder involvement, *i.e.* the decision rights strategy could be easily thwarted.[160]

The described loophole results from both the IAS definition of related party transactions that the proposal incorporates[161] and the wording of the pertinent rule on related party transactions itself. Under IAS reporting obligations a related party transaction has to involve the (direct) transfer of resources from the reporting entity to the related party.[162] According to IAS 24(19) disclosure has to be separate with regard to the type of group affiliates involved, i.e. "parent" and "subsidiaries" constitute different "categories". Hence, transactions between the parent's controlling shareholder and the subsidiary do not represent reportable transactions of the parent, although they have to be reported in its consolidated accounts. Quite importantly, the proposed Revised Shareholder Rights Directive only incorporates the IAS definition of related party transactions; it doesn't dwell on the pertinent reporting obligations as such. Moreover, the proposal only governs transactions that cov-

the group to the detriment of creditors (*cf.* Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589, 622 (1975)) by demanding intra-group guarantees, Richard A. Squire, *Strategic Liability in the Corporate Group*, 78 U. CHI. L. REV. 605, 606 note 2 (2011).

[158] *Supra* note 5.

[159] Recent empirical research on the financial crisis corroborates the theory. In particular, strong evidence suggests that certain tools of equity governance are indeed apt to align managerial and shareholder interests to enhance volatility to the detriment of debtholders and/or tax payers, Rüdiger Fahlenbach & René Stulz, *Bank CEO Incentives and the Credit Crisis*, 99 J. FIN. ECON. 11 (2011) (showing that banks in which managerial incentives were closely aligned with shareholders' general objective function through high powered incentive compensation fared worse during the crisis); Luc Laeven & Ross Levine, *Bank Governance, Regulation and Risk Taking*, 93 J. FIN. ECON. 259 (2009) (finding a stronger risk appetite in banks in which shareholders had stronger influence on firm governance).

[160] The danger of this type of indirect tunneling transactions was recently recognized in principle by French law. The pertinent rules now mandate that transactions between subsidiaries in which the parent directly or indirectly holds a majority stake and—*inter alia*—significant shareholders of the parent (holding at least 10% of the voting rights) have to be disclosed to the parent's shareholders, C.com. art. 225-102-1(13).

[161] *Supra* note 140.

[162] *Cf.* IAS 24(9) para. 3: "A related party transaction is a transfer of resources, services or obligations between a *reporting entity* and a related party…" (emphasis added).

ered companies[163] themselves conclude with related parties which further clarifies that the parent has to be directly involved in the transaction.[164] Thus, transactions between the subsidiary and controlling shareholder do not require approval on the parent level.

3.1.3.2 Evaluation

Apart from the proposed rule's internal design flaws, an assessment of its merits and shortcomings has to deal with the observation that the legal transplant may encroach massively on pre-existing institutions of corporate law that also constrain controlling blockholders' latitude to disadvantage minority shareholders in intra-group transactions but follow disparate approaches.[165] Furthermore, the particularities of Member States' corporate law environment may be such that the rule creates higher costs in some jurisdictions than it does in others. On the other hand, a construction of the rule that is more hospitable to Member States' idiosyncrasies risks compromising the rule's effectiveness and contradicts the Directive's harmonization goal (*infra* 3.1.3.2.1). More generally, however, the rule rests on a contestable presumption of outside shareholders' willingness and capacity to serve as effective counterweights to detrimental influence of controlling shareholders when vested with a right to vote on potentially tainted transactions (*infra* 3.1.3.2.2).

3.1.3.2.1 TRANSPLANT AND ANATOMY: THE RULE'S EFFECT IN AN ENVIRONMENT WITH PARALELL INSTITUTIONS IN NATIONAL CORPORATE LAWS

As delineated,[166] the proposed rule applies to listed firms for which calling a shareholder meeting to affirm significant transactions of the corporation with its dominant shareholder is particularly expensive. The (welcome) pre-effect of the rule thus can be seen in decreasing (horizontal) agency costs by limiting the scope and the frequency of blockholders' self-dealing transactions that pass a certain threshold in magnitude. A comparison with—usually much higher—threshold values, the excess of which would precipitate a shareholder vote on management's business decisions under Member States' corporate law, is misguided insofar as the pertinent doctrine seeks to address vertical principal agent conflicts between managers and (dispersed) shareholders. This is particularly true for the German "*Holzmüller*"-rule, named after the leading case,[167] which primarily aims at curbing managerial self-

[163] Shareholder Rights Directive, art. 1(1).

[164] *Proposal Revised Shareholder Rights Directive*, art. 9c(2) reads "Member States shall insure that transactions with related parties representing more than 5% *of the companies'* assets…" (emphasis added).

[165] *Supra* 3.1.2.2. For a general overview *see also Reflection Group Report supra* note 61, at 59-60; EMCA *supra* note 12, at 3-4.

[166] *Supra* 3.1.3.1.

[167] BGH Feb. 25, 1982 BGHZ 83, 122. The precedent was later confirmed and refined as to apply only to transactions involving approximately 80% of the corporation's assets, BGH Apr. 24, 2006 BGHZ 159, 30 (para 48); for a detailed description of the doctrine *cf.* Marc Löbbe, *Corporate Groups: Competences of the Shareholders' Meeting and Minority*

empowerment that occurs when a corporation's key activities are shifted to wholly owned subsidiaries. In these scenarios, the parent's managers—as representatives of the sole equityholder—can administer all shareholder rights and thus execute transactions at their own discretion even if they required a shareholder vote if they were conducted in an integrated corporation.

Naturally, the aspired decrease in horizontal agency costs comes at the price of increasing the administrative costs of hierarchy,[168] i.e. the centrally planned allocation of resources within the group.[169] The latter will require either engaging the general meeting more frequently in intra-group dealings or managing the group in a more decentralized manner. Yet, the general burden should also not be overestimated, particularly if Member States and their courts make sensible use of the option to relieve standard transactions that do not by themselves raise the suspicion of tunneling from the requirement of individual ad hoc approval and allow for a general annual assent *ex ante* instead (*e.g.* the controlled corporation's integration in a group-wide system of cash-management).[170] With this possibility, efficiency enhancing transactions can (and will) be rubber-stamped at the general shareholder meeting each year, however not without devoting some resources to convincing a majority of informed shareholders that the transactions indeed create no danger of controlling shareholder rent-seeking.

Yet, the underlying fundamental assumption of the proposed rule is that a consenting shareholder resolution at the general meeting is readily achievable if warranted on the merits, *i.e.* that shareholder voting works frictionless and is not fraught with its own problems. Yet, it is precisely this supposition that does not hold in the context of German corporate law, where shareholder resolutions can be voided by an action that any individual shareholder can bring regardless of a quorum[171] and where a class of shareholders deliberately exploits the hold-up position the regime creates.[172] Clearly, in this context, any approval requirement for intra-group

Protection - The German Federal Court of Justice' Recent Gelatine and Macrotron Cases Redefine the Holzmüller Doctrine, 5 GERMAN L.J. 1057 (2004). English translations of both judgments are printed in ANDREAS CAHN & DAVID C. DONALD, COMPARATIVE COMPANY LAW 695-721 (2010).

[168] *Supra* note 46 & 47.

[169] On the efficiency rationales for this intermediate form of resource allocation *see infra* 3.2.1.

[170] *Supra* 3.1.3.1.

[171] AktG §§ 243, 245, 246. For a concise description of the German regime *cf.* CAHN & DONALD *supra* note 167 at 605.

[172] For a brief account of these so-called predatory shareholders' business model *cf.* CAHN & DONALD *supra* note 167 at 606; Markus Roth, *Corporate Boards in Germany, in* CORPORATE BOARDS IN LAW AND PRACTICE: A COMPARATIVE ANALYSIS IN EUROPE, 253, 348 (Paul Davies, Klaus J. Hopt, Richard Nowak & Gerard van Solinge eds., 2013). For empirical analyses of the persistent significance of the phenomenon *see* Theodor Baums, Astrid Keinath & Daniel Gajek, *Fortschritte bei Klagen gegen Hauptversammlungsbeschlüsse? Eine empirische Studie* [*Progress with Suits against Shareholder Resolutions? An Empirical Analysis*], 27 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1629 (2007); Theodor Baums, Florian Drinhausen, Astrid Keinath, *Anfechtungsklagen und Freigabeverfahren. Eine empirische Studie* [*Action of Voidance and Release Procedure. An Empirical Analysis*], 32 ZIP 2329 (2011).

transactions inevitably created uncertainty for the centralized management of the group as soon as an action of voidance is pending. It thus produced both a new field of activity for shareholders of the type just described and—as a consequence—a full-grown specter for corporate counsel.[173] Yet, these problems seem idiosyncratic and thus should rather stimulate the German legislature to fix the broken system of shareholder avoidance suits in its entirety,[174] instead of opposing an institutional arrangement for incongruent reasons if it was efficient in principle.[175]

Moreover, the proposed rule's effect depends critically on the consequences that attach when the approval requirement is violated. If the transaction is effectively barred from going forward before it is validly approved by a general or specific shareholder resolution, the disruptive effect of the proposal is substantially more severe than it would be if the transaction could still be executed as scheduled. The former result is favored in English law where an unapproved related party transaction is voidable,[176] unless it is ratified by shareholders *ex post*.[177] Yet, this rule, that is rooted in the *common law* of director's dealings and agency,[178] is by no means intrinsically tied to the idea of majority-of-the-minority votes as illustrated by Delaware law where disinterested shareholder approval only shifts the burden of proof in shareholder derivative actions.[179]

If it was indeed a sanction of the latter type that attached to executing significant related party transactions without prior shareholder consent, the proposed European rule could be easily integrated into those regimes that pin their hopes in minimizing the private benefits of control on standard based liability *ex post*[180] For instance, the lack of shareholder approval could figure as a factor in determining the "detrimental effect" under AktG § 311(1)[181] or the abuse of majority power under French and Italian law.[182] To this effect, the approval could establish a statutory assumption that the transaction's terms are fair and just. It would thus shift the burden of proof similar to Delaware law.[183]

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[173] *See for instance* the critique of one of Germany's leading attorneys in the field in a daily paper, Nikolaos Paschos, *Aktionäre sollen Managergehalt deckeln* [*Shareholders Shall Put a Lid on Executive Remuneration*], FRANKFURTER ALLGEMEINE ZEITUNG, March 19, 2014, at 16.

[174] Full-fledged proposals have been produced by expert groups and could serve as a template or at least as a starting point for comprehensive law reform, e.g. Arbeitskreis Beschlussmängelrecht, *Vorschlag zur Neufassung der Vorschriften des Aktiengesetzes über Beschlussmängel* [*Proposal for a Revision of the Provisions of the Stock Corporation Act on Deficient Resolutions*], 53 DIE AKTIENGESELLSCHAFT [AG] 617 (2008).

[175] On the latter point *see infra* 3.1.3.2.2.

[176] Companies Act 2006, §§ 195(2), 213(2).

[177] Companies Act 2006, §§ 196, 214.

[178] *Cf.* Aberdeen Railway Co. v. Blaikie Bros, (1854) 1 Macq. H.L. 461, 471-2, H.L. Sc.

[179] *Supra* 3.1.2.2.1.

[180] *Supra* 3.1.2.2.1.

[181] *Supra* 2.1.1.

[182] *Supra* note 9.

[183] *Supra* 3.1.2.2.1 at note 110.

Yet, although the Commission proposal leaves discretion to Member States in determining the sanctions for infringements of the substantive duties outlined in the Directive, the latter approach would arguably not provide for the effective, proportionate and dissuasive penalties E.U. law calls for.[184] Hence, when the Directive explicitly proscribes that the company concludes the transaction before shareholders approved it,[185] respecting the shareholder competence has to be understood as a precondition for the transaction's validity.[186] Any other interpretation would dramatically modify the harmonization goal of the proposal, because Member States could simply cling to their discrete regimes and transnational investors would be left with more or less the same variety of institutions supposed to safeguard their interests (with questionable effectiveness).

To be sure, the proposal's regime for related party transactions with dominant shareholders thus constitutes an encompassing regulation. Yet, it does not automatically compel Member States to scrap their parallel rules that adhere to different regulatory strategies, which is all the more true as the scope of the proposed rule is considerably limited[187] and thus demands complementing regulation. However, it should not be overlooked that extensive sets of rules, like the codified German law on corporate groups based on share-ownership (AktG §§ 311 et seq.) seem somewhat redundant against the new regulatory background. This is particularly true because they were initially promulgated by the national legislature with the intention to completely medicate the substantive problems of minority protection. The implementation of the Directive should be a good point in time to revisit the expedience of these national regimes in light of the precise overlaps between the new supranational and the traditional domestic rules.[188]

3.1.3.2.2 INFORMED VOTING IN THE AGE OF INSTITUTIONAL INVESTORS AND PROXY ADVISORS

The prior analysis of the proposed disinterested shareholder approval requirement was mostly concerned with how a consistent implementation of the regulatory strategy that underpins the proposed rule could be achieved. A more fundamental critique looks at the rule's tacit assumption that outside shareholders' are willing and capable to serve as effective counterweights to the detrimental influence

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[184] *Cf. Proposal Revised Shareholder Rights Directive*, art. 14b.

[185] *Proposal Revised Shareholder Rights Directive*, art. 9(2) subpara. (1)(3).

[186] This is not natural from the perspective of jurisdictions where infringement of shareholder approval requirements do not entail that the corporation's representatives act *ultra vires*, *cf. for instance* the German *Holzmüller*-doctrine that upholds the transaction despite the violation of shareholder approval requirements, BGH Feb. 25, 1982 BGHZ 83, 122 (132).

[187] *Supra* 3.1.3.1.

[188] The latter may prove less extensive then one might initially assume where Member States use the option to generally exempt transactions with wholly owned subsidiaries from the Directive's requirements, *supra* 3.1.3.1. For a German perspective cf. Tim Drygala, *Europäisches Konzernrecht: Gruppeninteresse und Related Party Transactions* [*European Corporate Group Law: Group Interest and Related Party Transactions*], 58 DIE AKTIENGESELLSCHAFT 198, 206-10 (2013).

of controlling shareholders when vested with a right to vote on potentially tainted transactions. To be sure, the query is not solved by a simple reference to rational shareholder apathy.[189] Even though the arrival of institutional investors as the dominant, at the margin more concentrated shareholder base of large public firms did not fundamentally change the equation,[190] a more granular look at institutional investor microstructure seems warranted. Mutual fund and pension fund managers typically have no incentive to either develop the skills or employ the tools for effective firm level monitoring, because they are evaluated in relative terms. Hence, they cannot get ahead of their peers by improving the performance of large public firms who are also part of their competitors' portfolio. To the contrary they would in fact lose out against them because they would have to bear the full costs of activism but share the (probabilistic) benefits of successful interventions with all passive rivals who could free-ride on their efforts.[191] As a consequence, rational shareholder passivity extends to the vast majority of institutional investors whose key competence lies in risk-taking through portfolio construction. On the other hand, those institutional investors that specialize in firm level monitoring typically do not rely on voting at the targeted firms' general meetings.[192] Moreover, their public relations centered strategies that aim at orchestrating a shareholder majority against management[193] do not function well in the presence of a controlling blockholder.

Given this environment, an increase in shareholder decision rights may not be the appropriate strategy to curb private benefits of control because it would not necessarily lead to an informed assessment of the critical transactions. To be sure, rationally passive institutional investors could rely heavily on the voting recommendations of proxy advisors, particularly so where they are pushed to exercising their voting rights.[194] Ultimately, the system then depends on the skills and competences

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[189] The basic phenomenon was already described in ADAM SMITH, AN INQUIRY INTO THE WEALTH OF NATIONS 741 (1776) and is present where the costs to (dispersed) shareholders of actively engaging in firm-level monitoring exceed the (probabilistic) benefits that would accrue from its success.

[190] For early, somewhat more optimistic accounts see e.g. Bernhard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992); John C. Coffee, Jr., *Liquidity versus Control: The Institutional Investor as a Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered* 93 COLUM. L. REV. 795 (1993); but see also Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L. J. 445-506 (1991).

[191] Ronald J. Gilson and Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 889-95 (2013).

[192] For the preferred strategies of activist hedge funds *cf.* Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1029-42 (2007).

[193] This holds true even where activist investors target firms with significant blockholdings, *cf.* e.g. Sam Jones, *TCI hedge fund ups pressure on EADS over Dassault Aviation stake*, FIN. TIMES ONLINE, Sep. 16, 2013, http://www.ft.com/cms/s/0/df75c07c-1eba-11e3-b80b-00144feab7de.html (reporting that a TCI, a hedge fund, was trying to forge alliances with shareholders in EADS to compel the sale of a business unit)

[194] The U.K. Stewardship Code which applies on a comply or explain basis stipulates that institutional investors have "a clear policy on voting and disclosure of voting activity"

of these players.[195] Yet, given the business model of these firms and their fee structure that both depend on achieving economies of scale,[196] it remains at least doubtful whether they will be in a position to adequately scrutinize the critical, non-routine related party transactions even though candid disclosure and outside fairness assessments facilitate the challenge.[197] The advisability of the Commission's general strategy to curb tunneling through self-dealing transactions of controlling shareholders—and rent-seeking by related parties in general—obviously hinges on dispelling these doubts.

3.2 Facilitating efficient group integration

While the Commission's favored regulatory strategy *vis-à-vis* related party transactions represents a rather extemporaneous initiative,[198] the second area of current European harmonization efforts in the law of corporate groups follows a consistent thread that starts with the Forum Europaeum Corporate Group Law and was persistently endorsed in all expert groups' recommendations ever since.[199] The general idea is that supranational legislation has to tackle impediments to efficiency enhancing group-integration that result from legal fragmentation within the Common Market. Yet, if the Commission took up the proposals its initiative would not stop there but go much further, because the recommendations identify a need to modify the protection of corporate stakeholders in order to facilitate group integration (*infra* 3.2.1). The envisioned recognition of an overriding group interest would bring about a rule that goes even further than the right of the single shareholder of a *SUP* in the

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which is understood as an obligation to vote all shares held, Financial Reporting Council, *The U.K. Stewardship Code, Principle 6* (Sep. 2012).

[195] For an influential account of (U.S.) proxy advisors' momentum in corporate governance *see* Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 Del. J. Corp. L. 673, 688 (2005). For more nuanced empirical surveys *see* Stephen Choi, Jill E. Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 Emory L. J. 869 (2010) (showing recommendations from Institutional Shareholder Services (ISS) to vote against management proposals to result in 6% to 13% lower approval rates compared to outcomes with positive recommendations); Michael C. Schouten, *Do Institutional Investors Follow Proxy Advisors Blindly?* 11-31 (Duisenberg School of Fin. Working Paper, 2012), available at http://ssrn.com/abstract=1978343 (surveying four large European mutual funds and showing a correlation between the voting decision's impact on portfolio performance and investors' propensity to verify the accuracy of and deviate from proxy advisors' recommendations).

[196] For a description of the (European) market for proxy advisors *cf.* Holger Fleischer, *Proxy Advisors in Europe: Reform Proposals and Regulatory Strategies*, 9 Eur. Comp. L. 12, 13-15 (2012); Lars Klöhn & Philip Schwarz, *The Regulation of Proxy Advisors*, 8 Capital Mkts L.J. 90, 91-94 (2013); for the similar picture in the U.S. *see* Colin Diamond & Irina Yevmenenko, *Who Is Overseeing the Proxy Advisors?*, 3 Bloomberg Corp. L.J. 606, 608 (2008).

[197] For a bleak account on how proxy advisors develop their voting recommendations *cf.* David F. Larcker, Allan L. McCall & Brian Tayan, *And Then a Miracle Happens!: How Do Proxy Advisory Firms Develop Their Voting Recommendations* (Rock Center for Corp. Gov. Research Paper No. 31, 2013), *available at* http://ssrn.com/abstract=2224329.

[198] None of the expert groups in their detailed reports had recommended the approach which came on the regulatory agenda only through the ECGF, *supra* 2.2.1.2 and 2.2.3.

[199] *Supra* . 2.2.1.2.

proposal for a European Single Member Limited Liability Company (*infra* 3.2.2). Despite the ostensibly broad consensus for the pursued policy, it can be questioned on efficiency grounds (*infra* 3.2.3).

3.2.1 Efficiency gains from group-integration and law's relevance in the Common Market

Research on the theory of the firm delineates that and how group integration of separate legal entities can enhance efficiency (*infra* 3.2.1.1). Against this background, legal fragmentation may hinder socially desirable centralization in transnational groups and thus provides a policy rationale for supranational legislative intervention (*infra* 3.2.1.2).

3.2.1.1 Group integration and (transaction cost) theory of the firm

From the perspective of transaction cost economics, corporate groups represent an intermediate form to coordinate the allocation of resources in production that resides between conscious planning within a fully integrated enterprise and the unfettered reliance on the price mechanism in spontaneous market transactions.[200] In this view, corporate groups minimize transaction costs by combining closer integration (hierarchy) with retained legal entity independence. They separate profit centers with limited liability[201] that also enjoy some degree of organizational autonomy. Given that the positive welfare effect of asset partitioning within a group is questionable in practice,[202] it becomes all the more important that firms can actually reap the benefits of the hierarchy/market-combination. In other words that they are actually able to achieve the desirable degree of centralization, particularly in strategic management (not necessarily in operational management).

3.2.1.2 Undoing inefficient legal fragmentation in the Common Market and one step beyond: recognition of the interest of the group

Where groups operate across jurisdictions within the Common Market, Member States' diverging corporate laws may inhibit an efficient integration of the group's affiliates. In this spirit, the Commission—following the Reflection Group's

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[200] *Supra* note 46 & 47.

[201] By creating subsidiaries, a firm can reserve assets for specific activities and risks, *see* Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. Chi. L. Rev. 499 (1976). The efficiency enhancing effect follows from a group-specific extension of the fundamental idea of affirmative asset partitioning through organizational law. This theory posits that risk evaluation and monitoring is easier for creditors where they can lend against a discrete pool of assets that is reserved for their claims, Henry Hansmann & Reinier H. Kraakman, *The Essential Role of Organizational Law*, 110 Yale L.J. 387 (2000), Henry Hansmann, Reinier H. Kraakman & Richard D. Squire, *Law and the Rise of the Firm*, 119 Harv. L. Rev. 1333 (2006).

[202] For a verification of Posner's hypothesis with a view to corporate practice *see* Squire *supra* note 157, at 611-21 (finding strong correlations between the insolvency risks of group affiliates as a consequence of intra-group guarantees).

thorough comparative legal and policy analysis[203]—identified excessive legal impediments to efficient group integration where Member States' corporate laws safeguard the subsidiaries' "self interest".[204] Critical areas where a legally bolstered status of subsidiaries as autonomous entities may impede efficient group integration are easy to identify, for instance where parents seek to establish group-wide compliance and risk-management organizations,[205] cash-management facilities based on intra-group loans, or a concentration of R&D activities.

To be sure, the problem of fragmentation as such—where it cannot be tackled by allowing for choice of law and regulatory competition[206]—could be addressed by simply streamlining national corporate laws in pertinent respect, *i.e.* by supranational harmonization as such. Yet, the Reflection Group and—should it ultimately decide to follow in the Group's footsteps[207]—the Commission intend to go beyond mere approximation of national laws and seek to cut back some of the protection thus far afforded in Member States' corporate law to vulnerable corporate constituents in the group context. To be specific, the adequate regulatory strategy to facilitate efficient group integration is seen—at least in the more granular recommendation of the Reflection Group[208]—in the recognition of the interest of the group as a legitimate and potentially overriding determinant in managerial decision making. This could, in its strongest form translate into both a right and a duty of the parent (and its directors) to manage the firm in accordance with the group interest.[209] Furthermore, the directors of the subsidiaries would have the right (or even the duty) to take the interest of the group into account when managing "their" corporation (safe harbor).[210] The latter means that corporate managers could dismiss those duties in general corporate

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[203] *Reflection Group Report supra* note 61 at 60-65.

[204] *2012 Action Plan*, *supra* note 17, at 14-5 (para 4.6).

[205] The latter are mandatory for banks, *cf.* Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance, art. 109(2), 2013 O.J. (L 176) 338.

[206] The freedom of establishment as granted by TFEU art. 56 in principle would allow the parent of a corporate group to organize all its E.U. subsidiaries under the same Member State's corporate law. For a recent analysis of the actual European situation *cf.* Wolf Georg Ringe, *Corporate Mobility in the European Union – a Flash in the Pan?* 10 Eur. Company & Fin. L. Rev. 230, 232-46 (2013); for earlier studies *see* John Armour, *Who Should Make Corporate Law? EC Legislation Versus Regulatory Competition*, 58 CURRENT LEGAL PROBS. 369 (2005); Luca Enriques, *EC Company Law and the Fears of a European Delaware*, 15 EUR. BUS. L. REV. 1259 (2004); Martin Gelter, *The Structure of Regulatory Competition in European Corporate Law*, 5 J. CORP. L. STUDIES 247 (2005); *Tobias H. Tröger*, *Choice of Jurisdiction in European Corporate Law*, 6 EUR. BUS. ORG. L. REV. 3 (2005).

[207] *See supra* note 84 and accompanying text.

[208] *Reflection Group Report supra* note 61, at 60-65.

[209] This strong-from duty of the parent's management to direct the group in an integrating manner remained controversial among the members of the Reflection Group, *cf.* *Reflection Group Report supra* note 61, at 60; see also Conac *supra* note 83, at 221 (speculating that the issue might not be addressed on the European level). It obviously traces back to concepts advanced in the German literature, *cf.* PETER HOMMELHOFF, DIE KONZERNLEITUNGSPFLICHT [THE DUTY TO DIRECT THE GROUP] 43-6, 165-7, 184 (1982).

[210] *Reflection Group Report supra* note 61, at 60.

law that mandate the preservation of the corporation's "self-interest" as a proxy for the interests of all shareholders or all constituents.

It is true but also mundane that such a European rule would provide legal certainty for executives at all levels of the group if they discharge their duties with a view to the "greater good", because the safe harbor by its very nature would avert both civil as well as criminal liability.[211] It is further true that the rule would allow the uniform implementation of a group strategy in transnational groups[212] and would thus align the law with reality. Yet, the question remains whether these results are desirable from the policy maker's point of view. Seen from another perspective, managing subsidiaries in the interest of a group despite the existence of (defunct) institutions to protect minority shareholders and creditors, may well be understood as the consumption of private benefits of control that the Commission rightfully seeks to curb so vigorously.[213] Still, a more precise response to the pivotal policy question has to look at the likely preconditions under which the recognition of the group interest would be effected in European law.

3.2.2 PRECONDITIONS OF THE SAFE HARBOR AND THE PROPOSAL FOR THE *SOCIETAS UNIUS PERSONAE*

The Reflection Group[214] shows some fondness of the French *Rozenblum* doctrine—and its close relatives in other legal systems—which creates a safe harbor in criminal actions where a controlling shareholder is charged with an abuse of corporate assets.[215] Apart from the prerequisites pertaining to the close structural integration of the group, this "group defense" requires that the burden a disadvantaged group member has to carry is both offset on balance by positive effects associated with the group affiliation and does not threaten the subsidiary's solvency.[216] The generalized idea of letting an overall economic *quid pro quo* suffice for the defense not only in criminal but also in private actions[217] deviates, at least on the books, quite sharply from those standard based systems that require an immediate or deferred, but assessable compensation for each and every individual up-front disadvantage the controlled corporation incurs.[218]

[211] *Reflection Group Report supra* note 61, at 60 denotes this observation as a "major advantage of the rule".

[212] The cost saving effect of uniform rules (cf. *Reflection Group Report supra* note 61, at 61) does not hinge critically on the rule's content, while their other social welfare effects certainly do.

[213] *Supra* 3.1.

[214] *Reflection Group Report supra* note 61, at 62-3.

[215] The criminal offense of *abus des biens sociaux*, C. com., art. L. 242-6, can also be committed by shadow directors (*dirigeant de fait*), C. com, art. L. 246-2.

[216] Cass. Crim., 4 Feb., 1985, 103 Rev. Soc. 648 (1985). For a brief description of the doctrine *see* Conac, Enriques & Gelter, *supra* note 8, at 519-20; for an in depth analysis *cf.* Marie-Emma Boursier, *Le Fait Justificatif de Groupe dans l'Abus de Biens Sociaux: Entre Efficacité et Clandestinité* [*The Group Excuse in the Abuse of Corporate Assets: Between Effectiveness and Clandestineness*], 113 REV. SOC. 273 (2005).

[217] *Reflection Group Report supra* note 61, at 60.

[218] *Supra* 3.1.2.2.1.

Although the Reflection Group does not consider the concept intrinsically limited to wholly owned subsidiaries,[219] it implicitly recognizes the particularly delicate position of creditors who stand to suffer when disadvantages inflicted on their debtor have to be compensated only at some indeterminate point in the future. It thus contemplates whether the safe harbor should be closed in the vicinity of insolvency.[220] The distinction is palpably informed by Delaware law that recognizes a shift in the reference for directors' duties in the vicinity of insolvency from shareholder interests to those of creditors.[221] Yet, the principle has proved hard to translate into operational law.[222]

However, the flipside of the withdrawal of the safe harbor near bankruptcy clearly is that the rule in normal times also serves to modify institutions designed to protect creditors. Without a mature legislative proposal it remains a speculative question whether this consequence of the recognition of the group interest has wider ramifications: is it apt to derogate or delimit other institutions of creditor protection if the latter is not instituted through directors' duties? It is noteworthy in this respect, that the proposal for a Single Member Limited Liability Company in which controlling shareholder influence naturally impacts only on creditor interests contains no hint into this direction. In fact, the single shareholder's right to instruct the management body is strictly bound to the applicable national and—it has to be added—supranational law.[223] As a consequence, the proposed Directive in its current shape does not recognize an overriding interest of the group.[224] Instead it is content with clarifying that the parent may direct the subsidiary without relocating its real seat.

3.2.3 Assessment

[219] *Reflection Group Report supra* note 61, at 61; see also Conac *supra* note 83, at 221-5.

[220] *Reflection Group Report supra* note 61, at 64. For a discussion of the issues see also Conac *supra* note 83, at 220-1.

[221] Crédit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., C.A. No. 12150, 1991 WL. 277613 (Del. Ch. Dec. 30, 1991); North American Catholic Educational Programming Foundation v. Gheewalla, 930 A.2d 92, 98-102 (Del. 2007). For similar modifications in the U.K. now recognized in Companies Act 2006, § 172(3) *see* West Mercia Safetyware Ltd. v. Dodd [1989] 4 Buttersworth Company L. Cases 30, 33; Kuwait Asia Bank EC v. Nat'l Mutual Life Nominees Ltd. [1991] 1 App. Cases 187, 217-19. See also Paul S. Davies, *Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency*, 7 Eur. Bus. Org. L. Rev. 301 (2006).

[222] For a cautionary remark of the Delaware Supreme Court Chief Justice at the time *see* E. Norman Veasey & Christine T. di Guglielmo, *What Happened in Delaware Corporate Law and Governance From 1992–2004? A Retrospective on Some Key Developments*, 153 U. Penn. L. Rev. 1399, 1432 (2005).

[223] *Proposal Single-Member Companies Directive*, art. 23(2).

[224] Considerations of political feasibility may drive this abstinence, because a controversial recognition of an overriding group interest could provide additional ammunition to the opponents of the directive. Yet, a tiny amendment to what is now *Proposal Single-Member Companies Directive*, art. 23(2) later down the road could alter the scope of the right to issue instructions and ultimately usher-in a full-blown recognition of the group interest.

In the current state of affairs most questions on the rule's specific properties cannot be answered.[225] First and foremost, this is true for the fundamental question of who gets to define the pivotal "group interest". Neither granting full discretion at the level of the parent nor providing for extensive judicial review of whether a challenged transaction complies with a plausible or even "good" group strategy is enticing. Similarly, it is unclear whether an operative definition of when a firm enters the "vicinity of insolvency" can be found.[226]

However, it is worth highlighting that no fundamental dichotomy between minority/creditor protection and the efficiency gains from group integration exists. To the contrary, business combinations that are based on the expropriation of corporate constituents are socially undesirable. Moreover, opening a possibility to exploit minority shareholders or creditors is also objectionable from the *ex ante* perspective of firms: efficient capital markets will anticipate the increased risk of expropriation and either install costly safeguards in bond indentures and loan agreements or simply charge upward-adjusted risk-premiums. At the margin, the cost of capital effect would weaken European firms' competitive position and hinder market development.[227] It is the charm of those standard based solutions that require compensation for discrete disadvantages either immediately or at a fixed later date[228] that they tie gains and losses together tightly and thus—if they work at least half-decently—align controllers' incentives with the social optimum that lies in facilitating (only) welfare enhancing forms of integration: they thwart those strategies where the assessable advantages from group-integration do not compensate its impositions on individual group members. The alternative concept of a cloudy promise of some mysterious future benefit seems quite unattractive from the perspective of outside investors and arguably gives unwarranted leeway to parent corporations/dominant shareholders.

As a consequence, the recognition of a safe harbor as contemplated by the Reflection Group and—albeit hesitantly—the Commission requires that such a rule is embedded in a set of adequate safeguards for minority shareholders and creditors.[229] In fact, the Reflection Group also saw the necessity of complements to the proposed recognition of the group interest and candidly hinted that the new rule might create an impetus for those jurisdictions that currently adhere to a rather inflexible approach with a codified law of corporate groups to innovate and switch to a more

[225] For an example of a codification *see* EMCA, ch. 16, § 16.

[226] Already the Winter-Group pushed for such a definition as part of the recommended European wrongful trading rule, High Level Group of Company Law Experts *supra* note 56, at 68-9. Under the *Rozenblum*-doctrine the substantive question resurfaces in a different guise because it prohibits following instructions that would jeopardize the continued existence of the disadvantaged corporation, *supra* 3.2.2. *See also* EMCA, ch. 16, § 16(1)(c).

[227] *Cf.* the law and finance literature *supra* note 7.

[228] *Supra* 2.1.1 and 3.1.2.2.1.

[229] On the need to protect minority shareholders if the group interest is recognized *see also* Conac *supra* note 83, at 223-5 (proposing sell-out rights and controls for related-party transactions).

flexible system.[230] The strategy that can be extrapolated from this testimony seems to lie in providing one part of the full picture through E.U. legislation, and leaving its completion to national corporate lawmakers who should experiment with various approaches.[231] However, the need to supplement a rule that recognizes the interest of a group with viable safeguards for both minority shareholders and creditors is also illustrated in the EMCA where the recognition of the interest of the group is coupled with a multiplicity of provisions that cater to the interests of these constituents.[232] Yet, if it was true that neither *ex post*-policing through standard based liability[233] nor *ex ante* shareholder involvement work well, a much broader sell-out right for minority shareholders might constitute a viable option.[234] In its rationale, such a sell-out right would be akin to the mandatory bid rule,[235] but it was not limited to specific acquisition techniques. Concerns that this regulatory strategy—particularly if the trigger event falls in the early stages of group integration—may come at high costs,[236] have to be qualified. It is true that the appraisal remedy, just like the mandatory bid-rule,[237] at the margin may prevent efficient transactions from going forward. Yet, the effect may be much smaller when it comes to group integration, because the latter arguably does not involve the magnitude of search and monitoring costs for the parent a bidder typically incurs in a control contests. Hence, the wedge that uncompensated costs the controlling shareholder incurs potentially drive between the social optimum and private incentives is much smaller in the context of group integration than it is on the market for corporate control. In sum, it is fair to assume that compensating minority shareholders at an early stage of group integration would do more good than harm.

4 Conclusion

[230] *Reflection Group Report supra* note 61, at 62 (arguing that the European recognition of the group-interest might represent an impellent for "Member States which have adopted the German approach but wish to have an opportunity to change to a more flexible approach); *see also ibid.*, at 64 (the rule "could lead the German and German oriented system to move towards the alternative model").

[231] Insofar as the Reflection Group tacitly places hopes also in inducing those Member States who already recognize the group interest to review their complementing institutions of minority protection, the strategy may backfire, because Member States may simply feel confirmed and thus abstain from any further law reform.

[232] *See* EMCA, ch. 16, § 16 (recognition of group interest) on the one hand, § 13 (corporate opportunity rule), § 14 (right to request special investigation), § 17 (wrongful trading) on the other.

[233] The assumption is particularly plausible where the standard is generally blurred by a fuzzy concept like that of group interest which applies not only when certain procedural preconditions are fulfilled. For the counter example of Delaware law where the duty of loyalty standard remains unfettered except for cases where double approval requirements are met *supra* notes 110 and 111.

[234] ECMA, § 15 limits this option to rather extreme scenarios of at least 90% blockholdings.

[235] Supra 2.2.2.

[236] Conac *supra* note 83, at 223.

[237] *Supra* note 73.

The perspective of a German-born European on the law of corporate groups finds the German codified law of corporate groups under pressure from Brussels. The contemplated E.U. legislation revisits old themes in the field. On the one hand, it seeks to curb private benefits of control and enhance minority protection in sensitive scenarios (related party transactions). On the other hand, the Commission contemplates to emphasize the enabling dimension of the law of corporate groups by recognizing an overriding interest of the group. In doing so, it introduces different concepts that supplant existing institutions of corporate law (not only in Germany). It would be misguided to take a defensive stance *per se vis-à-vis* these initiatives. Yet apart from the proposed rule's own merits and shortcomings (table 1), a careful consideration of the piecemeal approach is required, because it potentially destroys complementarities between the institutions of national law. A more comprehensive and inter-coordinated approach might be needed if European lawmakers want to intervene at all. Yet then, the project will become closer related to the Ninth Directive in spirit—though not in content—then might be politically desired.

	The "classical" theme revisited: minority protection in sensitive scenarios	**The new twist: "enabling" dimension of the law of corporate groups**
Driving issue	private benefits of control	efficiency gains from integration
Proposed counter-strategy	transparency, independent fairness review, and disinterested approval of related party transactions	recognition of "interest of the group" as a legitimate determinant in managerial decision making (safe harbor)
Evaluation	Flawed design of the rule that also rests on questionable assumptions of informed institutional investor voting	requires counterbalance to protect creditors/minority shareholders

Table 1 – Summary of main results

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