The European Company – A Challenge to Academics, Legislatures and Practitioners

By Christoph Teichmann

A. History of the SE*

The European Company – or *Societas Europaea* (SE) – has been referred to as the "flagship of European Company Law".[1] This is certainly true if one considers the ambitious origins of the project. In 1970, the European Commission presented the first draft of the Statute for a European Company.[2] A completely autonomous European legal form was intended, freely floating above the national legal forms and based solely on the sturdy branch of a purely European corporate law. The text of 1970 was, in substance, a complete code of corporate law. From the management structure to shareholders' actions, from the law of corporate groups (*Konzernrecht*) to accounting law, from tax law to co-determination – every regulation required in a modern corporate law was provided for.[3]

It was not long before the first difficulties became apparent. A central area of dispute was co-determination.[4] The 1970 draft proposed a dualistic system with a management body and a supervisory body. A third of the members of the supervisory body were to be elected by the employees.[5] Following suggestions by the European Parliament, the European Commission presented in 1975 an amended proposal, the so-called "three bench model": a supervisory board consisting of one

* Extended version of a presentation given at the Fifth Nordic Company Law Conference in October 2002 at the Aarhus School of Business, Aarhus, Denmark. The contributions to this conference will shortly be published in: Engsig Sørensen / Neville (editors), The Regulation of Companies.

[1] *Hopt*, Zeitschrift für Wirtschaftsrecht (ZIP) 1998, p. 96, 99.

[2] Proposal presented on June 30, 1970, O.J. 1970, C 124/1

[3] For a comprehensive study (based on the proposal of 1975) see the contributions in *Lutter* (editor), Die Europäische Aktiengesellschaft, 2nd ed., 1978.

[4] A comprehensive historical outline of this issue is given by *Mävers*, Die Mitbestimmung der Arbeitnehmer in der Europäischen Aktiengesellschaft, 2002.

[5] Art. 137 of the 1970 proposal.

https://doi.org/10.1017/S207183220001600X Published online by Cambridge University Press

third of shareholders' representatives, one third of employees' representatives and one third of independent members.[6] It is interesting to see that the idea of independent members, well known in the current debate on corporate governance, is indeed a very old one. Europeans of the time, however, focused on the issue of co-determination and were not able to find a common solution. This was one of the main reasons why it took another 25 years for the SE to be accepted by the Member States, at the summit of Nice in December 2000.

In the second place, there was disagreement about the roots of the company in European law. The proposals of 1970 and 1975 had tried to avoid any reference to national company law by combining two regulatory mechanisms: firstly, the statute was drafted in a detailed way so as to avoid any possible gap. Secondly, any remaining gap was to be filled by applying the "general principles" of the statute and, as a last resort, the "common principles" of the national legal systems. Mere national company law was not to interfere with the new European legal entity. Many academics and practitioners were of the opinion that this idea of a purely European legal form could not function.[7] A system of corporate law must develop and could not grow overnight.

Resultingly, years of tedious and strenuous negotiation did convert the allegedly complete code of corporate law into a Swiss cheese. Issues which could not be agreed upon were simply not regulated and to fill eventual gaps, references were included to the laws of the Member States pertaining to public limited liability companies. The 1975 proposal consisting of more than 300 articles was followed by a proposal in 1989 with a mere 137 articles. With the final text of 2001, the European "flagship" is heading for the high seas modestly equipped with exactly 70 articles – Article 70 merely stating that the Regulation will enter into force on 8 October 2004.

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[6] Art. 74a of the 1975 proposal, COM (75) 150 final. The origins of the three bench model are elaborated by *Mävers*, Die Mitbestimmung der Arbeitnehmer in der Europäischen Aktiengesellschaft, 2002, p. 122 and 138 et seq.

[7] See, for example, the opinion of *Lindacher* in: Lutter (editor), Die Europäische Aktiengesellschaft, 2nd ed., 1978, p. 10 and *Hauschka*, Die Aktiengesellschaft (AG) 1990, 85, 102, pointing out that it was unrealistic to expect European courts to find "general principles" of a European company law; whereas *Ficker*, liber amicorum Pieter Sanders, 1972, p. 37 et seq., and *Raiser*, Festschrift für Johannes Semler, 1993, p. 277, 282, expressed the more optimistic view that courts and legal academics would be capable of creating such "general principles" in case law.

B. The legal text

The text of the legal statute of the European Company, finally approved on 8 October 2001, clearly reflects this history. Formally, a Regulation[8], which contains the applicable corporate law, as well as a Directive[9] on employee participation, were passed.

I. The Regulation – Corporate law

In the Regulation we find provisions for a genuine European company law (see below 1.); they deal mainly with the formation of the SE, its organs and the transfer of seat. Most of the other issues usually covered by company law are dealt with by references to national law. In this respect we find two categories: firstly, mere references to national law as applicable to public limited liability companies formed in accordance with the law of the Member State in which the SE has its registered office (see below 2.); secondly, instructions and options for the national legislatures enabling them to create new rules in relation to SEs (see below 3.).

1. Genuine European company law

1.1 Formation of an SE

Article 2 of the Regulation deals with the establishment of the SE, as a rule of genuine European law which is directly applicable in every Member State. Four possibilities are provided: the *merger* of two joint stock companies, the formation of a *holding SE*, the formation of a *subsidiary SE* and the *transformation* of an existing public limited liability company into an SE. These provisions on the formation of an SE offer new options for cross border co-operation but are nevertheless subject to certain restrictions:[10]

(a) The formation of a European Company requires a "*European link*": a merger can only be effected by companies governed by the law of different Member States. The holding SE requires two or more companies governed by the law of different

[8] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European Company (SE), OJ L 294/1 of 10 November 2001 The Regulation is available online at: http://www.europa.eu.int/eur-lex/en/index.html

[9] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ L 294/22 of 10 November 2001. The Directive is available online at: http://www.europa.eu.int/eur-lex/en/index.html

[10] For the following see the provisions of Art. 2 of the Regulation.

Member States or having had a subsidiary governed by the law of another Member State or a branch situated in another Member State for at least two years;[11] the same requirements apply to the formation of a subsidiary SE. Finally, a transformation into an SE is only permitted to companies having had a subsidiary governed by the law of another Member State for at least two years.

(b) To make things even more complicated, the formation of an SE is not permitted to every *legal form*: both merger and transformation are only available to public limited liability companies, whereas the holding SE may be established by private limited liability companies as well.[12] In this respect, the most liberal way to form an SE is the subsidiary-SE since it may be established by "Companies and firms within the meaning of the second paragraph of Article 48 of the Treaty and other legal bodies governed by public or private law" (Art. 2 para. 3 of the Regulation).

1.2 Management system

Given the different management systems in the company laws of the Member States, the Regulation leaves the choice to the founders of the SE. Under Art. 38 b) of the Regulation, the statutes of an SE may adopt either the two-tier system with a supervisory body and a management body or the one-tier system with a single administrative body. This choice is available irrespective of whether the SE is subject to co-determination or not. Thereby the legal form of an SE may be a way to structure a Europe-wide group of companies with similar management systems in any company of the group.

The provisions of the Regulation on the *two-tier system* are taken to a considerable extent from Austrian and German company law. Given the general reference to national law regarding any issue not regulated in the Regulation, an SE having chosen the two-tier system and having its registered seat in Germany will in general look like an ordinary German *Aktiengesellschaft*. Other countries, who do not know the two-tier system so far have the option to adopt the appropriate measures in relation to SEs (Art. 39 para. 5 of the Regulation) in order to make this system work in the context of their national legal system.

Up to now, the one-tier system is unknown to German law of public limited liability companies. Germany will therefore take the opportunity to adopt

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[11] See, for an analysis of the issues concerning a Holding SE, *Oplustil*, Selected problems concerning formation of a holding SE (societas europaea), in: 4 GERMAN LAW JOURNAL No. 2 (1 February 2003), available at: http://www.germanlawjournal.com.

[12] Annex I and Annex II to the Regulation contain a list of the different national types of companies falling into the categories of either public limited liability company (for Germany: Aktiengesellschaft) or private limited liability company (for Germany: Gesellschaft mit beschränkter Haftung).

provisions in relation to SEs on the basis of the option given by Art. 43 para. 4 of the Regulation.[13]

1.3 Transfer of seat

Another innovative feature of the European Company is the transfer of seat. For the first time, a special procedure is provided for enabling a company to transfer its registered seat from one Member State to another without having to wind-up and re-incorporate the company. Lawyers from Member States following the incorporation theory may not find this very revolutionary, it is, however, a new perspective in Member States whose rules on conflicts of law is based on the real seat (*siege reel*) theory. One has also to take into account that the registered office of an SE shall be located in the same Member State as its head office (Art. 7 of the Regulation). The transfer of seat within the procedure of Art. 8 of the Regulation is a mere transfer of the registered office. If, however, by way of this transfer, the head office remains in the former location thereby violating the requirements of Art. 7 of the Regulation, the SE may face liquidation according to Art. 64 of the Regulation.

1.3.1 Procedure laid down by Art. 8 of the Regulation

According to Art. 8 of the Regulation, the transfer of seat is subject to the following procedure: The management of the European Company has to draw up a transfer proposal which has to be agreed upon by the general meeting. The transfer of the seat is regarded by the Regulation as an amendment of the company's statutes and therefore requires a majority of no less than two thirds of the votes cast, unless the law applicable to public limited liability companies in the Member State in which the SE's registered office is situated requires or permits a larger majority.[14] A Member State may adopt provisions designed to ensure appropriate protection for minority shareholders who oppose the transfer (Art. 8 para. 5); in addition the SE will have to ensure that the interests of creditors and holders of other rights in respect of the SE have been adequately protected in accordance with the requirements laid down by the Member State where the SE has its registered office prior to the transfer (Art. 8 para. 7). Last but not least, the laws of a Member State may provide that the transfer of the registered office shall not take effect if any of that Member State's competent authorities oppose the transfer (Art. 8 para. 14).

[13] See below (D. II.) where the tasks of the national legislature are considered.

[14] See Art. 8 para. 6 of the Regulation referring to Art. 59.

1.3.2 The case "Überseering"

The sophisticated procedure for the transfer of seat may have been rendered obsolete by the European Court of Justice by its recent "*Überseering*" decision .[15] In the case, originating in Germany, a Dutch company, Überseering B.V., had transferred its real seat to Germany – at least that was the factual finding of the courts. The German courts held that, as a company incorporated under Netherlands law, Überseering did not have legal capacity in Germany and, consequently, could not bring legal proceedings there. This was based on the real seat doctrine judging the legal capacity of a company according to the laws of the state where the real seat is located. As result, Überseering B.V., having not been incorporated under German law, had no legal capacity under German law. This doctrine, however, was just about to change. While the Überseering case was still pending, a judgment of the *Bundesgerichtshof* held that a company having transferred its real seat to Germany may, under German law, be regarded as a civil law partnership and could bring legal proceedings there.[16] – But this turnaround came too late. The European Court of Justice in *Überseering* ruled that the freedom of establishment precludes Member States from denying such companies legal capacity and, as a consequence thereof, the capacity to bring legal proceedings before its national courts. So it seems that this decision is still based on the assumption that companies having transferred their real seat to Germany could not bring legal proceedings there. In addition, the ECJ stated that the Member State has to recognise the legal capacity which the company enjoys under the law of its state of incorporation. This seems to exclude the former solution of the Bundesgerichtshof to regard such companies as civil law partnerships.

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[15] Case C-208/00, 5 November 2002. published in Zeitschrift für Wirtschaftsrecht (ZIP) 2002, p. 2037 et seq. Available online at http://curia.eu.int/en/content/juris/index.htm. Commentaries e.g. by: *Eidenmüller*, Zeitschrift für Wirtschaftsrecht (ZIP) 2002, p. 2233 et seq.; *Leible/Hoffmann*, Recht der Internationalen Wirtschaft (RIW) 2002. p. 925 et seq.; *Lutter*, Betriebs-Berater (BB) 2003, p. 7 et seq.; *Neye*, Entscheidungen zum Wirtschaftsrecht (EWiR) 2002, p. 1003; *Baelz/Baldwin*, The End of the Seat Theory in European Company Law: The ECJ's *Überseering* Decision , in: 3 GERMAN LAW JOURNAL No. 12 (1 December 2002), available at: http://www.germanlawjournal.com; *Schanze/Jüttner*, Die Aktiengesellschaft (AG) 2003, p. 30 et seq.; *Zimmer*, Betriebs-Berater (BB) 2003, p. 1 et seq.

[16] *Bundesgerichtshof*, July 1st 2002 (case no. II ZR 380/00) published in Neue Zeitschrift für Gesellschaftsrecht (NZG) 2002, p. 1009. One may ask why the *Bundesgerichtshof* in one case referred to the European Court of Justice for a preliminary ruling and in another case solved the same question itself thereby removing the basis for the first case. An explanation is, that the cases were dealt with by different chambers of the *Bundesgerichtshof* which did not contact each other.

In light of the Überseering decision, the Regulation on the European Company (SE) might actually seem to be in breach of the freedom of establishment.[17] If companies incorporated in one Member State are entitled to transfer their real seat to another Member State, how can the Regulation in Art. 8 require a specific procedure for such transfer or even require in Art. 7 that the registered office and the head office of the company be in the same Member State?

A closer look at the judgement, however, does reveal that it may not be applicable to the European Company. Referring to its judgement in the 1989 *Daily Mail* case[18], the ECJ reiterated in *Überseering*:[19] "A company which is a creature of national law, exists only by virtue of the national legislation which determines its incorporation and functioning." Consequently, a Member State is able, "in the case of a company incorporated under its law, to make the company's right to retain its legal personality under the law of that State subject to restrictions on the transfer of the company's actual centre of administration to a foreign country". It follows that Member States have the right to create legal entities and to impose certain restrictions on them as long as they do not restrict the freedom of companies incorporated in *other* Member States. The same applies to the European Company. It is a creature of European law and exists only by virtue of the European legislation which determines its incorporation and functioning. Consequently, the European legislature is able to make the European company subject to restrictions on the transfer of seat.

2. References to national law

As already mentioned, the Regulation does not by far contain all of the provisions the functioning of a company would require. Instead, the Regulation refers in many respects to the legal provisions which would apply to a public limited liability company formed in accordance with the law of the Member State in which the SE has its registered office.

It has therefore been suggested by many authors that eventually there will be no uniform European Company but – depending on the number of Member States – fifteen different types; or even more, if we take into account that in each Member State a European Company will have the choice between the one-tier and the two-

[17] For example *Eddy Wymeersch*, The transfer of the company's seat in European Company Law, Working Paper 2003-3 of the Financial Law Institute, Ghent University, Belgium, available at http://www.law.rug.ac.be/fli.

[18] Case C-81/87, available online at http://curia.eu.int/en/content/juris/index.htm.

[19] See no. 67 of the Überseering case, referring to Daily Mail

https://doi.org/10.1017/S207183220001600X Published online by Cambridge University Press

tier system.[20] On the other hand, the national provisions applicable to public limited liability companies are to a great extent based on the European directives on company law. Recital 9 of the preamble to the Regulation expressly refers to the fact that the work on the approximation of national company law has made substantial progress since the submission of the Commission's first proposal of an SE statute in 1970. There remain, however, areas where national laws are different, such as the management structure and the organisation and conduct of general meetings. But the general approach in European law has changed since 1970. Whereas in this early stage of the European Community, unification of national law was the ultimate goal, the respect for national particularities has grown ever since.[21] Given this evolution of European law it is not a mere accident that the European company has not been equipped with a complete Company Law Code. In a way, it is a unique European attempt to reconcile a common European structure with national traditions.

In terms of the regulatory approach this leads to a "sophisticated pyramid of legal layers"[22] made up of community law, national law and the company's articles of association. The Regulation generally refers to national law in Article 9 and, in addition, contains several references on particular issues.

In Article 5, the first of these references to national law can be found:

"Subject to Article 4(1) and (2), the capital of an SE, its maintenance and changes thereto, together with its shares, bonds and other similar securities shall be governed by the provisions which would apply to a public limited-liability company with a registered office in the Member State in which the SE is registered." *Therefore, an SE registered in Germany will have to comply with German capital rules. In Article 5 national law is invoked for a concrete regulatory issue. Furthermore, in Article 9 there is the general reference that the SE is governed,*

> *in the case of matters not regulated by this Regulation or, where matters are partly regulated by it, of those aspects not covered by it, by:*
>
> *(ii) the provisions of Member States' laws which would apply to a public limited-liability company formed in accordance with the law of the Member State in which the SE has its registered office;*

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[20] See for example *Hirte*, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2002, p. 1, 2; *Hopt*, European Banking and Financial Law Journal 2000, 465, 468 et seq.; *Lutter*, Betriebs-Berater (BB) 2002, p. 1, 3; *Wiesner*, Zeitschrift für Wirtschaftsrecht (ZIP) 2001, 397.

[21] For an overview of the evolution of company law in the European Union see for example *Hopt*, International and Comparative Corporate Law Journal 1999, p. 41 et seq.

[22] *Hommelhoff*, Die Aktiengesellschaft (AG) 2001, p. 279, 285: „kunstvoll aufgeschichtete Rechtsquellenpyramide".

The question to be solved (by practitioners, academics and courts) is, however, whether or not a specific issue is regulated by the Regulation.[23]

3. Options and instructions to the national legislatures

A surprising feature to be found in a Regulation which by its very nature is directly applicable in every Member State are the numerous instructions and options to the national legislatures. Making use of these will, at least in Germany, require a specific Act of Parliament.[24] The first example of an option can be found in Article 7 of the Regulation.[25] Whereas the first sentence of Article 7 is a genuine European provision: "The registered office of an SE shall be located within the Community, in the same Member State as its head office", sentence 2 offers an option to the Member States: "A Member State may in addition impose on SEs registered in its territory the obligation of locating their head office and their registered office in the same place."

The most important options, from a German perspective, are the options for the protection of minority shareholders in the case of a transfer of seat, a merger or the establishment of a holding SE (Articles 8 para. 5, 24 para. 2 and 34 of the Regulation)[26] as well as the option to adopt appropriate measures with respect to the one-tier system (Art. 43 para. 4 of the Regulation). Since the Regulation will enter into force on 8 October 2004 (Art. 70), legislators of the Member States will have to introduce national legislation by then. Germany recently has published a

[23] See below (E.). For a general analysis of the applicable law and the determination of possible gaps: *Brandt/Scheifele*, Deutsches Steuerrecht (DStR) 2002, p. 547 et seq.; *Casper*, Festschrift für Peter Ulmer, 2003, p. 51 et seq.; *Ch. Teichmann*, Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR) 2002, p. 383, 394 et seq.; *Wagner*, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2002, p. 985 et seq.

[24] A draft will be published end of February or beginning of March 2003 and discussed by *Neye/Ch. Teichmann* in: Die Aktiengesellschaft (AG) 2003, issue no. 4. Preceding proposals from academics were discussed by *Brandt*, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2002, p. 991 et seq. and *Ch. Teichmann*, Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR) 2002, 383 et seq. as well as Zeitschrift für Wirtschaftsrecht (ZIP) 2002, p. 1109 et seq.

[25] For a list of the instructions and options see *Ch. Teichmann*, Zeitschrift für Wirtschaftsrecht (ZIP) 2002, p. 1109 et seq.

[26] See below D.I.

draft on an act on the implementation of the European Company.[27] Some aspects of the task of the legislator will be discussed below.[28]

II. The Directive – employee participation

The Directive on employee participation reflects the fact that agreement on a unified model was not possible.[29] Recourse was taken to the position that it is best when the participants themselves agree upon their own model. This results in the principle of the "Primacy of Negotiation".[30]Prior to the formation of an SE, the employer and employees must consult and agree on employee participation. If they do so successfully, the agreement would apply– instead of any other rule, including the German provisions on German co-determination.[31] If, however, the contracting parties do not reach agreement, a so-called "rescue solution" applies, which follows the "before and after" principle. Where there was co-determination *before*, there will continue to be co-determination (*after*), the latter even without affecting the actual level of co-determination.

In the case of a German company transforming to or entering into an SE, this could result in the entire SE being (all of a sudden) subject to co-determination, although this had at first only applied to the original German company Representatives as well as observers of the German economy have voiced their heartfelt dissatisfaction

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[27] Available online at http://www.bmj.bund.de/gesetzgebungsvorhaben. Comments by *Neye / Ch. Teichmann* will be published in Aktiengesellschaft (AG) 2003, issue no. 4.

[28] See below D.II.

[29] The Directive has been analysed, inter alia, by: *Heinze*, Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR) 2002, p. 66 et seq.; *Herfs-Röttgen*, Neue Zeitschrift für Arbeitsrecht (NZA) 2001, p. 424 et seq.; *Pluskat*, Deutsches Steuerrecht (DStR) 2001, p. 1483 et seq.; *Henssler*, Festschrift für Peter Ulmer, 2003, p. 193 et seq.

[30] This principle has already been applied with regard to the European Works Council (Council Directive 94/45/EC of 22 september 1994, available online at: http://www.europa.eu.int/eur-lex/en/index.html). In the Directive on the European Company the primacy of negotiations follows from Art. 13 (2): "Provisions on the participation of employees in company bodies provided for by national legislation and/or practice, other than those implementing this Directive, shall not apply to companies established in accordance with Regulation (EC) No 2157/2001 and covered by this Directive." The negotiating procedure provided for by Article 3 et seq. of the Directive therefore prevails over any national law on the participation of employees.

[31] In Germany, employee representatives fear that the SE may be used to reduce the level of co-determination. Under the Regulation, however, this can only occur in rare cases. Analysing possible dangers to the German co-determination level: *Nagel*, Arbeit und Recht (AuR) 2001, p. 406 et seq.

with this solution.[32] It is alleged that, due to this constellation, German companies are being regarded by foreign potential business partners as if they were suffering from an infectious disease. It is feared that they will, therefore, have particular difficulties in forming SEs with foreign partners. This issue will be dealt with below, as we look more closely at the issues posed by the SE for practitioners, legislatures and academics.

C. Issues for practitioners

I. An additional choice for European business

Practitioners have the problem – if one so wishes to employ this term in this context – that, in international transactions, the range of available choices has been extended.[33] No one is obliged to make use of the SE, as it only constitutes an additional option. In order to assess the pros and cons of this venture, one must examine the reasons why an SE should be preferred in comparison of the respective national legal form. This assessment will be difficult, especially at the beginning, because the actual advantages of the SE depend on its registered seat. Apart from offering a legal framework for trans-national co-operation of companies, the architects of an SE have the important advantage to freely choose between the one-tier and the two-tier model at the board level. Only the SE offers this possibility of uniting the legal culture of various companies in a unified management structure.[34]

II. Co-determination

One of the core stepping stones or, to stick to our maritime imagery, the possibly most prominent danger for the European Company Law 'flagship' SE[35], surely was the degree to which co-determination would find its way into the ultimate legal form. For the first time, at least in Germany, co-determination by agreement is possible, which entails – at least theoretically – a wide spectrum of possibilities. But why should employees be interested in consenting to such an agreement? If the negotiations between employees and management are unsuccessful, employees

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[32] For a discussion of this issue see also *Hopt*, European Banking and Financial Law Journal, 2000, p. 465, 474.

[33] For an economic analysis of the choices offered by the European Company: *Blanquet*, Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR) 2002, p. 20, 34 et seq.; *Wenz*, Die Aktiengesellschaft (AG) 2003, issue no. 4 and *Kallmeyer*, Die Aktiengesellschaft (AG) 2003, issue no. 4.

[34] Also in this sense *Bungert/Beier*, Europäisches Wirtschafts- und Steuerrecht (EWS) 2002, p. 1, 9.
[35] See, again, *Hopt*, ZIP 1998, above, note 1

would have the comfort of the rescue provision, guaranteeing the same co-determination status as before.

Whether or not there is even reason to fear such constellations, however, entirely depends on the negotiating partners... There are good reasons why social partners should engage in serious negotiations. Negotiations should not, of course, be regarded from the outset as zero-sum games, in which one side can only win to the material detriment of the negotiating partner. Modern negotiations techniques teach us to seek for a "win-win situation", or, – in other words – to seek for a bigger cake to be divided. What does this entail for co-determination? From the point of view of both managers and shareholders, co-determination has regularly been the target of more or less elaborated critiques.[36] In fact, boards tend to be too big with one third or even half of the members to be elected by the employees. And, quite often, shareholder representatives fear that confidentiality is at stake with a considerable number of employee representatives on the board. There may be no employee representatives personally to be blamed, but confidentiality definitely becomes a problem given the mere size of German supervisory boards consisting of up to 21 members.[37] On the other hand, co-determination has its merits. The lack of insight into the company's affairs, often regarded as a specific corporate governance problem,[38] rarely occurs if employees are sitting on the supervisory board. Usually they are the best informed members as far as the inner problems of the company are concerned. And strategic decisions causing hardship to the workforce are easier to carry out if the members of the board representing the employees agreed to them. In a way, the social conflicts which would eventually result in strikes or even more violent ways of protest may be managed in advance if employee representatives are sitting on the board.[39]

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[36] For a recent criticism see *Ulmer*, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 2002 (166), p. 271 et seq.

[37] See § 95 (1) *Aktiengesetz*: The maximum number of members of an advisory board may be 21 in companies with a legal capital of more than 10.000.000 Euros.

[38] See, for example, the analysis of the cases Enron and WorldCom by *Schwarz/Holland*, Zeitschrift für Wirtschaftsrecht (ZIP) 2002, p. 1661 et seq.; for further analysis of the issue see e.g.: *Bhagat/Black* in: Hopt//Kanda/Roe/Wymeersch/Prigge (ed.), Comparative Corporate Governance, 1998, p. 281 et seq.; *Monks/Minow*, Corporate Governance, 1995, p. 185 et seq.

[39] See for an economic analysis of co-determination *Gerum/Wagner* in: Hopt/Kanda/Roe/Wymeersch/Prigge (ed.), Comparative Corporate Governance, 1998, p. 341 et seq. Co-determination creates transaction costs, but it may as well reduce other costs, such as collective bargaining running and repeating at different levels. Compare the case of Renault announcing to close down of a factory in Belgium, without having informed their employees in advance (see *Kolvenbach/Kolvenbach*, Neue Zeitschrift für Arbeitsrecht 1997, p. 695 et seq.). Employees felt taken by surprise and – successfully – started court actions against the decision to close down the factory. A prior

Given these advantages offered within a co-determination system, the existing statutory provisions may be regarded as a straightjacket for both parties involved, shareholders and employees. A flexible co-determination structure which is tailored to the individual company could serve the interests of both sides more efficiently.[40] While the so far existing mandatory provisions did not leave any room for negotiation, there is now a clear field for *creative* negotiation partners, shedding their blinkers while seeking "win-win situations". It will be far more difficult in the future to blame the government for not having changed the laws on co-determination, if managers themselves miss the opportunity to negotiate a co-determination structure on their own.

D. Issues Addressed to National Legislators

The legislature must, of course, implement the Directive on employee participation. Member States shall adopt the provisions necessary to comply with the Directive no later than 8 October 2004.[41] The following will, however, focus on the Regulation. The Regulation will have the force of direct law when it comes into legal effect in the year 2004. By then the national legislatures must have introduced measures relating to the above mentioned instructions and options. Each state should have a national implementation act on the SE by the time the Regulation comes into force. Two examples may be extracted from the perspective of the German legislature.

I. Protection of minority shareholders on the formation of an SE

The formation of an SE is provided for in detail in the context of the SE Regulation. In addition, the Regulation does explicitly refer to national law in case of necessary supplementing. According to Article 18, the procedure adopted within each company shall be in accordance with national law. This affects, for example, both invitating to as well as conducting the calling the general meeting to vote on the merger. Moreover, there is an important option for the Member States. According to Art. 24, ss. 3 SE-Regulation, each Member State may pass measures to protect minorities who oppose the merger. From a German point of view, this is interesting at least for two reasons. First, German law provides a special protection for

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discussion in an advisory board consisting also of employee representatives would have avoided such a conflict.

[40] Trade unions seem to take the option to negotiate very seriously; see, for example, the analysis of *Köstler*, in: Theisen/Wenz (editors), Die Europäische Aktiengesellschaft), 2002, p. 301 et seq.

[41] In pursuance of Art 14 of the Directive

minorities in the event of a merger, which should also apply when an SE is founded.[42] Minority shareholders can have the conversion ratio reviewed or leave the company in return for cash compensation.[43] Second, the objective of minority protection in German law is to avoid challenges to the merger resolution. In general corporate law, a suit claiming the setting aside of the merger resolution would stop the completion of the merger. Under merger law, however, there is a special procedure (*Spruchverfahren*) provided to minority shareholders in which they can defend their rights to protection while the merger desired by the majority can proceed without further hindrance.[44]

For these reasons, the German government would like to implement the same minority protection for the formation of an SE. However, this meets the following practical difficulty. Under Art. 25. ss. 3 SE-Regulation, a procedure protecting the minority while not interfering with the progress of the merger, is only possible if the shareholders of the foreign company communicate their express consensus. As these shareholders themselves, however, have no advantage from the minority provision of German law, one may ask what incentive they should have to agree to the procedure.

The first incentive would be that otherwise the whole merger may be jeopardised by challenges of minority shareholders. In addition, German lawmakers are considering some procedural incentives that would render the German minority protection procedure more attractive to the shareholders of a foreign company.[45] One possibility would be to have them participate in the court proceeding in which the conversion ratio or the cash compensation is assessed. It is perfectly obvious that the shareholders in the foreign company have an interest in the outcome. If the conversion ratio is changed in a manner favourable to the shareholders in the German company, money must be taken from the shareholders in the foreign company. The same applies if the compensation is increased. This money has to come from the merged assets which will be those of the SE. The dice have not concludingly been rolled on this question and furthersuggestions are welcome.

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[42] For a more detailed analysis of minority protection in the course of the foundation of an SE as well as in the case of a transfer of seat: *Ch. Teichmann*, Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR) 2003, issue no. 3.

[43] §§ 15 and 29 *Umwandlungsgesetz* (Transformation Act).

[44] Consequently, the merger resolution may not be challenged by minority shareholders on the grounds of an inadequate conversion ratio (§ 14 Transformation Act) or an inadequate cash compensation (§ 32 Transformation Act).

[45] For a more detailed analysis see *Ch. Teichmann* in: Theisen/Wenz (editors), Die Europäische Aktiengesellschaft, 2002, p. 573, 584 et seq.

II. One-tier and two-tier system of management

A second example of homework for the national legislatures is the management system since the SE has the choice between the one-tier and the two-tier system of management (Art. 38 b) of the Regulation).

1. Option for national legislation

The Regulation provides an option directed at each state which does not have the one or the other system. For Germany, Article 43 ss. 4 applies:

"Where no provision is made for a one-tier system in relation to public limited-liability companies with registered offices within its territory, a Member State may adopt the appropriate measures in relation to SEs."

An interesting academic discussion has set off as to whether a legislator does have the option or, even, an obligation to draft such a provision.[46] Although Germany is not exactly renowned for its pragmatism - this is one issue which will have to be decided pragmatically. Whether or not something must be legislated, can be considered irrelevant, when considering that a state wanting to attract SEs, will simply find it advisable that the one-tier system be catered for. It can thus be expected that the German legislature will oblige. The following section will provide a brief sketch of the task which the German legislator would face in this regard.

2. Co-determination in the one-tier system

Firstly, a regulation for employees' co-determination must be found in the one-tier system. Co-determination is mandatory by law, and also enjoys political consensus. Its integration into the monistic system cannot be circumvented. So far, all regulation of co-determination has been within the two-tier system – and it is more at home there. Neither the business nor its employees want employees' representatives involved in the daily management of the business. The two-tier system has the advantage that management and supervision are clearly separated. Co-determination in Germany traditionally functions only on the supervisory board.

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[46] Some authors are of the opinion that the national legislature has to adopt provisions (*Hommelhoff*, Die Aktiengesellschaft (AG) 2001, p. 279, 284; *Lutter*, Betriebs-Berater (BB) 2002, p. 1, 4); others raise doubts (*Bungert/Beier*, Europäisches Wirtschafts- und Steuerrecht (EWS) 2002, p. 1, 3; *Schulz/Geismar*, Deutsches Steuerrecht (DStR) 2001, p. 1078, 1082) or read the Regulation as a mere option (*Hirte*, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2002, p. 1, 5; *Vossius* in: Widmann/Mayer (editors), Umwandlungsrecht, 65. update June 02, § 20 UmwG, no. 399, footnote. 1).

Therefore, it does not seem so easy to apply co-determination to the one-tier system. The international discussion on Corporate Governance, however, offers a solution. The calls for separation of management and supervision are ever louder even from within the one-tier system. This is reflected by the work of those scholars that argue for a stronger and more effectful distinction of inside and outside directors (or, executive and non-executive members of the board). It is by hooking up to this distinction, that co-determination could be accommodated in the monistic system. It must be provided that employee representatives exclusively fulfil roles of non-executive members (or outside directors) while not being involved in day-to-day management.[47]

3. The Law of Corporate Groups

A second issue is the German Law of Corporate Groups, which is also linked to the separation of management board and supervisory board.[48] This can be demonstrated by the example of the dependency report pursuant to § 311 *Aktiengesetz*. This report reflects the relationship between the company and its parent. The report is prepared by the management board, which is reasonable as the management will be most acquainted with the business relations of the company. The report is then checked by the supervisory board and the auditors. This can be seen as an application of a "checks and balances"-concept: the supervisory board also knows the company and can at least assess the plausibility of the management board's report. Moreover, the supervisory board is usually close to the parent company and will be reminded by the report that relations between the subsidiary and the parent are subject to review. In some cases, influence is thereby avoided in the first place, because the parent does not want to have it reported.

At present, Germany is thinking about how to implement this element of mutual checks into a monistic administrative organ.[49] A comparison with other legal systems shows that influence by dominant shareholders can also be made subject to control within the monistic system. French law, for example, provides that certain

[47] See *Henssler*, Festschrift für Peter Ulmer, 2003, p. 193, 208, and *Ch. Teichmann*, Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR) 2002, p. 383, 446.

[48] For the development on the European level of a law of corporate groups see *Forum Europaeum*, Corporate Group Law for Europe, Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR) 1998, 672 et seq. (= European Business Organization Law Review (EBOR), 2000, p. 165 et seq.) and the commentaries by *Windbichler*, EBOR 2000, p. 265 et seq. and *Kluver*, EBOR 2000, p. 287 et seq.

[49] See *Hommelhoff*, Die Aktiengesellschaft (AG) 2002, issue no. 4; *Maul* in: Theisen/Wenz (editors), Die Europäische Aktiengesellschaft, p. 399 et seq.; *Ch. Teichmann*, Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR), 2002, p. 383, 444 et seq.

transactions between a major shareholder and the company require the consent of the administrative body.[50] The auditors of the company will have to draft a report on these transactions which will be presented to the general meeting. Under Belgian law, public limited liability companies listed at the stock exchange have to report any transaction between the company and a shareholder exercising a major influence on the nomination of the administrative body of the company. A special committee within the administrative board, consisting of independent members, has to check the transactions.[51] A future German one-tier system may be modelled on one of these examples.

4. Separation of management and supervision: managing director

Furthermore, the German legislator should also consider the separation of management and supervision in the one-tier system. This would be perfectly in line with the intentions of the Regulation, as recital 14 of the preamble states that "the respective responsibilities of those responsible for management and those responsible for supervision should be clearly defined".

A draft of the German implementation act of the European Company which has been published recently, will therefore propose the appointment of a managing director responsible for the day-to-day management.[52] At first sight, this looks like a mere twin of the two-tier system. It will, however, offer the freedom to structure the management along the lines of one-tier systems as they are well known in other countries. For example, the managing director will be subject to the instructions of the administrative body and may be removed at any time. The ultimate power to manage the company will therefore be vested in the administrative body which is a fundamental difference to the existing German two-tier system.[53]

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[50] Art. L. 225-38 et seq. Code de commerce.

[51] Art. 524 Code des sociétés.

[52] As a provision of the German legislature this is not based on Art. 43 para. 1 of the Regulation (which offers an option only to introduce managing directors "under the same conditions as for public limited-liability companies that have registered offices within that Member State") but on the general option of Art. 43 para. 4 (addressing Member States which do not know the one-tier system at all).

[53] The *Vorstand* of a German *Aktiengesellschaft* is, under the German law pertaining to public limited liability companies, appointed for a period of up to five years; any removal prior to the expiration of that period needs to be justified. The *Aufsichtsrat* may not give any instructions to the *Vorstand*.

E. Academic challenges

Finally, the SE statute's incompleteness poses a myriad of challenges to academics . These may be assessed at three levels. First, it has to be assessed whether or not the Regulation actually addresses a specific issue. Secondly, it needs to be seen to what degree eventual lacunae may be closed by European law. And thirdly, the application of national law to the SE at hand needs to be evaluated.

I. Does the Regulation deal with the issue?

At first glance, one might find this question simple, because the European legislature has put it very clearly: wherever there is a gap in the Regulation, national law is to apply.[54] But, the 'law in action' is going to differ from the written law. The Regulation does provide hints as to how gaps may be ascertained. But even these remain somewhat unclear. Art. 9 of the Regulation states that in the case of matters not regulated by the Regulation or, where matters are only partly regulated, national law shall apply. This reference to partly regulated matters is interesting. Usually, when considering a provision which only partly deals with a certain issue, one will most likely wonder as to whether or not the legislator "did forget' to include the provision found missing. In German legal theory and methodology of law, this is commonly referred to as an "unintended gap".[55] This gap is to be closed by virtually taking the legislator's plan further than what did originally find its way into codification. This can lead to a wider interpretation of the provision or to an 'application by analogy'. But as regards 'partially regulated matters', the European legislature apparently did not intend such a gap, because for these "partially regulated areas" we are referred to national law.

Should this reference be understood to include even "unintended gaps"?[56] Unintended gaps, of course, have the unfortunate characteristic that the legislator, when drafting the law, had not been aware of them. It would accordingly be contradictory to think that the legislator had at the same time wanted to provide for their regulation. This would also not be justified in substance, because the legislator could not have had any awareness of the consequences of its oversight. No one

[54] See Art. 9 of the Regulation.

[55] *Larenz*, Methodenlehre der Rechtswissenschaft, 6th edition, 1991, p. 370 et seq.

[56] In this sense apparently *Brandt/Scheifele*, Deutsches Steuerrecht (DStR) 2002, p. 547, 552, stating that a distinction between planned and unintended gaps was artificial with regard to the SE Regulation. They propose to look at the specific issue in question and to determine whether it could better be solved on the European level or on the national level.

knows the unforeseen gaps that will be exposed in the SE-Regulation through legal development. In this situation it can be argued that it is the task of the courts and of academics in such cases to consider how to supplement the Regulation in the light of general European law principles, before resorting without further thought to national law.[57]

An example from the *formation of a holding SE* may help to further clarify the issue.[58] In every formation of a holding SE a resolution on the formation must be passed by each company promoting the formation. No majority for the passing of these resolutions is specified in the Regulation. The first impulse is to resort to national law. However, the SE-Regulation provides no provision for such resort. According to Art. 15 of the Regulation, the formation of an SE shall be governed by the law applicable to public limited-liability companies in the Member States in which the SE establishes its registered office. For several reasons, this cannot be understood as a reference with relation to the general meeting of the companies promoting the formation of a holding SE. First of all, the provisions related to the merger indicate that the necessary steps to be taken in the companies involved in the formation of an SE shall be governed by national law (see Art. 18 of the Regulation). It is true, that a provision like Art. 18 is missing in the provisions related to the holding SE. But a direct application of Art. 15 would lead to very strange results: a holding SE may be promoted not only by public but also by private limited liability companies; instead, the application of Art. 15 would exclusively refer to the law applicable to *public* limited liability companies in the state where the SE will be registered. Art. 15 of the Regulation, taken literally, would mean that a Danish *anpartselskaber* and a German *Gesellschaft mit beschränkter Haftung* both promoting the formation of a holding SE in Greece would have to convene and to organise the meeting of their shareholders in Denmark and Germany according to the law applicable to Greek public limited liability companies; a very strange result, indeed.

The reference of Art. 9 of the Regulation is not suitable either, because it applies to the law applicable to the SE. Here, however, the SE is not concerned at all, but rather the resolution of a shareholders' meeting of a national company. In addition, it seems that national laws do not recognise the formation of a holding as a special procedure. In German law, in any event, there is no provision which prescribes a resolution such as that required in the Regulation. And naturally, therefore, there

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[57] This view, however, is not shared by all in German literature. See, for example, *Casper*, Festschrift für Peter Ulmer, 2003, p. 51, 57: Art. 9 para. 1 lit. c) of the Regulation leaves no room for closing gaps by general principles of European company law.

[58] The following has also been elaborated in *Ch. Teichmann*, Zeitschrift für Gesellschafts- und Unternehmensrecht (ZGR) 2002, p. 383, 432 et seq. For selected questions related to the formation of a holding SE see also *Oplustil*, German Law Journal, http://www.germanlawjournal.com, Volume 4 No. 2 (1 February 2003).

are no indications as to what the majority for such a resolution should be. In this case, at least in the German law, national law does not assist us any further.

It appears likely that this point was overlooked in the drafting of the Regulation. In earlier drafts of the Regulation there was a reference to the law applicable to mergers.[59] This reference would have covered the provision on the majority required for the resolution. In the last draft, the reference to the merger law was deleted. That suddenly, thereby a provision for the majority required for the resolution was lost, seems not to have been noticed. Everything suggests that this is, in fact, a genuine "unintended gap".

An opposed view points out that the reference to the merger provisions may have been deleted on purpose since in the case of the formation of a holding SE, there is no need for specific protection of the minority by a qualified majority requirement.[60] Unlike the merger procedure, the companies promoting the formation of a holding SE do not cease to exist. Consequently, every shareholder has the option to decide against exchanging his shares and instead to keep holding on to them. While this is certainly true, at the end of this line of argument the requirement of a general meeting resolving on the holding SE should have been abolished altogether. If the European lawmaker did not see any need for protecting shareholders against the will of the majority, it would not have provided for draft terms (including all the information typically required in the case of a merger), for a report of management explaining and justifying the formation of the holding, for an examination by independent auditors and, last but not least, for a resolution of the general meeting.[61] All these aspects are taken from the blueprint of the merger procedure – except the qualified majority.

From the perspective of other legal systems other gaps may occur. French law, for example, knows the distinction between ordinary and extraordinary general meetings with different procedural provisions.[62] Therefore, it seems, that the whole calling for and organisation of the meeting resolving on the holding formation has to be considered as a gap in European legislation.

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[59] Art. 31 para. 2 of the proposal of 1991; Art. 32 para. 3 of the proposal of 1989; Art. 32 in the proposal of 1975 and 1970.

[60] *Casper* in: Festschrift für Peter Ulmer, 2003, p. 51, 61.

[61] See the provisions of Art. 32 of the Regulation.

[62] *Assemblée général ordinaire* and *assemblé générale extraordinaire* (see *Guyon*, Droit des Affaires, Tome 1, 11th edition, 2001, p. 318 et seq.)

https://doi.org/10.1017/S207183220001600X Published online by Cambridge University Press

II. Closing the gap by means of European Law

The gap in the matter of the formation of a holding-SE can however be closed with reference to the general thrust of European Corporate Law. The procedure for formation of a holding corresponds in its structure to that of a merger. The drawing up of a formation report, the resolution of the general meeting, the expert report are all elements known from the third directive on mergers. [63]

What could be more consistent than to fill the "unintended gap" with the help of the plan of the third directive? As this directive has been implemented in the legal systems of the Member States, it can therefore be expected that any legal question arising out of the calling for and the organisation of the general meeting can be solved by this analogy. The outcome for the majority would be: the resolution on the formation of a holding SE requires a majority of at least two thirds of the votes of the shares represented or of the subscribed capital represented (this is what Art. 7 ss. 3 sentence 3 of the Third Directive, 78/855/EEC of 9 October 1978 on Mergers provides). If, however, a national law in implementing the Directive provided a greater majority, this latter provision would apply.

III. Application and interpretation of national law

There remain, of course, many areas in which reference to national law is suitable and justified. Usually, issues which are not dealt with by the Regulation are subject to national law. The numerous references in the Regulation make this very clear. What are the consequences for the application of national law provisions? They will be applied to regulate matters in supra-national companies. Do national rules thereby acquire the status of community law? There is a good argument for this opinion.

1. Application based on the authority of European law

Firstly, the application of national law is based on the authority of European Law. The supra-national legal form of the SE exists only because of the legislative competence of the European legislator. A new legal form requires a comprehensive solution, as it could not function otherwise. The European Commission, in its proposal of 1970,[64] did recognise this in principle. This proposal contained everything a company required for life. This approach faced the difficulties already

[63] See, Third Directive, 78/885/EEC (*Habersack*, Europäisches Gesellschaftsrecht, 2nd edition, 2003, p. 194 et seq., also , available online at http://www.europa.eu.int/eur-lex/en/index.html.)

[64] See above note 2.

https://doi.org/10.1017/S207183220001600X Published online by Cambridge University Press

mentioned in the introduction: Even the European Community of the time with no more than six Member States was not able to agree upon a common company law. In subsequent proposals, therefore, the work was made easier and holes were torn in the legal garment, and patched with provisions taken from national law. In substance, this is nothing less than the European legislator copying national law provisions and including them in the Regulation. In all the cases where references are made to national law, the provisions of national law are not applicable as "national" provisions but the European legislator is asking them for assistance to enable its creation of a European Company to exist in the national environment.[65]

In German law, this is clear from the example of the reference of Art. 18 SE-Regulation to national merger law. The German merger law is, according to the express intention of the legislature, applicable only to national mergers.[66] With a stroke of the European legislator's pen, this has been changed. German merger law now has a supplementary application to mergers between German and foreign corporations.

2. "Europe friendly" interpretation and recourse to the European Court of Justice

It is possible to draw the conclusion that national law, when applied through the SE-Regulation, should be dealt with as community law. This has practical implications for its interpretation.[67] If national law is invoked to fill a gap in the SE-Regulation, a Europe friendly interpretation must have priority. For example, national law on the procedure at a general meeting when applied to an SE certainly cannot have the result that foreign shareholders be placed at a disadvantage in any form – for example, by short notice periods or actual hindrance in the appointment of representatives to exercise voting rights.

At the end of this line of argument, there is the question whether the interpretation of national law in such cases can be reviewed by the European Court of Justice. The ECJ is, according to Art. 234 EC Treaty, responsible for the interpretation of the acts of the institutions of the European Community. All secondary legislation is included, i.e. the SE-Regulation. If this Regulation provides for reference to national law, the scope of this reference is subject to interpretation by the ECJ.

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[65] The expression of assistance to European Law given by national law ("EG-rechtliche Hilfestellung") stems from *Sonnenberger*, Münchener Kommentar zum BGB, 3rd edition, 1998, Internationales Privatrecht, Introduction, footnote 317.

[66] *Lutter* in: Lutter (Hrsg.), Umwandlungsgesetz, 2nd edition, 2000, § 1, notes 5 et seq..

[67] In the same sense *Brandt/Scheifele*, Deutsches Steuerrecht (DStR) 2002, p. 547, 554.

Can the Court also make any statement as to a "Europe friendly" interpretation of national law? If one considers that the application of national law exclusively based on the authority of the European legislator, the application of national law in these circumstances must be subject to review by the European court.

By way of conclusion, let us take a closer look at one final example taken from German law. German corporate law requires that the articles of association of a public limited liability company be notarised.[68] Could this be required of an SE, formed in Denmark which later changes its registered office to Germany, under the procedure provided by the SE-Regulation? If we assume that the SE from Denmark will not be registered because the articles of association have not been notarised by a German notary, or, even worse, have not been notarised at all since this requirement does not exist in Denmark, can the SE the resort to the ECJ on this issue? Much points to answering this question in the affirmative.. Whoever accepts that the SE is a European legal form, cannot bar its path to the ECJ. Whether the European legislator itself resolves a question of detail or merely provides for a reference to national law, cannot be the decisive issue.

So, the SE contributes comes to confirm the assumption that the compatibility of our national laws with the internal market must be subject to testing before the ECJ. As 'good Europeans', we will not allow our national law to contain any provisions discriminating companies or shareholders from other Member States. The experience from "*Centros*" or "*Überseering*" has shown, on the other hand, that the European Court of Justice may not always share this view. With the European Company on its way he may have even more opportunities to stir up the traditions of national company law. Indeed, exciting times lie ahead!

[68] § 23 (1) *Aktiengesetz*.

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