The law of business associations

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Chapter 5
The Law of Business Associations

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A. INTRODUCTION

I. Survey of Corporate Legal Forms

1. Corporations, Partnerships and Mixed Forms

The aim of this chapter is not to describe the law of associations in general, but to concentrate on business associations. They occur in two different types: corporations and partnerships. German business law provides for three forms of corporations: the stock company (Aktiengesellschaft – AG), the public limited partnership by shares (Kommanditgesellschaft auf Aktien – KGaA) and the limited liability company (Gesellschaft mit beschränkter Haftung – GmbH).

In practice, the limited liability company is predominant. There are more than 500,000 limited liability companies, about 3,000 stock companies and only 30 public limited partnerships by shares.

Civil law and commercial law provide for five forms of partnerships: the partnership under the Civil Code (BGB-Gesellschaft), the non-trading partnership under the Partnership Act 1994 (Partnerschaftsgesellschaft), the general partnership (offene Handelsgesellschaft – oHG), the limited partnership (Kommanditgesellschaft – KG) and the ‘dormant’ partnership (stille Gesellschaft).

There are no official statistics about the number of partnerships. However, general partnerships and limited partnerships are reported in the commercial register (Handelsregister). Based on these data, it may be estimated that there were about 100,000 of them in 1994.

As previously stated, other forms of associations such as the incorporated association (eingetragener Verein), the ‘unincorporated’ association (nicht

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eingetragener Verein), the foundation under the Civil Code (Stiftung), the shipping company (Reederei) and the registered cooperative (Genossenschaft), are not described, because they are of little or no practical importance to business.

Finally, it should be noted that under German company law there are no general restrictions on mixing corporate forms. On the one hand, shareholders may give the company an individual structure which differs more or less from the form's legal model. On the other hand, mixed corporate forms may emerge from mixing basic types by means of one company's participation in another. The most common example is the limited liability company & Co. (GmbH & Co. KG): it is a limited partnership (KG) in which a limited liability company (GmbH) participates as the sole personally liable partner. However, a vast amount of court decisions has made the GmbH & Co. KG almost a legal form of its own.

2. The Characteristics of Corporations and Partnerships

In contrast to corporations, partnerships never have a distinct legal personality. A consequence of the legal personality of corporations is that the corporation itself is the owner of its assets. In contrast, a partnership is not able to own assets: all assets belong to the partners in joint ownership (Gesamthandsgemeinschaft, § 719 BGB). The principle of joint ownership means that two or more persons hold property not in distinct shares but jointly, each having an identical interest in the undivided whole. An asset may be transferred only with the consent of all partners, which can be given either in the partnership contract (for example by authorizing the management to make such transactions) or in a general meeting of the partners.

A corporation's credit is the fixed share capital, whereas partnerships do not have fixed amounts of capital (with the exception of the limited partnership, infra C.III.2.). Instead, the partners are personally, jointly and severally liable to the partnership's creditors for any debts of the partnership to the full extent of their private assets.

All business associations have a contractual basis to complement the statutory law and to adapt it to the needs of the partners and members of the corporation respectively. Even the one-person limited liability company (Ein-Mann-GmbH) or the one-person stock company (Ein-Mann-AG) are deemed to be based on a contract.

The agreement of incorporation for corporations is called memorandum of association. It is the basic document that contains not only the constitution and powers of the company but also the necessary internal regulations, such as the amount of capital or the number of directors. Thus German law does not differentiate between 'memorandum of association' and 'articles of association,' it provides for only one basic document. However, separate contractual agreements among shareholders (e.g., agreements binding the parties in the exercise of their membership rights) are often used.
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The partnership agreement and the memorandum of association of a limited liability company are to a great extent governed by the principle of freedom of contract. In contrast, the law of stock corporations (§ 23 V AktG) allows little room for the individual structuring of a corporation.

II. Law of Capital Markets

Looking at other industrialized countries' legal systems, corporate law is generally closely linked with the law of capital markets (securities regulation). In Germany, only stock corporations have access to the country's regulated capital markets; thus statutory capital market law does not go beyond the regulation of the primary and secondary market for shares or derivatives of shares of a listed stock corporation.

Capital market law in Germany has not only been practically restricted to stock exchange law but, at the same time, has lacked any consistent regulatory model. In part, this may be attributed to the fact that capital markets themselves have been underdeveloped during the past decades. To start with the 1950s and Germany's post-war-economy, private savings, if any, were invested in low-risk investments. Accordingly, corporate finance was obtained either by self-financing or by borrowing capital.

In the mid-1960s it became obvious that industrial growth without the development of a capital market system of corporate finance was not feasible. At the same time, large amounts of capital were looking for investments offering better returns than those from savings accounts. However, the market was not generated by the stock corporation. The investor was, rather, attracted by new types of investments offered by companies neither organized as stock corporations nor subject to any existing capital market regulation. This led to the birth of the 'grey' capital market, which, to date, is not subject to statutory regulation. Still, the 'grey' market is governed by some judge-made law providing a minimum of investor protection, partly by adapting the company law applicable to the investment company to the capital market needs, and partly by amending precontractual obligations of those participating in the distribution of investments.

Both competing national and international financial markets and the implementation of EC company and stock exchange harmonization directives in German law have caused a gradual modernization of the country's regulated capital market. Simultaneously, the efforts to live up to international standards of securities regulation have introduced into Germany's capital market law a variety of legal norms not only affecting the stock company's behavior in the capital markets but also the company's organization. This is most obvious in respect to increased disclosure obligations that have been imposed on the listed stock company, such as intermediate (§ 44b BörsenG) and immediate disclosure requirements (§ 15 WPHG), obligations to report and disclose major investments or disinvestments in the capital stock of a listed company (§§ 21 et seq. WPHG), or obligations to publish a prospectus for securities that are offered
Modernization of Germany's capital market regulation, however, has been restricted to only one segment of the country's capital markets, i.e., the market for stock and derivatives. Statutory regulation of the 'grey' market is still not in sight. Consequently, the terms of competition for each segment of Germany's capital markets remain different.

B. COMPANIES LIMITED BY SHARES

I. The Stock Company

1. The Two Types of Stock Companies and the Applicable Law

The Stock Company Act of 1965 (Aktiengesetz – AktG) is the legal basis for the stock company and the public limited partnership by shares (infra B.II.). The AktG has been amended several times since 1965, mainly to implement the EC company law harmonization directives. However, deregulation was the object of the latest amendment, on August 2, 1994. Several sections that had proved to be inadequate or too complicated for small companies were simplified.

For particular matters on which the AktG does not make specific provision, the laws generally applicable to associations also apply to stock companies. For example, §§ 238 et seq. of the Commercial Code of 1897 (Handelsgesetzbuch – HGB) provide most of the regulations relating to commercial records and accounting requirements. Pursuant to § 31 BGB, stock companies are vicariously liable for wrongful acts of their directors and other senior members of management. In addition, a company can be liable for its employees' misconduct (§§ 278, 831 BGB).

2. The Legal Nature of the Stock Company

The stock company (Aktiengesellschaft) is a corporation with a fixed capital stock (§§ 6, 7 AktG) divided into transferable shares (§ 1 II AktG). Shareholders are not personally liable for the company's obligations (§§ 1, 54 I AktG) and ownership of shares is usually anonymous. The stock company, a legal person pursuant to § 1 I of the AktG, has an incorporated organization. Regardless of the actual purpose of the enterprise the stock company is always deemed to be a commercial company (§ 3 AktG). Consequently all provisions of the HGB on merchants apply (§ 6 I HGB), even if the company serves a non-profit purpose.
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3. The Incorporation of the Stock Company

The stock company becomes a legal entity upon registration in the commercial register (§ 41 I AktG). To qualify for registration, five requirements have to be fulfilled:

(i) The memorandum of association is determined by one (or more) founder(s) in notarized form (§ 2, 23 I AktG). § 23 II-IV AktG sets out minimum content requirements for the document. Further stipulations are possible, but may only differ from the AktG if the law explicitly allows for deviations. Because such exceptions are rare, German stock company law is rather strict in comparison with other legal systems.

(ii) The founders have to subscribe for all shares (§§ 2, 28, 29 AktG) and pay in the amount of capital that is called up in the memorandum of association. § 36a I AktG requires the company to call up at least 25 per cent of the nominal value of a share and the entire premium, where shares are issued for an amount higher than the nominal value. A shareholder may not set off a contribution and the company may not waive the obligation to pay the shares (§ 66 I AktG) or repay a contribution (§ 66 II AktG). Contributions in kind must be verified by independent auditors to determine whether they are equal to the amount stated in the memorandum (§§ 33 III-V, 34, 35 AktG). Such contributions must be fully performed (§ 36a II AktG).

(iii) The founders elect the first auditors and the supervisory board (§ 30 I-III AktG) who in turn appoints the board of directors (§ 30 IV AktG). The founders, the supervisory board, the board of directors and the first auditors are subject to special civil and criminal liability for all matters relating to the correct incorporation of the company (§§ 46 et seq. AktG).

(iv) The founders deliver a written incorporation report that the supervisory board and the board of directors scrutinize to determine whether all conditions for a proper incorporation were met (§§ 33 et seq. AktG). In special cases, e.g., if one of the founders is a member of the supervisory board, the court must appoint independent auditors to verify the report.

(v) The founders, the supervisory board and the board of directors apply to the local commercial register for registration. The court verifies whether the above-mentioned conditions have been met. If this is not the case, the application for entry is rejected (§ 38 AktG). Otherwise the court registers the company in the commercial register, section B. Registration contains the name and purpose of the company, its registered office (that has to be in Germany), the memorandum of association (including subsequent changes), the nominal stock capital and the signatures of the directors (§§ 37 IV, 39 AktG). The content of the commercial register is deemed to be effective with regard to third parties acting in good faith (§ 15 I, III HGB). The registration is effective immediately and its subsequent publication (§ 40 AktG) has merely a declaratory character. Once registered, a court may declare the incorporation void only on grounds of severe errors (§ 262 no. 5 AktG).
4. Shares

The shareholder's right of membership is expressed in the share. The shareholder acquires membership in the company either as a founder, by subscribing for shares, or by a transfer or transmission of shares subsequent to the incorporation.

In addition to conferring membership, shares have a second function. They represent a part of the total share capital of the company. According to § 7 AktG, the minimum share capital (Grundkapital) is DM 100,000. It is divided into shares which must have a nominal value in Deutsche Mark (§ 2 I AktG); proportional shares are prohibited. Since August 1994 the minimum nominal value of a share has been reduced from DM 50 to DM 5 (§ 8 I AktG) in order to allow investors a broader diversification of their portfolios. To date, only few companies have made use of the possibility either to reduce the nominal value of outstanding shares to the minimum of DM 5 or to issue new shares with such minimum nominal value.

The third function of a share is its use as a security. Membership in the company is represented in a written document (share certificate) that can be transferred within or outside the stock market. Bearer shares, issued only after full payment of the contribution (§ 10 II AktG), are transferred by agreement and delivery of the certificates (§ 929 BGB), whereas registered shares are transferred by agreement, endorsement of the certificates and delivery (§ 68 AktG; §§ 12, 13 WG). The memorandum may require the company's consent to a transfer of a registered share (§ 68 II AktG: vinkulierte Namensaktie), granted by the board of directors.

The memorandum may provide for different classes of shares. The most common use of this is to create preferred shares (Vorzugsaktien) without voting rights (§§ 12 1 2, 139 et seq. AktG).

5. Capital Increase and Other Forms of Financing the Company

As previously stated, the amount of share capital has to be determined in the memorandum of association. The share capital may be increased according to business fluctuations. Capital increases may take four different forms: the capital increase against contributions, the conditional capital increase, the authorized capital, and the capital increase from the company's funds.

(a) The Capital Increase Against Contributions

A capital increase against contributions requires a special resolution of the general meeting of shareholders (Hauptversammlung) by a qualified majority
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of at least 3/4 of the share capital represented at the meeting. The memorandum of association may require a higher or a lower majority (§ 182 AktG). If different classes of shares were issued, a majority of each class has to consent (§ 182 II AktG). If contributions in kind are made, the principles described for the incorporation apply (§ 183 AktG). A capital increase against contributions may only be performed by the issue of new shares, not by an increase of the nominal value of already existing shares (§ 182 I AktG). The board of directors (Vorstand) and the chairman of the supervisory board (Aufsichtsrat) apply for the entry of the resolution in the commercial register and an auditor's report on contributions in kind must be attached (§ 184 I AktG). Subsequently, the subscription for new shares takes place. The pay-in conditions correspond to those prescribed for incorporation (see supra B.1.3.). The board of directors and the chairman of the supervisory board declare the fulfillment of these conditions to the commercial register.

A share capital increase is valid and takes legal effect as soon as it has been registered (§ 189 AktG). The new shares may then be issued (§ 191 AktG). To protect the proportionate interests of shareholders, the AktG provides for preemptive rights (Bezugsrecht), i.e., new shares must first be offered to existing shareholders in proportion to the nominal value of their shareholdings (§ 186 AktG). The offer must be published and then be open for at least 14 days (§ 186 I AktG). Preemptive rights may be wholly or partly excluded by a special resolution of the general meeting (§ 186 III AktG). The exclusion has to be announced expressly in the agenda of the general meeting deciding on the issue. Moreover, the board of directors has to deliver a written report setting forth grounds for the exclusion. A shareholder doubting that the resolution is based on reasonable grounds may contest the resolution in court and may obtain a judgment declaring it void.

In practice, indirect forms of subscription and preemptive rights are common. To effect the increase of capital, all shares are subscribed for and paid in by a bank or a consortium of banks with an obligation to offer the shares to the existing shareholders before selling them on the open market (§ 186 V AktG).

(b) The Conditional Capital Increase
A second form of capital increase is the conditional capital increase (§§ 192 et seq. AktG). It is permitted only to grant a conversion to the owners of convertible bonds (Wandelschuldverschreibungen), to prepare the merger or acquisition of several enterprises and to grant preemptive rights to employees in the case of a profit-sharing agreement with the company (§ 192 II AktG). All other preconditions resemble those just explained in respect to a capital increase against contributions. The share capital increase takes effect as soon as the new shares are issued. The board of directors annually reports to the commercial register the amount of shares issued throughout the year.

(c) The Authorized Capital
The third form of capital increase is the authorized capital (§§ 202 et seq. AktG). The board of directors may be authorized for a maximum period of five years (starting from the day of the registration of the resolution in the com-
cial register) to issue a certain amount of new shares against contributions. The authorization may be granted either in the memorandum of association or by a subsequent amendment to it, requiring a special resolution of the general meeting of shareholders by a qualified majority of at least 3/4 of the share capital represented at the meeting. The memorandum may prescribe a higher or lower majority (§ 202 II AktG). Each different class of shares needs to consent by the required majority (§§ 202 II, 182 II AktG). The board of directors may decide to use the authorization wholly or in part. It may issue the new shares only with the consent of the supervisory board (§ 202 III AktG). The issue of new shares is performed in the same manner as for a capital increase against contributions (see supra B.I.5.a).

(d) The Capital Increase from the Company’s Funds

The fourth form of capital increase is called capital increase from the company’s funds (§§ 207 et seq. AktG). The general meeting of shareholders may convert all or part of the ‘share premium account’ (i.e., capital-surplus) or the ‘revaluation reserve’ (i.e., retained-earnings) into share capital. A special resolution is required according to the modalities described above. The conversion may not exceed 10 per cent of the previously existing capital stock, but a higher percentage is permissible if the memorandum of association so provides. Such a capital increase must be based on a properly audited and certified recent balance sheet (§§ 208, 209 AktG). The share capital increase is effective as soon as it has been registered (§ 211 AktG). The new shares may then be issued (§ 191 AktG). Each shareholder has a mandatory preemptive right on the new shares of his or her class of shares (§ 212 AktG).

(e) Convertible Bonds, Debentures and Participating Bonds

With the approval of the general assembly by a special resolution, the company may issue convertible bonds, debentures and participating bonds (§ 221 AktG). In contrast, ordinary credit financing without the issuing of securities requires only a decision of the board of directors and no consent of the general meeting.

6. The Capital Reduction

(a) Legal Basis

The amount of share capital fixed in the memorandum may be reduced. However, it may not be below the minimum stock capital of DM 100,000 unless it is combined with a parallel capital increase against contributions in cash (§ 228 I AktG). High losses leading to a balance deficit may require the company to reduce its share capital. By adjusting the capital figures to the actual level of assets, financial soundness is restored. Further objects may be the distribution of committed assets of the company among the shareholders or the establishment of a free reserve.

Capital reductions may take one of three different forms: the ordinary capital reduction, the simplified capital reduction and the capital reduction by redemption of shares. The ordinary capital reduction and the capital reduction by
redemption of shares may serve all three purposes described above, whereas the simplified capital reduction is available only for the restoration of financial soundness or the establishment of a free reserve (§ 229 I AktG). All forms of capital reduction require a special resolution of the general meeting of shareholders by a qualified majority of at least 3/4 of the share capital represented. The memorandum may prescribe a higher majority and/or further requirements (§§ 222 I, 229 III, 237 II AktG). The purpose of the reduction must be stated in the resolution.

(b) The Ordinary Capital Reduction
The ordinary capital reduction is effected by a reduction of the nominal value of shares. This is not possible where the nominal value of shares is already set at the legal minimum of DM 5. A capital reduction would then take the form of a consolidation of shares (§ 222 IV AktG). The ordinary capital reduction is effective as soon as it has been registered (§ 224 AktG). The company must secure payment to all creditors who cannot demand immediate consideration of their claims, if they apply for the security within six months after registration of the reduction. Payments to shareholders may only be made after the expiry of this six months period.

(c) The Simplified Capital Reduction
The simplified capital reduction may only be executed to compensate for a deterioration of the value of assets, to cover losses, or to transfer value into the capital reserve. Thus, it is only permissible if certain other (reserve) funds have been used to cover the losses (§ 229 II AktG). The procedure for a simplified capital reduction resembles, for the most part, that of an ordinary capital reduction with one exception: as previously stated, assets remain untouched and payments to shareholders are forbidden (§ 230 AktG). Creditors are therefore less endangered. Their interests are properly secured by a limitation of the distribution of dividends to shareholders (§ 233 AktG).

(d) The Capital Reduction by Redemption of Shares
In contrast to other forms of reduction, which concern all shareholders, the capital reduction by redemption of shares is a cancellation of the rights of individual shareholders. A capital reduction by redemption of shares can be executed in two ways: either by redemption subsequent to the company’s purchase of shares or by compulsory redemption. The latter is only permissible if it is provided for in the original memorandum of association or a subsequent amendment. The rules governing ordinary capital reductions are applicable in general, but the requirements for and the method of execution of the redemption must be set down either in the memorandum or in a special resolution (§ 237 II AktG).
7. The Membership and the Minority Protection

(a) Property Rights
The legal position of the shareholders may be looked at from two different perspectives: on the one hand a shareholder has administrative rights (see infra B.I.7.b.), on the other hand he or she has property rights, e.g., a right to dividends (§ 58 IV AktG), preemptive rights (see supra B.1.5.a) or a right to participate in the distribution of assets after liquidation of the company (§ 271 AktG).

(b) Administrative Rights
Shareholders have individual administrative rights. The most important of these is the right to vote (§§ 12 I, 134 AktG) which is exercised in the general meeting of shareholders. A shareholder may be represented by the use of a written proxy (§ 134 III AktG). It is a special feature of German stock company and capital market law not to encourage proxy contests. As a corollary, a large percentage of voting rights in publicly-held companies are exercised on the basis of a proxy voting power for deposited shares held by banks (Depotstimmrecht). Since most shareholder-depositors refrain from instructing the depositary how to exercise the voting rights, banks may have a great influence over the company.

The right to vote implies the right to attend the general meeting (§ 118 I AktG). It also implies adequate information as solid basis for decisions. Complementing a variety of ordinary and extraordinary disclosure and reporting obligations, the board of directors has a special duty to inform shareholders, upon request, about all matters concerning the company, its interests and its policy (§ 131 I, II AktG). Only in certain enumerated cases (§ 131 III AktG) may the board of directors refuse to inform the shareholder, e.g., in order to avoid damage to the company. Lastly, the shareholder has the right to contest the validity of a resolution of the general meeting (§ 245 AktG), e.g., on grounds of violation of the law or the memorandum of association (§ 243 AktG).

In addition to these individual rights, shareholders have collective administrative rights in the form of minority rights. A minority representing 5 per cent of the share capital may request a general meeting. Similarly, a minority representing 5 per cent of the share capital or DM 1 million par value may request the court to order a special examination of an impermissible undervaluation (§ 258 II AktG). The same minority may also, under certain circumstances, contest the validity of a resolution not to declare a dividend in order to retain profits (§ 254 II AktG). Some other minority rights are worth mentioning: a company may waive or restrict its claims to damages against founders (§ 50 AktG), members of the board of directors (§ 93 IV AktG) or the supervisory board (§ 116 AktG) for breach of duties, unless a minority of shareholders representing 10 per cent of the share capital opposes the resolution. Such a minority may also request that the company enforce its claims to damages (§ 147 AktG). A separate discharge of each member of the board of directors or the supervisory board can be requested by a minority representing DM 2
million par value or 10 per cent of the share capital (§ 120 I AktG). The same minority may seek the removal of a member of the supervisory board who was not elected but appointed according to a special provision in the memorandum of association (§ 103 III AktG). Such a minority can also ask for the judicial appointment of special auditors (§ 142 II AktG) or another annual auditor (§ 163 II AktG).

(c) The Shareholders’ Duties and Liabilities
Original shareholders are obliged to pay in their contributions (see supra B.1.3.). Shareholders are not personally liable to creditors of the company. However, shareholders who received unlawful payments by the company are obliged to reimburse the amount; creditors may claim this amount directly from the shareholder if the company is not able or willing to meet its obligations (§ 62 AktG). As every other member of the company, a shareholder is liable for damages if he intentionally, by taking advantage of his influence upon the company, induces a member of the board of directors or the supervisory board to act to the detriment of the company or its shareholders (§ 117 AktG). The courts have restricted the liability of an individual shareholder by lifting the corporate veil (Durchgriffshaftung) in two exceptional cases, i.e., when an obvious undercapitalization works to the disadvantage of the creditors, and when the company’s and the shareholders’ private assets have been commingled.

8. The Administration
The stock company has three necessary organs: the board of directors (Vorstand), the supervisory board (Aufsichtsrat) and the general meeting (Hauptversammlung).

(a) The General Meeting of the Shareholders
The general meeting is the assembly of all shareholders. It has to be called at least once a year. In addition, it must be convened in cases provided for either by the memorandum of association or by the law, e.g., if a minority representing 5 per cent of the share capital so requests (see supra B.I.7.b.) or when it becomes necessary for the welfare of the company (§ 121 I AktG).

The general meeting’s competence is not comprehensive but limited to questions assigned to it by the law or by the memorandum of association, such as the election of the members of the supervisory board, the appropriation of accumulated earnings (§ 174 AktG), the appointment of the annual auditors (§ 119 I no. 4 AktG), the amendment to the memorandum of association (§§ 179 et seq. AktG), changes in the capital basis (see supra B.1.5.), certain decisions relating to the law of ‘affiliated companies’ (§§ 291 et seq. AktG), conversions and fusions (i.e., amalgamations and mergers as regulated by the Umwandlungsgesetz of 1994), the total transfer of assets, and dissolution (§ 262 I no. 2 AktG).
(b) The Supervisory Board

The supervisory board is an independent organ elected by the general meeting for a maximum period of four years (§ 102 AktG). If provided so in the memorandum of association, some members of the supervisory board may be appointed by certain shareholders (§ 103 III AktG). The board consists of at least three members. The memorandum may fix a higher number. The maximum number is determined in relation to the amount of share capital (§ 95 AktG). A company with a share capital of more than DM 20 million may have a supervisory board of 21 members. Only natural persons with full legal capacity may become board members. The memorandum may prescribe other personal requirements such as age, nationality, special professional qualifications (§ 100 IV AktG). The accumulation of memberships in supervisory boards of different companies is limited to ten (§ 100 II no. 1 AktG). Certain interlocks are prohibited. Thus, for example, a person serving on the board of directors of a subsidiary company may not be a member of the supervisory board of the parent company (§ 100 II no. 2 AktG).

The supervisory board appoints and supervises the board of directors. Supervision extends to all the activities of the board of directors including their legality and commercial soundness. In order to ensure a proper supervision, the board of directors must report regularly on its activities (at least four times a year). If necessary, the board of directors must inform the chairman of the supervisory board of any important developments in the company or its subsidiaries. The supervisory board may call a general meeting if the welfare of the company so requires (§ 111 III AktG). In addition, the board must be asked to consent to certain decisions.

Recent collapses of enterprises, some of them leading to the bankruptcy of the company, have given rise to questions about the legal concept of the supervisory board. There is no doubt that neither the three-tier legal structure of the stock corporation nor the function of the supervisory board will be subject to legal reform. But it is most likely that there will be some new legislation scheduled to make the board work more effectively.

(c) The Board of Directors

The company’s management and representative organ is the board of directors. Its members are elected by the supervisory board. The board of directors may consist of one or more persons (§ 76 II AktG). A company with a share capital of more than DM 3 million must have at least two directors, unless the memorandum of association provides otherwise. Only natural persons with full legal capacity may be board members. Persons convicted of certain offenses in relation to bankruptcy may not be appointed. The appointment lasts for a maximum period of five years (§ 84 I AktG) and is renewable. The same applies to the employment contract between the appointed persons and the company. It is one of the subject-matters of such a contract to fix the remuneration and other terms of employment of board members. The law provides for special stipulations concerning the financial compensation of directors, such as salaries, profit-sharing, expense allowances, retirement and pension plans (cf. § 87 AktG).
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The supervisory board may dismiss a member of the board of directors for cause (§ 84 III AktG), e.g., following a vote of non-confidence of shareholders at a general meeting.

The direction of the company is the sole responsibility of the board (§ 76 I AktG). As a corollary, the board is not subject to any instructions from the general meeting (§ 119 I AktG). It represents the company in and out of court (§ 78 I AktG). The powers of the board to represent the company with regard to third parties are unlimited and may not be limited through special provisions of the memorandum. The ultra-vires doctrine does not apply in Germany.

In contrast, the internal powers of the board may be limited by the declared purpose of the company, the memorandum of association, the supervisory board and by certain resolutions of the general meeting. The most important limitation is that the memorandum or the supervisory board may require certain decisions or transactions to be undertaken only with the consent of the supervisory board (§ 111 IV AktG). In addition, members of the board of directors have fiduciary duties toward the company that may limit the board’s internal competence.

When managing the corporation, board members must apply the care of a diligent and prudent manager (§ 93 I AktG). Members of the board of directors who fail to fulfill their duties are jointly and severally liable for damages caused to the company (§ 93 II, III AktG). The supervisory board enforces such a claim.

9. The Law of Affiliated Companies

(a) Structure of the German Law of Affiliated Companies

§§ 291 et seq. AktG regulate affiliated companies by establishing a system of responsibilities and liabilities for the controlling company. This system is built on the definitions of ‘dependency’ (Abhängigkeit, §§ 15, 17 AktG) of one company on another and of the group of companies (§§ 15, 18 AktG), the dependent company being under the unitary management of the dominating company. The law of affiliated companies primarily provides for the protection of creditors and of minority shareholders of the dependent company. The law covers two forms of control: control on the basis of an agreement between two companies (§§ 291 et seq. AktG – Vertragskonzern or ‘contractual group’), and control based on the de facto exercise of management power without such an agreement (§§ 311 et seq. AktG – faktischer Konzern or ‘de facto group’).

(b) Contractual Groups

In cases of control on the basis of an agreement, the controlling company is entitled to give instructions to the board of directors of the dependent company (§ 308 I AktG). In turn, the board of directors of the dependent company is authorized to follow instructions ‘from above,’ even if they are to the disadvantage of their own company (§ 308 II AktG). While the agreement gives the dominating firm the right to place the dependent firm under its management, the directors of the controlling enterprise are liable both for damages caused to
the affiliated company as a result of the instruction (§§ 308, 309 II AktG) and for the debts of the affiliated company (§ 302 AktG).

In addition to the obligations and liabilities of the members of the board of directors, the interests of minority shareholders are taken account of in heightened requirements as to the conclusion, amendment or termination of a contract of domination or a contract to transfer profits (§§ 293–299 AktG). If such agreements are concluded, outside shareholders have the option, guaranteed by an appropriate recurring compensation payment, to remain in the company (§ 304 AktG) or to leave it with an adequate indemnity for the takeover (§ 305 AktG). Because of the disadvantages for minority shareholders of the controlling company arising from these obligations, § 293 II AktG requires the consent of the shareholders' meeting of the dominating company to the conclusion of such an agreement.

(c) De facto Groups

When drafting the Stock Company Act of 1965, it was the legislature's intention to prohibit all other forms of active control of another company. The draft therefore required that the exercise of group management power is permissible only after the conclusion of a contract of domination; but it was not possible to effect this end and to ban the noncontractual exercise of management power in a group. Instead, the law provided for strict liability of the de facto dominating company. However, this regulation shows all the faults of compromises diluting the original legislative concept.

To be sure, the law provides that the dependent company must not be subject to instructions or measures that would have a disadvantageous effect on the controlled company (§ 311 I AktG) unless it is compensated immediately or at the end of the fiscal year (§ 311 II AktG). If the disadvantage is not compensated by the controlling company, the dependent company and its shareholders are entitled to claim damages (§ 317 AktG). In order not to make this system of compensation void from the outset, the law provides for increased disclosure and verification of dependency relationships: the dependent company's board of directors must deliver a report on the relations with affiliated companies (§§ 312 et seq. AktG – Abhängigkeitsbericht). If the disadvantageous measures are not indicated in the report, the dependent company's board of directors is liable to the company and its shareholders for damages caused (§ 318 AktG).

Today it is doubted whether the legislature succeeded in putting the dependent company in the same position as if it were independent. Thus, the legal arrangements for de facto groups in the stock corporation law is widely regarded as in need of reform.

10. The Dissolution and Liquidation

§ 262 AktG sets out the causes of a dissolution of the company: the expiration of the period determined in the memorandum of association, a special resolution of the general meeting of shareholders by a qualified majority of at least
3/4 of the share capital represented at the meeting, the opening of bankruptcy proceedings, and a final court decision declaring the memorandum of association unlawful. On request of the competent agency of the state in which the corporation has its seat, a court may dissolve a company if it endangers the public welfare (§ 396 AktG). In case of a total lack of funds, certain public authorities (e.g., the tax office) may request the court to dissolve the company (§ 141a FGG). The dissolution has to be registered in the commercial register (§ 263 AktG).

Following the dissolution, liquidation takes place unless bankruptcy proceedings have already been opened. Usually, the directors are appointed liquidators. They finish current transactions, collect outstanding claims, realize the assets, and settle the company’s liabilities. The managing directors give public notice of the dissolution three times and request creditors to register their claims against the company (§ 267 AktG). The liquidators may distribute the remaining assets to the shareholders in proportion of the par value of their shares one year after the third public announcement of the liquidation (§ 272 I AktG). The company is terminated and loses its legal capacity when the liquidators have distributed all assets and reported this in the commercial register (§§ 273 AktG, 6 II, 31 HGB).

II. The Public Limited Partnership by Shares

The public limited partnership by shares (Kommanditgesellschaft auf Aktien) is a combination of a limited partnership and of a stock company (§ 278 AktG). Like the stock company it is a corporation with a fixed capital stock divided into transferable shares. In contrast to the stock company there are two groups of members: the general partners (Komplementäre) and the shareholders (Kommanditaktionäre). The general partners have the power to direct the company’s business. At the same time they have an unlimited liability towards creditors of the company, whereas the shareholders are not personally liable for the company’s debts (§§ 278 III, 1, 54 I AktG). § 278 II AktG provides that the law of the general partnerships (§§ 105 et seq. HGB) applies to general partners, including their rights and duties with regard to shareholders (see infra C.III.2.). All other matters (e.g., the rights and duties of the shareholders) are regulated in the same manner as for stock companies (§ 278 III AktG). Because it is rarely used in practice this survey of the law of business associations can do without a more detailed description.

III. The Limited Liability Company

1. Introduction

(a) The Applicable Law
The limited liability company or private limited company (Gesellschaft mit beschränkter Haftung) is governed by the Limited Liability Act (Gesetz betref-
The statutory law of Gesellschaften mit beschränkter Haftung has not changed much during the last hundred years. The only important amendment was the Act of July 4, 1980, which came into force on January 1, 1981, but this act only provided for a partial revision of the GmbHG. The Amendment of 1980 increased the minimum share capital from DM 20,000 to DM 50,000. It allowed the incorporation of limited liability companies by a single shareholder (‘One-person GmbH’; § 1 GmbHG). Last but not least, it adapted statutory law to judge-made law introducing special rules for the preservation of share capital (§§ 32a, 32b GmbHG). Further amendments to the GmbHG resulted from the transformation of several EC directives into German law.

The internal organization of the GmbH may, to a large extent, be structured to suit particular needs of its shareholders. However, the courts, being more flexible in adapting the law to practical experience than is the legislature, have elaborated several doctrines to limit both the freedom to form the articles and the exercise of rights conferred to individual shareholders by the memorandum of association. Similar to corporate law in general, jurisprudence has taken the leading role in the further development of the law of the limited liability company.

(b) Some Characteristics of the GmbH

There is no statutory definition of the limited liability company. However, it can be defined as a company with legal capacity and a capital stock to which one or more shareholders contribute without being personally liable for the company’s debts.

The formation of a limited liability company, including the contribution to the capital stock subscribed to by the shareholders, is less formalistic than that of a stock company. The same applies to the internal organizational structure of the GmbH. The company has only two legally required organs, i.e., the ‘meeting of shareholders’ (Gesellschafterversammlung) and the managing director(s) (Geschäftsführer). If not required by co-determination law (see infra B.IV.), the establishment of a supervisory board is not mandatory. From the outset, the GmbH may be formed as a one-person limited liability company.
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As the limited liability company is a legal entity, only the company’s assets are available to satisfy its creditors (§ 13 II GmbHG). Another characteristic of the GmbH is its flexible structure: although it is neither a smaller version of the stock company nor a special case of a partnership, through the articles it may resemble either one. Nevertheless, statutory law of the limited liability company is guided by the concept of a personally structured corporation, i.e., a company based on the shareholders’ close association to the common enterprise.

The procedure for joining and leaving the limited liability company rather equals the law of partnerships than the law of the stock company. However, contrary to the membership right in a partnership, the shares of a GmbH are transferable and inheritable (§ 15 I GmbHG), unless otherwise provided for in the company’s articles; but, to restrict the negotiability of limited liability shares, the transfer of such shares must be in notarized form (§ 15 III, IV GmbHG). Thus, a GmbH is not a suitable corporate legal form to invite the public to subscribe to its shares. Accordingly, the GmbH has no access to the public capital markets.

The limited liability company must have a minimum capital stock of DM 50,000. However, only DM 25,000 have to be paid in prior to the company’s registration. To assure the contribution and preservation of the committed assets, the GmbHG provides a broad range of safeguarding measures such as prohibitions against release, deferment and set-off (§ 19 II GmbHG). In this area of law, statutory law has largely been complemented by judge-made law (e.g., the rules preventing circumvention of the statute’s provisions on contributions in kind).

The limited liability company can be established for any legitimate purpose, commercial or otherwise. Whatever the objectives of a GmbH may be, it qualifies as a commercial enterprise (Handelsgesellschaft) within the meaning of the Commercial Code (§ 13 III GmbHG). However, enterprises operating in special branches of business, e.g., banks and insurance companies, may not be organized as limited liability companies. Recently, Bavaria’s highest court in civil matters decided that law firms may be organized as a GmbH.

(c) Appearance and Significance

Since the introduction of the limited liability company, the number of corporations organized as GmbHs have grown steadily. Today, the limited liability company is the most widely used corporate legal form in Germany. In 1992, the total capital of about 510,000 limited liability companies exceeded DM 231,600 million. Due to its flexible structure, the GmbH serves the purposes of small or medium sized corporations and family-held companies as well as those of big business enterprises.

The limited liability company is frequently used in combination with a commercial partnership in the form of a so-called ‘GmbH & Co. KG.’ This kind of company is a limited partnership in which a limited liability company rather than a natural person occupies the position of the general partner. As the limited liability company is liable for the partnership’s debts, the ‘GmbH & Co. KG’ is, as a matter of fact, a partnership with limited liability. The shareholders
of the GmbH and the special partners in the limited partnership are usually the same persons. A large number of limited liability companies are organized as one-person companies. About one third of all limited liability companies are dominated by another corporation.

2. The Incorporation of the Limited Liability Company

The incorporation of a limited liability company is governed by statutory law. It requires a contract between the founders in notarized form. Each founder subscribes for one share capital contribution. The sum of the share capital contributions must correspond to the amount of the initial share capital (§ 5 III 3 GmbHG). The capital must be fully subscribed on the formation of the company. Once at least one quarter has been paid and further capital requirements have been met, the managing directors can apply for registration in the commercial register. Upon registration, the limited liability company acquires legal personality (§ 10 GmbHG).

(a) The Founders

The limited liability company may be formed by one or more founders. The founders and the subsequent shareholders may be natural persons or legal persons. Even general partnerships, limited partnerships or partnerships under the Civil Code can be founders. In the case of a one-person GmbH, some stricter provisions apply: the sole founder must provide security for any cash subscription not entirely paid in before he can apply for registration of the company (§ 7 11 3 GmbHG). In contrast to many other countries, there is no limitation on the number of shareholders.

(b) The Memorandum of Association

The memorandum of association must be executed in notarized form and must state at least the company’s firm name and registered office, the objectives of the enterprise, the amount of the share capital and the amount of each shareholder’s contribution (§ 3 GmbHG):

- The company’s firm name may either indicate the company’s purpose or the name of a shareholder (§ 4 I GmbHG). It must not be misleading or confusing. Moreover, it has to be clear that the name used is the name of the company, not of a sole trader. If a limited liability company succeeds to the business of a sole trader or a partnership, the previous name can be taken over. The name must include the addition ‘with limited liability’ (‘mit beschränkter Haftung’) or the abbreviation ‘GmbH’ as a warning to creditors of the limit upon shareholders’ liability. A German subsidiary of a foreign company may comprise the name of the foreign parent company and the words ‘Deutsche’ or other reference to Germany.
- The registered office must be determined in the memorandum of association. A change of the registered office within Germany is effectuated by an
amendment to the memorandum of association and its entry in the commercial register.

- The share capital (Stammkapital) amounts to at least DM 50,000 (§ 5 GmbHG). There is no maximum amount of share capital. The share capital is the permanent capital of the company. Its important function is to protect creditors. The level of share capital can be altered only by the strict procedure of an amendment to the memorandum of association.

The company’s internal organization as well as the shareholders’ rights and duties may be structured by the shareholders in the memorandum. In practice, the memorandum usually sets out supplementary and detailed rules referring to shareholders’ accessory obligations, the obligation to make an additional contribution, representation and management of the company, shareholders’ meetings and resolutions, preference rights of individual shareholders, the transfer of shares, the distribution of net profits and a supervisory or advisory board.

An amendment to the memorandum of association requires a special resolution of the shareholders’ meeting by a qualified majority of at least 3/4 of the share capital represented at the meeting. Amendments to the memorandum of association must be notarized and registered in the commercial register (§ 54 GmbHG).

(c) The Share Capital Contributions
There are strict rules to ensure that the limited liability company obtains the required share capital (§§ 7, 9, 19 GmbHG). The share capital is divided into as many share capital contributions (Stammeinlagen) as there are founders of the company. Each founder subscribes only for one share capital contribution.

The share capital contribution is the amount of capital a founder contributes. The amount must be divisible by 100. The subscriptions of each of the founders may have different nominal values, but must be at least DM 500. Shareholders’ contributions may be paid in cash (Bargründung) or be made in kind (Sachgründung). A shareholder may not set off a contribution (§ 19 II 2 GmbHG).

The company may not waive a shareholder’s obligation to contribute (§ 19 II 1 GmbHG).

Payment in kind may be transferable assets (e.g., land, buildings, know-how, business, patents, copyrights or trademarks). If subscriptions are paid in kind, stricter provisions apply. The memorandum of association must clearly specify the items to be contributed by the shareholder and their value. The founders have to produce a report (Sachgründungsberichte) in which they substantiate whether the value of contributions is equivalent to the amount stated in the memorandum. If a business is transferred as payment, the balance sheets of its last two financial years must be added to the report. If the value of the consideration in kind is less than the value stated in the memorandum, the shareholder is liable to pay the difference (§ 9 GmbHG).
(d) The Application for Registration

In order to apply for registration, the entire share capital must be subscribed to by the founders, and at least 25 per cent of the nominal value of each share capital contribution must be paid in. The total paid-in share capital must be at least DM 25,000 (§ 7 lII GmbHG). Payments in kind must be fully performed (§ 7 lII GmbHG). Managing directors must be elected by a resolution of the founders, unless they are already appointed by the memorandum of association (§ 6 lII 2 GmbHG).

Managers have to submit the application for registration and certain documents (e.g., the memorandum of association, the signatures of the managing directors and their power of representation, a list of shareholders and their subscriptions) to the commercial register (§ 8 GmbHG). The court ensures that the application for registration complies with statutory provisions (§ 9c GmbHG). It verifies the admissibility of the company's name by requesting the Chamber of Industry and Commerce (Industrie- und Handelskammer) to review the proposed name. It examines especially the memorandum of association, the directors' appointment and the properly effected minimum capitalization. In the case of contributions in kind, the court reviews the valuation of these subscriptions.

(e) Defective Incorporation

Once registered, a court may declare the incorporation void only on grounds of grave error (as listed in § 75 GmbHG).

(f) The Pre-incorporation Status of the Company

There are several steps on the way to incorporation of a limited liability company. Prior to the conclusion of the memorandum of association, the potential founders form either a partnership under the Civil Code or a general partnership (Vorgründungsgesellschaft) depending on whether or not the intended company will run a commercial business as defined by §§ 1 to 3 of the Commercial Code. The partners are personally liable for the debts incurred in this period.

For the period between the adoption of the memorandum of association and the registration in the commercial register, the limited liability company is called 'pre-incorporation company' (Vorgesellschaft). The legal nature of this Vorgesellschaft is a particular form of partnership. Its object is to obtain the registration of the limited liability company. Thus the rules of the limited liability company apply to this partnership as long as these rules do not require legal personality. However, persons acting on behalf of the company before registration are personally, jointly and severally liable to creditors (§ 11 lII GmbHG). In addition, the founders are liable to the full extent of their subscribed shares. The rights and obligations of the pre-incorporation company pass to the limited liability company by universal succession. Hence, the liability of persons acting for the Vorgesellschaft ends upon registration. Consequently, the liability of founders and the liability under § 11 lII GmbHG is of importance only in cases where an incorporation is not obtained.
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In addition to these rules, there are special provisions for the protection of creditors and the public such as the liability of founders (see § 9a GmbHG).

3. Shares

(a) Shares versus Share Capital Contributions

When describing the legal position of the shareholders, the GmbHG uses two slightly different terms. Share (Geschäftanteil) means the sum of the rights and the duties inherent in the position of a shareholder; it represents the membership in the company. The share depends on the share capital contribution (Stammeinlage) of each shareholder (§ 14 GmbHG).

Rights and obligations are determined, first, by the memorandum of association and, second, by statutory law. The statutory law does not provide for a share certificate or a share register, but the individual shareholder may get a share certificate. This is merely a documentary proof, but not a security and, thus, not transferable.

As previously described for the stock company, there are two kinds of rights inherent in a share: property rights (e.g., right to dividend, § 30 GmbHG) and administrative rights (e.g., voting rights in the shareholders' meeting as well as information and minority rights, §§ 51a, 51b GmbHG). Beyond these statutory rights, the memorandum of association may allocate preferred shares as long as these shares comply with statutory law. Preferred shares carry preferential rights, e.g., the right to receive a fixed rate of dividend or a preferential dividend, the right to appoint one or all managing directors or members of an optional supervisory board, the right to be appointed as managing director or a priority for the repayment of capital in the event of winding-up. The preferential rights attached to preferred shares must be distinguished from special privileges granted to shareholders individually.

(b) The Transfer of Shares

Shares (not share certificates) are transferable and inheritable (§ 15 I GmbHG). The transfer of parts of a share can only take place with the approval of the company (§ 17 GmbHG). German civil law distinguishes between the actual contract to transfer the property in the share and the underlying contract of obligation. Thus two contracts are necessary for the proper and effective transfer of shares. Both need to be notarized (§§ 15 III, IV GmbHG). Upon completion of the transfer, the title to the share and the rights and duties connected to it pass to the transferee.

In practice, the memorandum of association often provides that the transfer must be approved by a certain shareholder or at the shareholders' meeting (§ 15 V GmbHG). The memorandum of association may provide that a transfer to certain persons only is permissible with prior consent of the shareholders' meeting. It is also permitted to exclude the right to transfer the shares. The memorandum of association may provide for a right of first refusal in favor of existing shareholders or may define standards for the qualification of potential shareholders. Thus, it is possible to control the shareholders' composition and
to stabilize the influence of a family or group of founders on the company. Once a year the managing directors have to file a list of shareholders with the commercial register (§ 40 GmbHG).

4. Share Capital Maintenance, Capital Increase and Capital Reduction

(a) Share Capital Maintenance
The provisions to guarantee the payment of the share capital contributions (§§ 7, 9, 19 GmbHG) are complemented by provisions to ensure the maintenance of the share capital and to protect creditors (principle of the effective maintenance of the share capital). The company may neither repay a share capital contribution nor distribute the company’s assets to the shareholders (§ 30 I GmbHG), if such a payment or distribution endangers the amount of share capital fixed in the memorandum of association. Shareholders receiving payments contrary to § 30 GmbHG in bad faith are obliged to refund the amount (§ 31 I GmbHG). In the event that a refund cannot be obtained, all shareholders are liable in proportion to their shares (§ 31 III GmbHG). Loans given to a company instead of equity capital may not be claimed in the case of a financial crisis or bankruptcy of the company (§§ 32a, 32b GmbHG).

Pursuant to § 33 GmbHG, the limited liability company may acquire its own shares only if the entire contributions have been paid in and if the payment to purchase the shares does not endanger the amount of the share capital or the capital reserve.

(b) The Capital Increase of Share Capital Against Contributions
The share capital can be increased only by an amendment to the memorandum of association and allotment of new shares to each existing shareholder and/or some new shareholders (§ 55 II, III GmbHG). The statutory law on capital increase (§§ 55 et seq. GmbHG) generally refers to the rules of the incorporation (see supra B.III.2.c. and B.III.4.a.). To preserve the ownership structure of companies, new shares must first be offered to existing shareholders in proportion to the nominal value of their share capital (preemptive right or Bezugsrecht). Preemption rights may (mutatis mutandis to the provisions of the stock company, see supra B.I.5.a.) be wholly or partly excluded by a special resolution of the shareholders’ meeting. A share capital increase is valid and takes legal effect as soon as it has been registered (§ 57 GmbHG).

(c) The Capital Increase from the Company’s Funds
The shareholders’ meeting may, by special resolution, convert (parts of) the ‘share premium account’ (i.e., capital surplus) or the ‘revaluation reserve’ (i.e., retained earnings) into share capital (§§ 57c et seq. GmbHG). Such a capital increase must be based on a properly audited and certified recent balance sheet (§§ 57e, 57f GmbHG). The share capital increase is effective as soon as it has been registered (§ 54 III GmbHG). Each shareholder has a mandatory preemptive right on the new shares (§ 57j GmbHG).
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(d) Reduction of Share Capital
The amount of share capital fixed in the memorandum may be reduced; however, it may not fall below the minimum stock capital of DM 50,000, unless it is combined with a parallel capital increase against contributions in cash (§ 58a IV GmbHG). The reduction of capital is effected by an amendment to the memorandum of association. Capital reduction may take two different forms: the ordinary capital reduction (§ 58 GmbHG) and the simplified capital reduction (§§ 58a et seq.).

The ordinary capital reduction may serve the purposes of restoration of financial soundness, the distribution of committed assets of the company among the shareholders or the establishment of a free reserve. The managing directors must announce the capital reduction three times. Creditors opposing the capital reduction can demand immediate payment of their claims or apply for a security respectively. One year after the third public announcement, the managing directors apply to the local commercial register for registration. The capital reduction is effective as soon as it has been registered (§ 54 III GmbHG).

In contrast to the ordinary capital reduction, the simplified capital reduction is allowed only for the restoration of financial soundness (§ 58a GmbHG) or the establishment of a free capital reserve, if it does not exceed 10 per cent of the share capital (§ 58b GmbHG). It is only permissible if certain other (reserve) funds have been used to cover losses (§ 58a II GmbHG). The procedure for a simplified capital reduction resembles, for the most part, that of an ordinary capital reduction with one exception: as previously stated, assets remain untouched and payments to shareholders are forbidden (§ 58b GmbHG). Creditors are, thus, less endangered and may not apply for a security.

5. The Membership
The shareholder acquires membership in the company either as a founder, by subscribing for a share, or by a transfer or acquisition of shares subsequent to the incorporation (e.g., purchase or devolution of inheritance). In the case of a transfer or acquisition of shares subsequent to the incorporation, the new shareholder may only exercise the relevant rights if the transfer has been notified to the company. Transferee and transferor are jointly and severally liable for the overdue contributions at the time of notification (§ 16 III GmbHG).

In the event of the death of a shareholder, the heir or the heirs are entitled to the share of the deceased shareholder. If several heirs inherit the share, it belongs to them in joint ownership until partition according to the last will of the deceased.

The memorandum of association may provide for the redemption of shares by shareholders' resolution (§ 34 GmbHG). Compulsory redemption requires that the provisions in the memorandum of association precisely stipulate the conditions for the redemption. Its effect is that the redeemed share accrues to the remaining shareholders. The memorandum of association usually provides
that a withdrawing shareholder (or his heirs) receives a lump-sum payment corresponding to the value of the share at the moment of his withdrawal. Although the GmbHG only mentions redemption as a cause for termination of the membership, case law and scholars hold that a shareholder may terminate his or her membership for good cause. For example, a shareholder is not bound to tolerate a total change of the company’s objects or a takeover of the company by another enterprise without his or her consent.

6. The Administration of the Company

The statutory organs of the company are the managing director(s) and the meeting of shareholders. The extent of the organs’ power depends on the memorandum of association.

(a) Management

The company must have one or more managing directors. In contrast to the general partnership or the limited partnership, managing directors need not be shareholders of the company. Only natural persons with full legal capacity can be appointed. In practice, most managing directors of limited liability companies are shareholders rather than third parties. The managing directors jointly represent the company in and out of court (§ 35 GmbHG). The memorandum of association may grant managing directors the right to act solely. Shareholders can impose internal restrictions on the ability to act on behalf of the company. However, such limitations are not effective against third parties (§ 37 II GmbHG).

Managing directors are obliged to ensure that proper accounting records are kept and to submit the financial statements to the shareholders’ meeting. They are required to call a shareholders’ meeting at least once a year. Furthermore, they must provide information on the company’s affairs to shareholders. In the case of bankruptcy proceedings, managing directors are required to file a petition for the commencement of bankruptcy (§ 64 GmbHG).

Managing directors are nominated by the memorandum of association or appointed by a resolution passed in the shareholders’ meeting (§ 46 no. 5 GmbHG). The memorandum of association may set out special requirements with regard to the appointment of managing directors (e.g., additional standards regarding the qualifications of managing directors). If the company has a supervisory board pursuant to the Co-determination Acts (see infra B.IV.), the board is responsible for the appointment of the management.

Unless otherwise provided in the memorandum, managing directors are subject to instructions from the shareholders meeting (§§ 37 I, 47 I GmbHG). Thus, a majority of shareholders can determine the business of the company. Hence, the limited liability company is considered to be the most appropriate corporate legal form of a subsidiary.

As previously stated, there are two legal relationships between the company and the managing directors: firstly, a corporate law relationship through their appointment or dismissal and, secondly, a relationship governed by labor law...
in relation to their employment contracts. The dismissal of a managing director requires a resolution of the shareholders' meeting. In practice, the memorandum of association often provides that managing directors may only be dismissed for good and sufficient cause.

Managing directors are responsible to the company for the diligent performance of their duties and are liable for damages caused (§ 43 GmbHG), unless they acted upon instruction of the shareholders' meeting. Managing directors have fiduciary duties toward the company. Thus, for example, they are prohibited from diverting corporate opportunities unto themselves.

Managing directors are liable to the company for any failure in the performance of their duties (§ 43 GmbHG). A resolution of the shareholders' meeting is needed to pursue such a claim (§ 46 no. 8 GmbHG). If the managing directors acted subject to instructions or with the approval of the shareholders' meeting, they are released from liability.

Managing directors are liable to third parties only in specific circumstances: firstly, during the pre-incorporation period; secondly, in cases of general tort liability for negligence and fraud; and thirdly, in cases where they breach certain duties inherent to the negotiation and conclusion of a contract between the company and third parties according to German civil law (precontractual liability or culpa in contrahendo).

Recently, the courts had to decide several cases on the issue of a general liability of directors under criminal law for tax fraud and similar misconduct. It was held that such personal liability does apply to directors in the exercise of their functions. Thus, the corporate veil does not protect managers from criminal or tax law proceedings.

Apart from the managing directors, other officers (especially agents within the meaning of the Commercial Code) may be entitled to act on the company's behalf.

(b) Shareholders' Meeting

By statutory law, the shareholders' meeting is the most important organ. It must be called by the management at least once a year. In calling it, one week's written notice must be given. As pointed out previously, the shareholders' meeting appoints, supervises and dismisses managing directors (§ 46 GmbHG). It decides on amendments to the memorandum of association, on the approval of annual financial statements and on the distribution of profits.

The resolutions need to be passed by a majority of votes cast unless the memorandum of association provides otherwise (§ 47 I GmbHG). A decision on the basic legal structure or on the purpose of the company, an amendment to the memorandum of association, a capital increase or reduction (§ 53 II GmbHG), an amalgamation or a merger, a conversion into a stock company or a public limited partnership by shares (regulated by the Conversion Act 1994) and the dissolution (§ 60 I no. 2 GmbHG) have to be passed by a qualified majority of three quarters of the votes cast (§§ 53, 60 I no. 2 GmbHG).

The shareholders' resolutions do not need to be notarized. It is possible to agree to certain decisions by written agreements outside the shareholders'
Every DM 100 of a share entitles a shareholder to one vote, unless otherwise provided in the memorandum of association (e.g., multiple voting rights). Shareholders may not vote in the resolution on their own discharge from a liability claim (§ 47 IV GmbHG). A shareholder may be represented at the meeting by use of a written proxy.

There are no specific statutory provisions relating to errors and defects in shareholders' resolutions. The prevailing opinion holds that the provisions of §§ 241 et seq. AktG should be applicable mutatis mutandis. Thus, every opposing shareholder may contest the resolution in court, to obtain a judgment declaring it void or invalid.

(c) Supervision of the Management by Supervisory or Advisory Boards
There is no statutory obligation for a GmbH to set up a supervisory board (Aufsichtsrat), unless the Co-determination Acts apply (see infra B.IV.). In the latter case, the supervisory board of a limited liability company have the same authority as granted to the supervisory board of a stock company.

A company may, nonetheless, give itself a supervisory board by a specific provision to this effect in the memorandum of association. In the case of an optional supervisory board, the law applicable to stock companies applies mutatis mutandis (§ 52 GmbHG).

Another possibility is the creation of an advisory board (Beirat). The shareholders are free to decide which functions are given to this board. In practice, advisory boards can be found particularly in family companies where members come from different branches of the family.

7. Liability of the Company and the Shareholders

From the creditor's perspective, the most important question is, who is liable for debts? The company as legal entity? Its managing directors, or its shareholders? The corporate veil implies that only the assets of the company are available to satisfy claims by company's creditors. Once the limited liability company is registered in the commercial register, shareholders are not personally liable for the company's debts (§ 13 II GmbHG).

However, there are some exceptions to the rule:

- If a shareholder fails to pay in his entire subscription and it cannot be recovered from him, then the remaining shareholders are liable for the difference (§ 24 GmbHG).
- The shareholders have to put up additional capital if the memorandum of association so provides (§§ 26 et seq. GmbHG).
- A shareholder-manager may be personally liable to creditors who would not have entered in a contract with the company, if a petition in bankruptcy would have been filed in due time (§ 823 II BGB and § 64 II GmbHG combined).
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In case of severe abuse of the corporate veil, i.e. mixture of private and company assets or obvious undercapitalization, the courts may pierce the corporate veil and hold a shareholder personally liable (Durchgriffshaftung).

Though this is not explicitly provided for in the GmbHG, the courts have developed a GmbH group enterprise law (GmbH-Konzernrecht). Because of the differing systems of competencies in the AG and the GmbH, it was clear from the outset that AG group enterprise law (see supra B.1.9.) could not simply be adopted or applied mutatis mutandis. Hence, GmbH group enterprise law developed into a unique branch of the law of affiliated companies. It applies to group relationships in which the dependent company is a GmbH. However, it is not domination of a GmbH per se that triggers personal liability of the dominant shareholder to the dependent company’s creditors. Rather, such liability is subject to the fact that the dependent company has no assets and the dominant shareholder has exercised its management power over a GmbH to the detriment of the company. In addition, it has to be shown that instructions for disadvantages cannot be identified and compensated for individually.

Based on the principle of culpa in contrahendo (‘pre-contractual liability’), a shareholder-manager is liable to a company’s creditor, if he or she, while acting for the company, has personally obtained and misused the creditor’s trust by false representations.

Finally, the courts recently found that a shareholder-manager may be held personally liable if he or she, in internally organizing the company, failed to prevent damages to third parties.

8. Accounting

The provisions of the Commercial Code (§§ 264 et seq. HGB) about annual financial reporting of the company are applicable to the limited liability company. Managing directors draw up the annual balance sheet (Bilanz), the statement of revenues and losses (Gewinn- und Verlustrechnung) and the annual report (Anhang) of the company. They must submit the properly audited and certified accounts and the annual report to the shareholders without undue delay (§ 42a GmbHG). If the limited liability company is a ‘small corporation’ within the meaning of § 267 HGB, there is no obligation to get the annual financial statements audited by an independent certified public accountant (§ 316 1 HGB) or to publish an annual report (§ 264 HGB). Shareholders adopt the annual financial statements (§ 46 no. 1 GmbHG) and decide about the distribution of profits.

9. The Dissolution and Liquidation

§§ 60 et seq. GmbHG set forth the causes of the (compulsory) dissolution and requirements of the liquidation. Both dissolution and liquidation are regulated in a similar manner as for stock companies (see supra B.1.10.).
IV. Co-determination

In order to secure a certain participation and influence of the employees in a company, German law provides three different forms of co-determination (Mitbestimmung) in the supervisory board of a company:

1. The Co-determination Act of 1976

The Co-determination Act (Mitbestimmungsgesetz – MitbG) of 1976 applies to all companies (stock companies, limited liability companies and public limited partnerships by shares) which are not regulated by the Coal and Steel Co-determination Act of 1951 (see infra B.IV.2.) and which employ more than 2,000 employees, including the employees of affiliated companies (§ 5 MitbG). The law provides that employees elect 50 per cent of the supervisory board members. The board consists of twelve, sixteen or twenty members depending on the number of employees of the company (i.e., less than 10,000, between 10,000 and 20,000 or more than 20,000). The chairperson, usually appointed by the shareholders, has two votes (§ 29 II MitbG), whereas all other members of the board have a single vote.

Furthermore, the employees elect one member (Arbeitsdirektor) of the board of directors of a stock company, and one managing director of a limited liability company respectively (§ 13 MitbG). In public limited partnerships by shares there is no Arbeitsdirektor because the management of this type of corporation is personally, jointly and severally liable for the company’s debts.

2. The Coal and Steel Co-determination Act of 1951

The Coal and Steel Co-determination Act of 1951 (Montanmitbestimmungs­gesetz – MontanMitbG) applies to stock companies or limited liability companies of the coal and steel industries which employ more than 1,000 employees. The supervisory board has eleven, fifteen or twenty-one members depending on the total share capital. Shareholders and employees elect 50 per cent of the members, who in turn elect the chairperson. In addition, employees elect one director (Arbeitsdirektor; § 13 MontanMitbG).

3. The Employees’ Representation and Co-determination Act of 1952

In companies which are not subject to the above two Acts (see supra B.IV.1. and 2) and which employ more than 500 persons, one third of the supervisory board members must be employee representatives (§ 77 of the Employees’ Representation and Co-determination Act or Betriebsverfassungsgesetz of 1952).
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C. PARTNERSHIPS

I. In General

German law provides for several different kinds of partnerships, which may be divided into two general categories: (i) commercial partnerships (i.e., general partnerships, limited partnerships and 'dormant' partnerships) carry on commercial activities as defined by §§ 1 et seq. of the Commercial Code; (ii) non-commercial partnerships (i.e., partnerships under the Civil Code and non-trading partnerships under the Partnership Act of 1994) serve all other purposes. §§ 705 et seq. BGB apply to non-commercial partnerships, whereas commercial partnerships are governed by §§ 105 et seq. HGB. The laws generally applicable to associations (mainly §§ 705 et seq. BGB) govern particular matters on which the Commercial Code does not provide specific provisions.

II. Non-Commercial Partnerships

1. Partnership under the Civil Code

The partnership under the Civil Code (BGB-Gesellschaft) is the basic form of all partnerships. Thus, its law applies to supplement the other legal forms of partnerships (see B.II.2. and B.III.).

(a) The Partnership Agreement and Its Contents

The partnership under the Civil Code is established by a contract between the partners (§ 705 BGB), who can be natural or legal persons. A notarized contract is only necessary if real property is contributed (§§ 313, 925 BGB). The partners must agree on a common purpose pursued by the partnership, such as building and construction (so-called Arbeitsgemeinschaft) or an underwriting syndicate (Emissionskonsortium). Any legal common purpose except the operation of a commercial business is permitted. If several partners operate a commercial business they automatically (see § 123 HGB) qualify as a general partnership (oHG).

Partners are free to decide which matters shall be regulated by the partnership agreement (principle of freedom of contract). The agreement may be amended by unanimous decision, unless the partners have stipulated to majority rule in advance. But this rule is only applicable to normal business operations or to those decisions explicitly mentioned in the partnership contract. Unlike partnerships operating a commercial business (see infra C.III.), a partnership under the Civil Code may be structured and operated as a purely internal partnership. In respect to their relations both to the partnership and to the individual partners, each partner is bound by a general duty of loyalty.

Subject to the specifications in the partnership agreement, partners may pay contributions in cash, in kind or in personal services (§§ 705, 706 III BGB). In the absence of any agreement to the contrary, the law provides for equal
contributions (§ 706 BGB). A subsequent increase of the original contribution is only permissible with the consent of all partners (§ 707 BGB).

(b) The Legal Nature, the Liability and the Assets

The partnership has no legal personality and, hence, no corporate organization. The partners are personally, jointly and severally liable to the partnership's creditors. The personal liability of the partners may be excluded either by agreement with the creditors or by limiting the power of representation in the partnership contract (see infra C.II.1.c).

The assets belong to the partners in joint ownership (Gesamthandsgemeinschaft, § 719 BGB). The principle of joint ownership means the holding of property by two or more persons not in distinct shares but jointly, each having an identical interest in the undivided whole. An asset may be transferred only with the consent of all partners which can be given either in the partnership agreement (e.g., by authorizing the management to dispose of assets) or in a general meeting of the partners.

(c) The Management

The law provides that partners manage the business jointly (Geschäftsführung, § 709 BGB), but the partners may agree to entrust one or more partners with the management of the partnership (§ 710 BGB). Third persons may not be managers. The partners agree on the scope of authority of the management. If the partnership contract does not provide otherwise, the authority to manage the business is combined with the authority to represent the partners (Vertretung, § 714 BGB).

The partners representing the partnership act in the name and for the account of all partners. The power to represent the partners in joint matters of the partnership may be restricted. The restriction may be such that an obligation incurred in a legal transaction may only be held valid subject to the exclusion of the partners' personal liability. However, the limitation of the power of representation, if not disclosed or evident, must at least be perceivable to the creditor. Partners acting beyond their power of representation are liable to the creditors (§§ 177, 179 BGB).

(d) The Distribution of Profits and Losses

Profits and losses are distributed in proportion to the number of partners (§ 722 BGB), unless otherwise agreed by the partners (e.g., a distribution proportionally to the amount of each partner's contribution).

(e) The Dissolution

§§ 723 et seq. BGB set forth the causes of a dissolution of the partnership: notice of termination by a partner, death of a partner, bankruptcy proceedings against a partner or a dissolution on grounds agreed to in the partnership agreement. Following the dissolution, liquidation takes place (§§ 730 et seq. BGB). The partners finish current transactions, collect outstanding claims, realize the assets and satisfy the obligations. If there is a surplus, the contribu-
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tions are repaid (§ 733 II BGB). The remaining assets are divided among the partners equally or in proportion to their contributions (§ 734 BGB).

2. The Non-trading Partnership under the Partnership Act of 1994

Professionals such as doctors, architects, interpreters and others are not subject to § 1 HGB. They were therefore prevented from using commercial partnerships as a form of business association. The canons of professional ethics did not allow incorporation either. As a consequence, professionals relied on the partnership under the Civil Code. This form of association has several major disadvantages: unlimited liability, the lack of legal personality and the lack of a firm name.

To improve this situation, in 1994 the legislature enacted the Non-trading Partnership Act (Partnerschaftsgesellschaftsgesetz – PartnGesG). A partnership (Partnerschaftsgesellschaft) under this Act may have a common firm name (§ 2 I PartnGesG). The partners are still personally, jointly and severally liable to the partnership’s creditors. However, the partners may limit liability for wrongful acts in a way that only the partner rendering a service to the third party and acting negligently or wrongfully may be held liable.

A partnership is established by a written contract between the partners. For particular matters on which neither the Partnership Act 1994 nor the partnership agreement provides specific provisions, the law generally applicable to partnerships or commercial partnerships applies (§§ 1 IV, 6 III, 7 II, III PartnGesG).

III. Commercial Partnerships

1. The General Partnership

(a) The Partnership Agreement and Its Contents

The general partnership (offene Handelsgesellschaft – oHG) is established by a contract between the partners (§ 105 II HGB, § 705 BGB). A notarized contract is only necessary if real property is contributed (§§ 313, 925 BGB). The partners must agree on the operation of a commercial business under a common firm name (§ 105 I HGB). The general partnership’s firm name must contain at least the family name of one partner, along with an indication of the existence of a partnership or the family names of all partners (§ 19 I HGB).

With regard to the content of partnership agreements and the contributions, § 105 II HGB refers to the law of partnerships under the Civil Code (see supra C.II.1.). The partners must apply to the local commercial register for registration (§§ 106, 107 HGB). If the partnership starts to conduct business before registration, the partnership is immediately deemed to be effective with regard to third parties (§ 123 II HGB).

Similar to the partnership under the Civil Code, partners of the general partnership have a duty of loyalty both to the partnership and to their partners. The duty of loyalty is complemented by each partner’s right of equal treatment.
(b) The Legal Nature, the Liability and the Assets
The general partnership does not have legal personality but it can acquire rights and obligations, acquire ownership and other rights in real property, and it can sue and can be sued in its own name (§ 124 I HGB).

With regard to the liability of the partners and joint ownership, the principles described above for the partnership under the Civil Code apply. However, there are some significant differences with respect to the partners’ liability to creditors. As the partners’ liability is accessory to the partnership’s liability, each partner may be sued directly for the full amount (§ 128 HGB). While the personal liability of the partners may be ruled out by agreement with the creditors, it can neither be excluded by limiting a partners power of representation (§ 126 II HGB; see infra C.III.1.e.) nor by the partnership agreement.

A partner who has been held liable by a creditor may demand reimbursement from the partnership (§ 110 HGB). If the partnership cannot fulfill this obligation, the partner has a right to be compensated by the other partners (§ 426 I BGB). Liability to third parties is also imposed upon partners newly joining the partnership. The liability extends to the partnership’s obligations incurred prior to entry of the new partner (§ 130 HGB). Partners withdrawing from the partnership may be held liable for obligations incurred prior to their withdrawal, if the claim becomes due within a period of five years after their withdrawal (§ 160 HGB).

(c) The Management
The law provides that management is carried out jointly by the partners (§ 114 I HGB), but here also the partners may charge one or more partners with the management of the partnership (§§ 114 II, 115 HGB). Third persons may not be managers.

Each managing partner may represent the partnership in and out of court (§ 126 I HGB). His or her powers to represent the partnership with regard to third parties are unlimited and may not be limited through special provisions in the partnership contract (§ 126 II HGB).

In contrast, the internal powers of managing partners may be limited. Managing partners who do not observe such internal limitations are liable for all damages caused to the partnership. A managing partner may be dismissed for cause by a final court decision (§§ 117, 127 HGB).

(d) Other Provisions
The distribution of profits and losses, dissolution and liquidation are all carried out according to the principles described for the partnership under the Civil Code (see supra C.II.1.d.-e.). In addition to the grounds for dissolution set forth in the Civil Code, the Commercial Code allows a dissolution of the partnership by a court decision on petition by a partner alleging good cause. Membership in a partnership may be acquired by inheritance or succession if the partnership contract provides so (§ 139 HGB).
2. The Limited Partnership

In contrast to a general partnership, the limited partnership (Kommanditgesellschaft) consists of two different groups of partners: the general partners (personlich haftende Gesellschafter or Komplementäre) and the limited partners (Kommanditisten). The liability of a limited partner in respect of the partnership’s creditors is limited to the specific amount of his or her contribution (§§ 161 ff. HGB). Once the entire contribution is paid in, the limited partner has no further liability (§ 171 I HGB). To the extent that the contribution of the limited partner has been repaid, it is deemed, with respect to creditors, not to have been made (§ 172 IV HGB). As previously stated for the general partnership, the liability of general partners is unlimited. In fact, most limited partnerships today are GmbH & Co. KG, where the general partner is a limited liability company (see supra A.I.1. and B.III.1.c.). As a result, only the corporate general partner is liable.

All other principles described for the general partnership also apply to the limited partnership with two exceptions: a limited partner may not represent the partnership with regard to third parties (§ 170 HGB), and in case of a limited partner’s death the partnership is not dissolved. A partnership interest is inheritable even if the partnership agreement does not explicitly provide so.

3. The Dormant Partnership

The ‘dormant’ partnership (stille Gesellschaft) is a partnership between a commercial enterprise (i.e., a corporation, a partnership or a sole trader) and the ‘dormant’ partner who contributes a certain amount of money to the enterprise (§ 230 HGB).

The dormant partnership therefore resembles the limited partnership. The main difference is that the partnership agreement has legal effect only for the enterprise and the dormant partner, but not against third parties who may not know of the existence of a partnership. Business activities are conducted only by the enterprise. This difference has several consequences. The partnership is not registered in the commercial register. The assets only belong to the enterprise and the principle of joint ownership does not apply. The dormant partner is not liable to the enterprise’s creditors. The dormant partnership is also similar to a loan with participation in the profit, because the dormant partner’s remuneration is paid out of the enterprise’s profits. The dormant partner bears losses only if explicitly provided in the dormant partnership contract (§ 231 II HGB).
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