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"The appropriate recognition of the interest of the group"

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List of Abbreviations

AktG - Aktiengesetz (German Stock Corporation Act)

BGH - Bundesgerichtshof (Federal court of Justice in Germany)

CCCTB - The Common Consolidated Corporate Tax Base

ECJ - The European Court of Justice

EU – The European Union

GmbH - Gesellschaft mit beschränkter Haftung (private limited liability company in Germany)

GmbHG - Gesetz betreffend die Gesellschaften mit beschrnkter Haftung (Limited Liability Companies Act)

KG - The Kammergericht (the highest state court for the City of Berlin, Germany)

SARL - Société à Responsabilité Limitée (private limited liability company in France)

SMEs – Small and Medium Enterprises

TEU - The Treaty of the European Union

TFEU - The Treaty on the Functioning of the European Union

U.K. - The United Kingdom of Great Britain and Northern Ireland

1. Introduction

The national company laws of the EU Member States have great importance in that they structure the constitution of civil society and establish social justice.[2] Company law is characterised by a need of exercising sovereignty in this matter. Therefore, the Treaty on the Functioning of the European Union (TFEU), being in line with the principal of conferral, gives no general competence to the EU to regulate company law in its entirety, which is why Member States continue to operate on the basis of individual company law systems. However, the competence of Member States in the domain of company law has to be exercised in compliance with the EU law.

The cornerstone of the Internal Market of the Union is the EU company law. The European Single Market renders the national systems of company law of Member States to be coherent.[3] Accordingly, the national company laws of Member States have high potential to endanger the Internal Market. In accordance with the principles of subsidiarity and proportionality, the power of harmonization in the field of company law is conferred to the EU under the Article 50 of the TFEU:

> "directives can be adopted aiming of coordinating to who necessary extent the safeguards which, for the protection of members and others, are required by Member States of companies…. with the view of making such safeguard equivalent throughout the Union, in order to attain freedom of establishment."[4]

The interest of the group is defined as "organized group management through network of companies, where central control is exercised by a parent company and local autonomy granted to a subsidiary."[5] The interest of each member of the group is

[2] "EU competence in private law - European Parliament." Accessed May 24, 2017. http://www.bing.com/cr?IG=4C2777B7F29949AB85DD0E46B286C6F5&CID=3A36925E7F64696A100298D27E626878&rd=1&h=n4N0Om4mHOqYC47xdcsdSeIekcuqHMO4zoEc6-We5gw&v=1&r=http%3a%2f%2fwww.europarl.europa.eu%2fRegData%2fetudes%2fIDAN%2f2015%2f545711%2fEPRS_IDA(2015)545711_REV1_EN.pdf&p=DevEx,5061.1 .

[3] "The Future of European Company Law." *The Spirit of Corporate Law : Core Principles of Corporate Law in Continental Europe*. doi:10.5040/9781472561565.ch-006.

[4] EUR-Lex - 12012E/TXT - EN – EUR – Lex. Accessed May 23, 2017 http://www.bing.com/cr?IG=CCB112A6D5B349B8868214A8EFF73EC5&CID=1A1BAAA3F60A69EB1F82A029F70C68FB&rd=1&h=GpyXOwJYJGPuNI-XwguHmGwgQ7vDr5Aja-gt3Y4picM&v=1&r=http%3a%2f%2feur-lex.europa.eu%2flegal-content%2fEN%2fTXT%2f%3furi%3dCELEX%3a12012E%2fTXT&p=DevEx,5062.1

independent profitability and sustainability, while the interest of the group is the economic well-being of an organisation, which points to potential differences in concerns. The concept of the interest of the group addresses the issue whether subsidiaries of the board of directors can pursue the interest of the group.

Of all 28 Member States (the U.K. still remains a full member of the EU until their full withdrawal from the Union (Aprill of 2019))[6] 17 states do recognize the interest of the group (such as France), while 11 states do not. (among them Germany). The German case law refuses to recognize the interest of the group for private limited liability companies.[7] All Member States have contrasting and even conflicting mechanisms to recognise the interest of the group. Respective discrepancies are found in the various approaches to questions about minority shareholders and creditors protection as well as the right of shareholders to influence the management of the company under national company law.

Although the recognition of the interest of the group forms the constitution of civil society and structures social justice, it cannot establish legal fragmentation in this matter, that becomes an obstacle or a barrier to the freedom of the establishment. Therefore, the competence cannot be exercised contrary to being bound by economic integration. The independent recognition of the interest of the group of Member States facilitates legal fragmentation in that it causes a lack of legal certainty, increased costs of cross-border business, harmful regulatory competition, and a hampering of the development of the CCCTB as well as the participation in cash pooling.

[5] Antunes, José Engrácia, Theodor Baums, Blanaid J. Clarke, Pierre-Henri Conac, Luca Enriques, Andras I. Hanak, Jesper Lau Hansen, H. J. De Kluiver, Vanessa Knapp, Noëlle Lenoir, Leena Linnainmaa, Stanislaw Soltysinski, and Eddy O. Wymeersch. "Report of the Reflection Group on the Future of EU Company Law." SSRN Electronic Journal. doi:10.2139/ssrn.1851654

[6] "European Parliament / Think Tank." Article 50 TEU: Withdrawal of a Member State from the EU - Think Tank. Accessed June 19, 2017. http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI%282016%29577971

[7] "The Informal Company Law Expert Group (ICLEG)." Accessed May 25, 2017. http://www.bing.com/cr?IG=C01A51EFBEF444579C73C9AEE0A25152&CID=2A5F1295C786664835401818C6806740&rd=1&h=oBGz6olQT1Ths73d3GrsCNa5g3qWgEAZX3o8tRScldU&v=1&r=http%3a%2f%2fec.europa.eu%2fjustice%2fcivil%2ffiles%2fcompany-law%2ficleg_recommendations_interest_group_final_en.pdf&p=DevEx,5062.1 .

2. Lifting the corporate veil

Traditionally, a company is considered an autonomous legal entity. Thus, even entities controlled by other companies exercise separation of legal personalities to achieve the highest possible degree of minority shareholder and creditor protection. Since, in reality, these autonomous legal entities form one enterprise, the interest of a group is different than that of each company. Accordingly, this situation creates tension between conflicting interests, i.e. that of the subsidiary and of the parent company.[8] The procedure to lift the corporate veil ignores the autonomy of legal entities in order to reach the "real beneficiary."[9] This procedure looks closely at the following points: "separate legal personality, limited liability, shared ownership by investors, delegated management power to a board structure and transferable shares."[10]

The separation of legal personalities in the parent and subsidiary companies is undertaken in order to facilitate investments through an increase of economic efficiency.[11] The principle of limited liability additionally assures that shareholders risk only their invested amount, since an investor without limited liability would otherwise not choose to invest more than with the ability to exercise this right. Moreover, the separation of legal personalities gives subsidiaries independence from their respective parent company.[12] However, the relationship between both parties cannot be considered to be that between ordinary investors, but rather compares to that of a controller of an affiliated company. Also, given the fact that the shareholders' liability is extended only to their investment, the burden of risk is transferred to creditors in case of business failure.[13] Consequently, it is common practice to establish a subsidiary as a company of private limited liability.

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[8] Conac, Pierre-Henri. "Director's Duties in Groups of Companies – Legalizing the Interest of the Group at the European Level." *European Company and Financial Law Review* 10, no. 2 (2013). doi:10.1515/ecfr-2013-0194.
[9] B. Hannigan, *Company Law*, Third Editi on, Oxford University Press, 2012
[10] H Hansmann and R Kraakman, "The End of History for Corporate Law", International Center for Finance Working Paper No. 00-09, 2000
[11] A. Dignam and J. Lowry, *Company Law, Core Text Series*, Oxford: Oxford University Press, 2012
[12] Manne, Henry G. "Our Two Corporation Systems: Law and Economics." *Virginia Law Review* 53, no. 2 (1967): 259. doi:10.2307/1071435.
[13] B. Pettet, "Limited Liability – A Principle For The 21st Century" Current Legal Problems, 1995

2.1 Parental influence over private limited liability subsidiary companies

Shareholders have no power to directly manage directors in that they are not their legal agents. The director works for the benefit of the subsidiary rather than the interest of the dominant shareholder. In contrast, all powers of management of the subsidiary come from the company bylaws, which in private limited liability companies are established exclusively by the parent company, in order to protect the shareholders' interests. Furthermore, the parent company can set appointments and terminations of directors, management agreements, and even financing of the subsidiary. Consequently, the very mechanisms that make private limited liability subsidiaries flexible and protect shareholders can be used by parent companies to pursue the goals of the group of companies and as such, avoid to fulfil the goals of the company itself. This creates tension between the freedom of the action of the board of directors and the protection of shareholders' interests.

2.2.1 German regulations regarding the duties of the board of directors

In German private limited liability companies (*Gesellschaft mit beschränkter Haftung* (GmbH)) all members of the management board must manage the company, as prudent and diligent managers would, that is, have to act in the best interest of the company.[14] In that effect, the interest of the group cannot be met and is thus not recognized. The actions performed by the director of the board should adhere to the standards of a prudent and diligent manager. Consequently, the director must act with greater care than the ordinary man would, in order to avoid the justification "I acted with the care that I would apply in my own affairs."[15] Also, if the director does not possess the relevant skill and knowledge in a particular matter, he or she is obliged to seek help.[16] The best interest of the company is to increase profits and sustainable

[14] Cotta, P, Goetz, A, von Rumohr, Karl. Corporate Governance, Board structures and directors' duties in 38 jurisdictions worldwide. Getting the Deal Through, Law Business Research Ltd, 2010

[15] Baums, Theodor. *Personal liabilities of company directors in German law*. Osnabrück: Inst. für Handels- und Wirtschaftsrecht, 1996 ADD PAGE NUMBER

[16] Smerdon, Edward. *Directors' liability and indemnification: a global guide*. Surrey: Globe Law and Business Ltd., 2016.

developments. However, the interest of shareholders might be different than that of the company (especially in a group of companies).

The board of directors, acting as the prudent and diligent manager of the company, would never challenge the shareholders' interests as long as their instructions are in line with normal market terms.[17] Accordingly, the shareholders' interests additionally need to be considered, to further pursue the interest of the group. Moreover, instructions given by the shareholders of the parent company to meet market requirements can differ in terms of profitability and sustainable development from the perspective of the subsidiary.

The principle of duty of loyalty assures that the board of directors can only exercise the power that is conferred upon them. In order to protect the shareholders' interests in the process of decision-making, a meeting of shareholders is established. The requirement of a supervisory board applies only to one per cent of all GmbH-companies. In accordance with the doctrine that the board of directors does not function as agents for shareholders, but act for the economic prosperity of the company. The management board thus acts autonomously from governance bodies. Nonetheless, the articles of association, statutes, bylaws or internal rules can set the requirement for written consent through shareholders for specific operations.[18] Additionally, the general meeting of shareholders can influence the operations of the board of directors by giving them precise instructions on how to act and operate company.[19] If these instructions are legal, the board of directors are bound to them. Otherwise, their actions could be classified as detrimental to the company.[20] Moreover, the power of appointment and termination of members of the board of directors lies within the shareholders' competence, in order to establish an effective mechanism that protects shareholders from careless and neglectful actions on the side of the board of directors. The shareholder meeting is, however, not the only tool for the protection of their interests, but can also be used as a means to advance the interest

[17] Cotta, P, Goetz, A, von Rumohr, Karl. Corporate Governance, Board structures and directors' duties in 38 jurisdictions worldwide. Getting the Deal Through, Law Business Research Ltd, 2010
[18] Müller, Klaus J. *The GmbH:* a guide to the German limited liability company. München: C.H. Beck, 2016.
[19] Schepke, J. Duties and responsibilities of directors in Europe. CMS Legal Services EEIG 2008
[20] Müller, Klaus J. *The GmbH:* a guide to the German limited liability company. München: C.H. Beck, 2016.

of the group of companies in relation to the board of directors, that can be problematic for the interest of the company. Furthermore, shareholders are entitled to remove the board of directors at any time with a majority vote (unless the statutes require a higher vote). The parent company can use this mechanism to influence the board of directors to pursue the goals of the group companies rather than the goals of the individual company creating friction between the duties of the board of directors to, on the one hand, represent the interests of the company, and on the other hand, to represent the interests of the shareholders (i.e. the interest of the group companies).

In the Elbert case, the Federal court of Justice (*Bundesgerichtshof* (BGH)) ruled that the board of the directors does not possess full autonomy over shareholders and thus cannot act with full competence.[21] Germany does not recognize the interest of the group of limited liability companies, but, on established grounds of flexible management, the parent company can still, by being the shareholder, limit the scope of the board of directors and their freedom to act, in order to assure their serving in the interest of the company and shift their duties towards presenting the interest of the group.

2.2.2 French regulations regarding the duties of the board of directors

In French private limited liability companies (*Société à Responsabilité Limitée* (SARL)) all members of management have to act in the best interest of the respective entity.[22] This concept of 'the best interest of the entity' can, on the one hand, be interpreted to be the interest of the firm, on the other hand, it can also be understood to be the interest of the shareholders.[23] Consequently, the board of directors has to both represent the interest of the company and that of the shareholders, which can be the interest of the group of companies. The definition of 'the best interest' can also be extended to account for the fact that directors not only have to represent shareholders but also stakeholders. The theory of 'the interest of the firm' is applied to determine

[21] BGH, Judgment of 15 May 2003 (Ebert), LSK 2003, 230107
[22] The Article 1848 of French Civil Code
[23] Gerner-Beuerle, Carsten, and Edmund-Philipp Schuster. "The Evolving Structure of Directors' Duties in Europe." *European Business Organization Law Review* 15, no. 02 (2014): 191-233. doi:10.1017/s1566752914001104

acts of mismanagement on the part of directors.[24] What is considered to be in the best interest of the entity is decided on a case-by-case basis and not considered to be the rule of law. This procedure inheres the potential to create conflict between the duties of the board of directors and the protection of the shareholders' interests, since, for one, the interest of the company can be the prevailing factor, while for another, the interest of the shareholders as the interest of the group of companies can equally be dominant.

Directors of the board can only act in accordance with the powers conferred to upon them and are bound to the duty of loyalty towards both the company and shareholders. In keeping with the principle of loyalty, the management has to act with care and fair dealing. Some scholars even extend this principle to the practice of good faith.[25] The board of directors that fulfills its duties in good faith would never endanger the shareholders' interests (the parent company). The shareholders' right to be informed about operations of the board of directors can have a beneficial effect on the parent company, as it can be more involved in day-to-day operations. Board members can be freely appointed and removed by shareholders in general meetings (unless the statutes of the company stipulate differently).[26] Based on established grounds, shareholders have a distinct power to influence the board of directors. It has to be noted that through shareholders meetings, the parent company can prioritise the interests of the group companies over the interests of the individual company.

In light of the abovementioned, it has been shown that as for private limited liability companies, France tolerates the shareholders' exertion of influence on the board of directors , since the management does not solely represent the interest of the business organisation but also serves the shareholders' interests. Therefore, in doing so, they recognize the interest of the group.

[24] Bézard, P. Face-à-face entre la notion française d'intérêt social et le gouvernement d'entreprise, Petites Affiches 2004,

[25] Brigitte Daille-Duclos, Le devoir de loyauté du dirigeant, La semaine juridique entreprise et affaires, 24 September 1998

[26] Carsten, Gerner-Beuerle and Schuster, Edmund-Philipp. "The Evolving Structure of Directors' Duties in Europe." *European Business Organization Law Review* 15 (2014) doi:10.1017/s1566752914001104

2.2.3 Concluding remarks on the German and French systems of duties of directors

In both legal systems a parent company can have control leverage over a subsidiary through being a shareholder. The parent company can become a controller of a subsidiary. In that sense, the parent company cannot be considered an ordinary investor given their ability to interfere in the business operations of the subsidiary. Conventional investors strive to reap all benefits from investments, while the interest of the parent companies is not the prosperity of the subsidiary, but the welfare of the group. France recognizes the interest of the group, while Germany does not, resulting in legal fragmentation and a need for an appropriate recognition of the interest of the group.

2.3 Protection of minority shareholders and creditors

Considering a group of companies as an economic unit but plurality as entity with limited liability granted to a subsidiary and the parent company exercising the ability to intervene with business actions of the group of companies, presents a risk for minority shareholders and creditors.[27] The risk carried by minority shareholders and creditors is increased given that the interest of the group can prevail over the individual interests of a group member. If the parent company imposes the interests of the group on the subsidiary, it raises the question whether minority shareholders and creditors are sufficiently protected, if the interests of the group are in conflict with the interests of the company (an interest being always profitability and sustainable development).

2.4.1 Minority shareholder protection in Germany

The general rule governing (the actions of) shareholders is that of "one share, one vote and equal rights and obligations for all shareholders." Since the structure of GmbH-

[27] Winter Group Report, 2002 Ecgi.org. Accessed June 19, 2017. http://www.ecgi.org/publications/winter.htm .

companies is flexible, the statutes of an entity can establish a regime concerning voting rights and obligations, which is being beneficial for the parent company, in order to enforce the interest of the group. This, however, can have a detrimental effect on minority shareholders. Nonetheless, the principle of non–discrimination of minority shareholders always applies. Minority shareholders can request a shareholder meeting if they represent one tenth of the capital (company statutes can even prescribe a lower threshold) (GmbHG Section 50 (1))[28]. Also for this measure the general principle of 'one share and one vote' applies. The management is obliged to provide information in accordance with the general principles of accountability and accuracy. Statutory provisions of Germany do not grant minority shareholders the right to independent audit and supervision.[29]

Section 61 of the GmbHG act allows for a so-called "nuclear option" through which minority shareholders can request the court to dissolve the company, if there are substantial grounds that suggest an unworkable environment hindering a successful pursuing of the goals of the company.[30] A clash between the interest of the group and that of minority shareholders might put into question what is in the interest of the company, since investors might be classified as key factors contributing to an unworkable environment. Furthermore, the national economic interest to save a company is based on the benefit of protecting minority shareholders, since well-functioning business organisations lead to more welfare than their liquidation. As such, a clash of interests might be most beneficially resolved by measures other than the dissolution of the company.

Consequently, in the case of infringements of equal rights and obligations, minority shareholders can protect their interests through the right to withdraw and the right to removal.[31] In the event of withdrawal, the withdrawing minority shareholder is entitled

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[28] "Limited Liability Companies Act (Gesetz betreffend die Gesellschaften mit beschrnkter Haftung, GmbHG)." Accessed April 27, 2017.
http://www.gesetze-im-internet.de/englisch_gmbhg/

[29] Stecher, Matthias W.: Germany In Protection of minority shareholders, series editor: AIJA, Kluwer Law International

[30] "Limited Liability Companies Act(Gesetz betreffend die Gesellschaften mit beschrnkter Haftung, GmbHG)."). Accessed April 27, 2017. http://www.gesetze-im-internet.de/englisch_gmbhg/

[31] Dornseifer, Frank. Corporate business forms in Europe: a compendium of public and private limited companies in Europe. London: Thomson, Sweet & Maxwell, 2006.

to receive fair market value for their contribution to the company.[32] In the event of removal, the shareholder is entitled to purchase the abusive shareholder's interests at fair market value. In both cases the key doctrine is that of substantial reason (*wichtige Grund*).[33] The (necessary) requirement to remove a shareholder is action brought before the responsible court of the company, not the shareholder alone. In order to satisfy this requirement either the shareholder or the board of directors have to authorise the relevant action to initiate proceedings. In the event of authorisation through shareholders, minority shareholders are unlikely to receive approval. In the event of actions through the board of directors, it is equally unlikely that a vote against the will of the majority of shareholders will be cast, given that shareholders can intervene in operations of the management and even remove the board of directors. Accordingly, in the case of conflicting interests, minority shareholders might be limited in their ability to remove majority shareholders, in order to seek the best interest of the company. From a procedural point of view, the withdrawal of minority shareholder represents the most effective measure, as there is no need for authorisation through shareholders or action brought by the management.[34] Nevertheless, it is the management or the shareholders that determine a fair market price for compensation. Additionally, minority shareholder can file a suit directly against the majority shareholder. If this legal action is successful, the voting rights of the majority shareholders will be suspended for this matter.

2.4.2 Minority shareholder protection in France

In France, the general rule governing shareholders is the same as in the German system, that is, "one share, one vote and equal rights and obligations." The SARL-structure is as flexible as that of the GmbH, which is why the respective articles of an association can establish special regulations about voting rights and obligations that can prove advantageous for the parent company in that it might enforce the interest of

[32] Rüster, Bernd: Business transactions in Germany, Looseleaf, first published in 1983, New York
[33] Sandra K. Miller: Minority shareholder oppression in the private company in the European Community: a comparative analysis of the German, United Kingdom and French close corporation problem, Cornell International Law Journal 1997, Cornell University
[34] Rüster, Bernd : Business transactions in Germany, Looseleaf, first published in 1983, New York

the group. This can, however, also be disadvantageous for minority shareholders.[35] Any shareholder who represents one tenth of the capital can summon a meeting.[36] Additionally, shareholders have a right to information. In order to safeguard this right, any shareholder is entitled to submit written questions to the board. The board is, in turn, obliged to reply to all questions asked, even if these requests might be without any real benefit to the company.[37]

Remedies against infringements of equal rights and obligations are the appointment of a temporary receiver (*administrateur provisoire)* or the dissolution of a company. These remedies are granted on the basis of the abuse of a majority position. An abuse of a majority position can be the imposition of the interest of the group by the parent company (majority shareholder) on subsidiary, if it is against the interest of the company. On the one hand, majority shareholders should not influence the management decisions. On the other hand, courts should also not intervene in the management of the company. Only resolutions that entirely serve the interest of the majority shareholders can be classified as an abuse of a majority position. The court can only rule for the appointment of a temporary receiver in case of the shareholders' disability to direct the management, due to a rift between the interests of the two parties. A person's competence to act will be defined by the court. In general, appointed temporary receivers will have the competence to manage the affairs of the company.[38] The dissolution of the company will be chosen as a means of solution only in cases where an unworkable environment to pursue the goals of the company exists. This measure always represents the last resort, since a functioning business organisation is more advantageous than its liquidation being not only disadvantageous for the overall society but also for the shareholders themselves. An alternative measure

[35]Shaun W. Thorpe: Company Law in Europe, Company Law In France (Section D), Trowbridge, Wiltshire, Great Britain
[36] Peguet Patrick, Carbiner Nathalie , Sabourin, Jean-Christophe: France In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997
[37] Guyon Yves: France in Shareholder voting rights and practices in Europe and the United States, Kluwer Law International, 1999
[38] Andenæs Mads Tønnesson, and Frank *European comparative company law*. Cambridge, UK: Cambridge University Press, 2009.

that courts might resort to in these cases is that of paralysing the operations of a company.[39]

2.4.3 Conclusion: German and French approaches towards protection of minority shareholders.

It has been shown that there is no substantial fragmentation in minority shareholder protection, but both the German and the French legal system are focused more on providing countermeasures for potential violations of the duty of loyalty rather than limiting abusive exercise on the part of the dominant shareholder. Consequently, inasmuch as majority shareholders (i.e. the parent company) do not affect the interests of minority shareholders in a detrimental way, they might never reap all the benefits from their contribution. Therefore, the need for appropriate recognition of the interest of the group becomes apparent.

2.5 Creditor protection

The mechanism of protection of creditors has to offset the risk imposed to a private limited liability company, which additionally lowers the cost of transactions for private limited liability companies.[40] On the one hand, it can be argued that creditors are in fact beneficiaries of the principle of limited liability because the funds of an entity are protected from the shareholders' creditors.[41] On the other hand, this also poses a risk for creditors since in the case of a company insolvency, the shareholders' liability is limited, whereby the creditors' interests rely on the well-being of the company.[42] The parent company can enforce the interest of the group on its private limited subsidiary, but this can also prevent liabilities for the outcome caused, in that

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[39] Miller Sandra K.: Minority shareholder oppression in the private company in the European Community: a comparative analysis of the German, United Kingdom and French close corporation problem, Cornell International Law Journal 1997, Cornell University

[40] Wittman, Donald A. *Economic analysis of the law: selected readings*. Malden, MA: Blackwell Publishers, 2003.

[41] Hansmann, Henry, and Reinier H. Kraakman. *The essential role of organizational law*. Cambridge, MA: Harvard Law School, 2000.

[42] Kraakman, Reinier H. *The anatomy of corporate law: a comparative and functional approach*. Oxford: Oxford University Press, 2009.

their interference in the management of the company is based on the limited liability doctrine. Accordingly, the potential for abuse of this concept lies within the group of companies.[43] This raises the question whether the parent companies, through forcing the interest of the group on private limited liability subsidiaries, are responsible for the outcome of all corresponding actions.

2.5.1 Liability of parent companies in Germany

In the German system, limited liability can be disregarded (*Durchgriffshaftung*) by the court. This approach is applied only in exceptional cases.[44] However, concerning groups of companies, the parent company as the shareholder in a private limited liability subsidiary is characterised as the "other entity." Due to the fact that the parent company is the other entity, both business organisations have legal autonomy and are not forming one single entity. The parent company and its subsidiary thus cannot share a group interest. Furthermore, the principle of limited liability ascertains that the shareholders' liability extends only to their contribution. In light of all the abovementioned, the parent company assumes no liability for the outcome caused by imposing the interests of the group companies on the subsidiary—despite the fact that these interests might inflict damage to the interests of the company. However, in general, liability of the parent company is at issue only in insolvency proceedings.[45]

According to the scholar Serick, shareholders can be liable for abusive acts. He emphasised that intent is not more important than actual behavior. Furthermore, Miller- Freienfels suggested that limited liability could be denied if it is unduly violated Moreover, Rehbinder's theory proposes that full separateness of the entity and its shareholders allow for violation of the general legal system. The court, however, has established that only a breach of equity, good faith or an inconsistency in the use of the corporate structure to achieve the goals of a legal system can count as cases for a disregard of the limited liability of the GmbH.[46] Accordingly, limited

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[43]Goddard, David "Corporate Personality – Limited Recourse and its Limits" in R Grantham and C Rickett Corporate Personality in the 20th Century (Oxford, Hart Publishing, 1998)
[44] Hachenburg, Max. "Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG)." 1997. doi:10.1515/9783110892116.
[45] *Cathy S. Krendl & James R. Krendl, PiercingThe Corporate Veil: Focusing the Inquiry (1978).*
[46] Schmidt Karsten. "*Gesellschaftsrecht*." Köln: Heymann, 2015. (1991)

liability of the subsidiary concerning interests of the group can be disregarded only in case of a breach of these specific requirements.

The undercapitalisation may be circumstance to a disregard of limited liability.[47] Nonetheless, there is a set minimum level of capital, which is why there is no statutory requirement for a sufficient amount of capital for a business. Still, a set minimum level of capital does not establish certainty for creditors; thus, statutory minimum requirements do not provide assurance for all creditors against financial risks.[48] Consequently, an attainment of the statuary minimum of capital does not fully limit the liability of the parent company. Correspondingly, the parent company, being the shareholder, has to provide a sufficient level of capitalisation in order to pursue the interests of the group of companies.

Concerning the parent company as creditor for the subsidiary, German legislation provides stability in case that the capitalisation of the subsidiary is carried out by the parent companies through loaning rather than the use of equity. Given the creditors' subordination, the parent company has no right to claim the loan granted from the creditors. As such, liability of the parent company is extended, turning it also into a creditor. An adequate capitalisation of the subsidiary ensures that the consequences of failure of business is not merely shifted to creditors, but is also in line/ with the principle of limited liability saying that shareholders (i.e. the parent company) only and fully vouch with their investment for the execution of their interests.

Limited liability of the subsidiary might also be disregarded if assets of the parent company and the subsidiary are pooled together.[49] A prerequisite for asset pooling is an unclear distinction between the two parties. As a consequence, the group of companies can be viewed as one single entity. The parent company can therefore have extended liability and might be precluded from claiming ownership of these assets. The principle of limited liability divides the assets of a company from that of the shareholders. A further possibility for interpretation would be to assume that there is also an obligation of maintaining separation between these two different spheres. Yet,

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[47] Baumbach, Adolf and Hueck Alfred. GmbHG (15th ed. 1988)
[48] Ibid.
[49] Judgment of Nov. 29, 1956, BGH, 22 BGHZ 226.

a simple asset transfer between the parent company and the subsidiary provides insufficient grounds for extended liability.[50] In contrast, the subsidiary might make a claim against the parent company for receiving back assets to facilitate capitalisation to fulfill its obligations. The parent company further carries liability for misrepresentation of the identity, in case the creditor is unclear that several entities are being dealt with.[51] It can be concluded that in the case of asset pooling the interest of the group would prevail over the interest of the company. Therefore, limited liability is disregarded and extended to the parent company.

It is very likely that the parent company might establish a domination agreement over a GmbH subsidiary, in order to diminish the delegated power of the management by German law, to facilitate the fulfillment of their interest (i.e. *qualified de facto control*)[52] Although statutory obligations exist, a domination agreement is legally binding. The management is therefore obliged to follow the instructions of the parent company. The interest of the group prevails in such a setting over that of the member of the group. The provisions of the AktG concerning the domination of shareholders also apply directly to GmbH subsidiaries. Accordingly, the GmbH management has to follow instructions as long as they are not detrimental to the interests of the business organization.[53] Moreover, the parent company must reimburse the GmbH subsidiary for all losses arising from their instructions and it is also obliged to provide guarantees for creditors in case of insolvency of the subsidiary.[54] Although, for the same reason, the parent company might avoid to establish a domination agreement and would rely more on previously discussed forms of control (*de facto control*).

In order for the parent company to carry liability for the GmbH subsidiary without breaching a domination agreement, control has to be exercised in a tight and disadvantageous manner (e.g. by being the majority shareholder) with damages caused to the creditors or minority shareholders. The legal consequence is that the parent company carries liability only for particular transactions, while the burden of proof

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[50] Baumbach, Adolf and Hueck Alfred. GmbHG(15th ed. 1988)
[51] Schmidt, Karsten. *Gesellschaftsrecht*. Köln: Heymann, 2015. (1991)
[52] Ibid
[53] Heiner Druke, Die Haftung Der Muttergesellshaft fur Schulden Der Tochtergesellshaft, Eine Untersuchung Nach Deutschem und US-Amerikanischen Recht 31 (1990)
[54] Karsten Schmidt, Insolvenzrisiko und GesellschaftsrechtlicheHaftung, 1985

lies with the creditors of the subsidiary and the minority shareholders.[55] However, even though one disadvantageous transaction caused by tight control of the parent company can be very damaging to the economic success of the subsidiary, the scope of liability in this particular instance is narrowed. Furthermore, the GmbH regulating provisions lack clear accounting approvals and annual reports. They only set general requirement of the information providing.[56] In accordance with the civil procedure of Germany and the burden of proof it is difficult to realise this legal remedy.

In conclusion, the limited liability of the subsidiary in Germany can be disregarded and extended to the parent company with regard to the interest of the group only if there is sufficient ground to establish control, undercapitalisation or pooling of assets. Thus, the application of the interest of the group on issues of liability is limited.

2.5.2 Liability of parent companies in France

The general principle of French law is that each member of the group is autonomous given that each company has its own assets and shareholders. Furthermore, in light of the principle of limited liability, shareholders are liable only with and for their contribution. Legal autonomy is, however, limited by actions that are not socially accepted. The statutory provisions only allow to lift the corporate veil in insolvency cases. Nevertheless, shareholders (the parent company) might be liable for forcing the interests of the group under tortious and contractual arrangements.[57]

Article 1382 of the Civil Code describes that "[A]ny act whatever of man, which causes damage to another, obliges him by whose fault it occurred, to compensate it."[58] Article 1383 even goes further, declaring that "Everyone is liable for the damage he causes not only by his intentional act, but also by his negligent conduct or by his imprudence."[59] Liability for actions of the representative of a legal person can be

[55] Michael B. Goldberg, Note, *The Fiduciary Duty of Parent to Subsidiary Corporation* (1971).
[56] Heiner, Druke, Die Haftung Der Muttergesellshaft fur Schulden Der Tochtergesellshaft, Eine Untersuchung Nach Deutschem und US-Amerikanischen Recht 31 (1990)
[57] Vandekerckhove Karen, 'Piercing the Corporate Veil' (2007) 4 *European Company Law*, Issue 5
[58] "Code_Civil of France Accessed May 4, 2017. http://www.fd.ulisboa.pt/wp-content/uploads/2014/12/Codigo-Civil-Frances-French-Civil-Code-english-version.pdf
[59] Ibid

extended to the respective legal person.[60] The wrongdoing is defined by whether the breach of statutory provisions or duty to care can, in line with Article 1383 of the Civil Code, be categorised as intentional or not.

The duty to care states that a person has to act as a careful, forward-looking, and reasonable individual.[61] It can be argued that the lack of interference in operations of their subsidiary on part of the parent company can be characterized as a wrongdoing in light of the shareholders' ability to influence the board of directors. Likewise, being unaware of unacceptable acts performed by the subsidiary does not limit the scope of liability of the parent company, as it violates the duty to care. A lack of information can never justify or excuse action (*ignorantia legis non excusat*). Still, the parent company is liable for acts of their subsidiary, but the freedom of the board of directors to act also has to be taken into account.[62] The victim has to prove that damages incurred, in order to hold the parent company liable for the actions of the subsidiary. As a result the parent company is relieved of liability for actions of the subsidiary, undertaken to pursue their interests as well as for conduct carried out by the subsidiary to satisfy their interests.

Concerning the casual link between wrongdoing and damages, the question arises to what degree the wrongdoing has contributed to the damages caused. French case law does not distinguish between a doctrine of effective cause or an equivalent cause doctrine. It is therefore unclear whether a wrongdoing has to be simply contributive to damages or the cause for damages. Notwithstanding that the possibility of causing damages and the key role of wrongdoing for an outcome (the doctrine of effective cause) are more beneficial for victims. Still, French case law shows a lack of certainty in this matter.[63] Moreover, a contribution to damages can be dissolved by providing other factors, which are out of the control of the parent company that influenced the outcome (e.g. *Force Majoure*). Hence, there is limitation of the liability of the parent companies against actions by the subsidiary if they act in their own interests. However, this setting does not allow for the possibility to escape partial liability. The

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[60]Simonart V, *La personnalité morale en droit privé compare,* Revue internationale de droit comparé, Année 1996 Volume 48
[61] Fenouillet, Dominique. *Les sources des obligations*: doi:10.4000/books.puam.431.
[62] Brüls, Christine. Droit des sociétés, 1st edition, December 2012
[63] Fenouillet, Dominique. *Les sources des obligations*: doi:10.4000/books.puam.431.

parent company is responsible to cover for all damages and can afterwards claim back the respective amount from other liable persons.[64]

Article 1384 says that "A person is liable not only for the damages caused by his own act, but also for that which is caused by the acts of persons for whom he is responsible, or by things which are in his custody."[65] Paragraph 5 describes that "Masters and employers are liable for the damage caused by their servants and employees in the functions for which they have been employed."[66] Thus, masters and employers are guarantors for their servants or employees.[67] One can argue that the director of the board in the subsidiary is not an employee in the strict sense, but is appointed by the parent company, which therefore could be characterized as 'master'. To engage the liability of the parent company by being a master, the director of the board has to be appointed by the parent company. The parent company also needs to have the right to give orders and instructions (the SARL corporate structure establishes that), even if this right is never actually exercised (based on the duty to care). Furthermore, the board of directors has to commit the wrongdoing under Article 1382 and 1383 of the Civil Code. Direct wrongdoing of the management does not have to apply. Directors of the board have to cause the damage while exercising their functions and responsibilities. Still, all members of group of companies have legal autonomy, therefore the directors of the board can and are only safeguarding the interests of the subsidiary, not the interest of the parent company. In contrast, the appointment of the management indicates that the interests of the group can prevail over that of the subsidiary.[68] All these prerequisites have to apply in order to hold the parent company liable for the actions of the subsidiary. French case law establishes that the parent company might be liable if the goal is to organise, control, and direct activities of its

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[64] Tourneau Philippe Le, Droit de la responsabilité et des contrats - Régimes d'indemnisation 10th edition, 2015

[65] "Code_Civil of France." Accessed May 4, 2017. http://www.fd.ulisboa.pt/wp-content/uploads/2014/12/Codigo-Civil-Frances-French-Civil-Code-english-version.pdf

[66] Ibid

[67] Daugareilh, Isabelle. La responsabilité sociale de l'entreprise transnationale, 1st edition, 2011

[68] Fenouillet, Dominique. *Les sources des obligations*: doi:10.4000/books.puam.431

subsidiary (the exercise of authority). This, however, has been criticised because it is the country that defines legal autonomy of legal persons.[69]

In this case, the interest of the group can be carried out, while the corporate structure of limited liability can be abused.[70] Accordingly, the privilege of limited liability can only be exercised if there is autonomy of the legal personalities in the group of companies; therefore, the subsidiary has to be able to act freely, so that the parent company is able to exercise the right of limited liability.[71] Any actions that lack carefulness and a forward-looking approach are defined as abusive. Limited liability will not be granted for these abusive actions. Therefore, the parent company will be liable for the actions of their subsidiary. Furthermore, the concealment of a wrongdoing equals an abusive act. The parent company and the subsidiary differentiate between expressed and actual intentions. Thus, the subsidiary cannot actually hide activities from the parent company.[72] Fraud is also considered an abusive act and is established as the general principle of the law. It is defined as behavior with the main purpose (intention) of damaging other person.[73] Fraud represents a breach of the duty to care. It is important to note that the burden of proof is shifted to the victim, as it is them who have to prove wrongful intent and the existence of damage caused.[74] As a consequence abusive domination by the parent company to execute the interests of the group restricts the privilege of limited liability.

The parent company may be ordered by the court to cover the entire or partial debt of the subsidiary in the event of insolvency and assume responsibility under the law or by influencing management affairs. In order for the parent company to be held liable for the insolvency of subsidiary the following requirements have to be met: acts of the parent company that are detrimental to the interest of the subsidiary, insufficient assets provided for the subsidiary by the parent company (undercapitalisation), a breach of the duty to care, a direct link between the actions of the parent company and the

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[69] Schmidt Dominique. 'La responsabilité civile dans les relations de groupe de sociétés', *Rev. Soc. 1981*

[70] RAAD N.F. *L'abus de la personnalité morale en droit privé* (Paris: L.G.D.J. 1991)

[71] Vandekerckhove Karen, 'Piercing the Corporate Veil' (2007) 4 *European Company Law*, Issue 5

[72] Simonart V, *La personnalité morale en droit privé compare,* Revue internationale de droit comparé, Année 1996 Volume 48

[73] Fenouillet, Dominique. *Les sources des obligations*: doi:10.4000/books.puam.431

[74] Simonart V, *La personnalité morale en droit privé compare,* Revue internationale de droit comparé, Année 1996 Volume 48

insolvency of the subsidiary. Additionally, liability is extended to the parent company for measures of asset pooling. Accordingly, if the parent company uses the subsidiary as a "puppet" for its own interests (such as the usage of subsidiary assets to affect negatively the interests of a third party, an abusive use of the subsidiary for circumventing a law etc.), limited liability is discharged for the parent company.[75]

2.5.3 Conclusion on the difference between the German and French systems

The German system strongly upholds the presumption of legal autonomy and disregards economic reality. The lifting of the corporate veil is applied only in the case of insolvency, therefore the interest of the group for liability is applied very narrowly. France follows a different approach that also allows for a piercing of the corporate veil through the tort law. In light of all the abovementioned, there is fragmented recognition of the interests of the group concerning the issue of liability, which deteriorates the general environment for the protection of creditors in the EU. Consequently, there is a need for appropriate recognition of the interest of the group.

2.6 Liability of the board of directors

Both under German and French law, shareholders in private limited liability companies can be deeply involved in the decision-making process. Accordingly, the active participation of shareholders in the decision-making process can determine them as shadow or de facto board members. Consequently, the question arises whether there is balance between the liability of the parent company and the directors of the board of the subsidiary.

[75] Luchex Jean-Michael, Pitron Reichel, Senechal Jean-Pier "Entreprises en difficultés" 1994

2.6.1 Germany

Germany grants the board of directors full autonomy, in order to allow for flexibility in the process of decision-making. Despite this flexibility, the board might also be liable for their actions of violation of the duty of loyalty and care. The unsuccessful management of a business organisation does not automatically result in personal liability for the board of directors. Liability can also be established if a statutory requirement or contract is violated.[76]

Furthermore, persons who act on the board of directors but are not appointed by the management are defined as de facto directors. Their main characteristics are duration, influence, and intensity, and they are required to act as an appointed director of the board would.[77] To de facto directors the same duties and liabilities apply as to the board of directors. However, a legal person cannot be a de facto director. Accordingly, the parent company cannot be constituted as de facto director.[78] It can only be a shadow director to pursue the interest of the group. Shadow directors may only instruct and direct the board of directors and cannot end relationship with third parties. They therefore do not carry any liability under this doctrine.[79]

On the one hand, the board of directors has to act in good faith, which is why the management is obliged to represent the best interest of the company. Accordingly, the manager always has to assess the risk with sufficient information and show an awareness for competition, consumers, and the market.[80]

On the other hand, superior bodies such as the supervisory board and the meeting of shareholders are also involved in the process of decision-making. Under German law the board of directors acts freely without any influence over other bodies They therefore assume conferred competence for organizing affairs of organisation. Moreover, the actions performed by the boards of directors are limited by the statutes,

[76] Loos, A. Directors' Liability: A Worldwide Review. Kluwer Law 2006
[77] Judgment of BGH from 25.02.2002, II ZR 196/00, BGHZ 150, 61; Judgment of BGH from 27.06.2005, II ZR 113/03, ZIP 2005, 1414; Judgment of KG from 23.05.2000, 14 U 6481/98, KG NZG 2000, 1032, 1033
[78] Judgment of BGH from 25.02.2002, II ZR 196/00, BGHZ 150, 61, 70
[79] Hueck Baumbach, GmbHG, 19th edition, Munich 2010
[80] Baums, Theodor. *Personal liabilities of company directors in German law*. Osnabrück: Inst. für Handels- und Wirtschaftsrecht, 1996

guidelines, employment contracts, and shareholders instructions of the company. German law establishes that the supervisory board only has the competence to monitor the board of directors, and thus cannot interfere in the management of the company. On the contrary, one of the functions of the supervisory board lies in the approval of specific transactions (established by the company statutes). The threshold for approval of transactions can be established to be low, which can have a limiting effect on the actions of the board of directors. Decision made by the supervisory board can be overturned by decisions made in the shareholder meeting, which, however, proves very unlikely, since the supervisory board represents the interests of shareholders and can be formed primarily through shareholders[81] Nevertheless, an approval of the supervisory board or the shareholders does not limit the liability of the board of directors.[82] If approval is not obtained, the board of directors is personally liable for corresponding transactions. Shareholders have the right to give specific instructions to the managing directors in shareholder meetings, who are expected to follow them. Instructions that might negatively affect the interests of the company have to be disobeyed.[83]

The directors of the board are liable if they breach their duties to act as prudent and diligent businessmen, fail to exercise their competence in good faith, and thus to represent the best interest of the company. Although the board of directors does not have full autonomy to act, they have to ignore instructions by shareholders that do not represent the best interest of the company. The parent company cannot be classified as a de facto director simply for imposing the interest of the group on. There thus exists an imbalance between the liability of the parent company being the shareholder and the board of directors that has to merely follow the principle of freedom to act and fulfill their duties.

[81] Müller, Klaus J. *The GmbH:* a guide to the German limited liability company. München: C.H. Beck, 2016.
[82] Baums, Theodor. *Personal liabilities of company directors in German law*. Osnabrück: Inst. für Handels- und Wirtschaftsrecht, 1996
[83] Müller, Klaus J. *The GmbH:* a guide to the German limited liability company. München: C.H. Beck, 2016.

2.6.2 France

In France, one of the duties of the board of directors is the representation of the interests of the shareholders. The management thus has to follow the instructions of shareholders and has to act in accordance with the principles of loyalty and care.[84] Since the board of directors not only represents the interest of the company but also the interest of the shareholders, one can argue that the management board lacks the autonomy to act. Furthermore, the board of directors is liable should they breach their duty to care and loyalty and violate statutory requirements.[85]

The unsuccessful management of a business organisation can cause liability for the board of directors as a result of a mismanagement of the company. This mismanagement is grounded in a conflict between the interest of the company and that of the board of directors, who violated their duties. The duty of loyalty applies not only to shareholders but also to stakeholders. The duty of care ascertains that the board of directors exercises their competence to act in a prudent and diligent manner. Every decision has to be made in good faith, based on sufficient information, with actions performed by an honest businessman. In general, the board of directors is not liable for the outcome, but is bound by an obligation of means. Moreover, the liability of the board of directors might be annulled if there is proof that the board of directors disapproved the decision made by shareholders, to which they are bound.

Under French law, the parent company as shareholder can also become de facto director and can, in the case of insolvency, become liable for mismanagement as the board of directors of a company (Article L. 651-2 of the French Commercial Code).[86] De facto directors can also be the legal representative of legal entities.[87] The representative of the parent company can become a de facto director. The parent

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[84] Carsten, Gerner-Beuerle and Schuster, Edmund-Philipp. "The Evolving Structure of Directors' Duties in Europe." *European Business Organization Law Review* 15, no. 02 (2014): 191-233. doi:10.1017/s1566752914001104

[85] Brigitte, Daille-Duclos, Le devoir de loyauté du dirigeant, La semaine juridique entreprise et affaires, 24 September 1998

[86] "COMMERCIAL CODE - Légifrance." Accessed May 10, 2017. https://www.bing.com/cr?IG=64211A4D341D429BB2B59AA3D1CF1ED7&CID=118ECAD412C7648A3A05C0AA1357655E&rd=1&h=Iu6p7z0pwtyZPdQN5Y4xzq63gdREc4Z4XaKMLV4fGOs&v=1&r=https%3a%2f%2fwww.legifrance.gouv.fr%2fcontent%2fdownload%2f1951%2f13685%2fversion%2f5%2ffile%2fCode_32.pdf&p=DevEx,5061.1

[87] Cass. Com. 06/27/2006, n°04-15831); Bull. Joly Sociétés 12/01/2006, n°12,p1372 François-Xavier Lucas.

company may thus also be liable for mismanagement of the entity. The parent company can only be qualified as de facto director if it acts independently as the director of the company. If the parent company is making decisions, taking actions, formulating instructions, and granting loans on a constant basis, these actions can be characterised as affirmative acts of management. From the shareholders' perspective, affirmative acts of management can only be imposed upon a company through domination.[88] However, as there are no statutory requirements that establish the precise scope that defines shareholders as de facto directors, decisions are made on a case–by-case basis.

Furthermore, the board of directors only has the competence to act within the framework and in accordance with the power conferred upon them. Therefore, shareholders can impose any limitations in the context of the shareholder meeting. The disapproval of a decision made has to be recorded and made explicit. It is more advisable for a member of the management board to resign and not participate in wrongdoing.[89]

The French Supreme Court of Justice established that the board of directors can take into consideration the interest of the group in the case of a solvent subsidiary, despite the fact that this might have disadvantageous effects. It may do so only if the counterpart has agreed on a corresponding action that does not provoke an imbalance of the mutual obligations and does not exceed the financial capacity of solvent subsidiarty Under the mentioned requirements, the board of directors of the limited liability company can thus pursue the interest of the group without breaching their duties to the company.[90]

The French system identifies parent companies with dominant influence as de facto directors and also grants the board of directors the right to purse the interest of the group without breaching duties to the company. It therefore establishes a fair balance

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[88] Hannoun Charley, Responsabilité pour insuffisance d'actif. Obligation aux dettes sociales, , 1er 2006

[89] Carsten Gerner-Beuerle and Schuster Edmund-Philipp. "The Evolving Structure of Directors' Duties in Europe." *European Business Organization Law Review* 15 (2014

[90] Hopt, Klaus J., and E. Wymeersch. *Capital markets and company law*. Oxford: Oxford University Press, 2003.

between the liability of the parent company and the board of directors of the subsidiary.

2.6.3 Conclusion on the question of liability of the board of directors

According to Werlauff, the EU law does not allow the board of directors of a private limited liability subsidiary to violate their duties to the company.[91] They thus cannot escape their liability for a company and its creditors, due to the existing instructions of the parent company to represent the best interest of the group. The board of directors of subsidiary carries an disproportionate burden to execute the interest of the group, since the interest of the group can be enforced upon them regardless of whether legislation or case law acknowledge that interest or not. On the contrary, France recognises the interest of the group regarding the liability of directors of the board and therefore achieves greater balance than the German legal structure. A lack of recognition of the interest of the group can have a detrimental effect on cross-border creditors and minority shareholders given a lack of legal certainty.

2.7 Possibility for reorganisation of the group of companies

The basic notion of insolvency laws in all EU Member States is that insolvency proceedings materialise one entity at the time, with every single business organisation having its own assets and creditors.[92] EU legislation provides merely the core principles and guidelines on this issue. Therefore technical implementing measures are to be established by the EU Member States.[93] Since procedural coordination is limited to administrative affairs, the substantive issues are out of scope. Thus, EU insolvency

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[91] WERLAUFF E. "EU Company Law", 2nd edition, DJOF, 2003

[92] "DIRECTORATE GENERAL FOR INTERNAL ... - europarl.europa.eu." Accessed April 29, 2017. http://www.bing.com/cr?IG=A59E417986E0449BB966933C41D5CB15&CID=1760CE2FC93565690547C45CC8A564E1&rd=1&h=C93gz2g0pc1RZLwht0aivBtyY9LCe4FI1k_ayi2CVH8&v=1&r=http%3a%2f%2fwww.europarl.europa.eu%2fRegData%2fetudes%2fnote%2fjoin%2f2011%2f432762%2fIPOL-JURI_NT(2011)432762_EN.pdf&p=DevEx,5060.1 .

[93] "The Informal Company Law Expert Group (ICLEG)." Accessed April 29, 2017. http://www.bing.com/cr?IG=2E29ED6A8345444784873C33BC9389C0&CID=0684DA50B87962EE14AAD023B9E9636A&rd=1&h=oBGz6olQT1Ths73d3GrsCNa5g3qWgEAZX3o8tRScldU&v=1&r=http%3a%2f%2fec.europa.eu%2fjustice%2fcivil%2ffiles%2fcompany-law%2ficleg_recommendations_interest_group_final_en.pdf&p=DevEx,5061.1.

law is fragmented. Hence, a substantive consolidation on matters of insolvency law without appropriate recognition of the interest of the group is put at the risk. Moreover, it is unlikely that the group of companies can be reorganized. [94] It is basic economic knowledge that continuity in the organisation of business proves more effective than fragmentation, since the greatest value in maximising all creditors' vindication cannot be obtained in a sustainable manner by mere application of liquidation.[95]

[94] DIRECTORATE GENERAL FOR INTERNAL ... - europarl.europa.eu." Accessed April 29, 2017. http://www.bing.com/cr?IG=A59E417986E0449BB966933C41D5CB15&CID=1760CE2FC93565690547C45CC8A564E1&rd=1&h=C93gz2g0pc1RZLwht0aivBtyY9LCe4FI1k_ayi2CVH8&v=1&r=http%3a%2f%2fwww.europarl.europa.eu%2fRegData%2fetudes%2fnote%2fjoin%2f2011%2f432762%2fIPOL-JURI_NT(2011)432762_EN.pdf&p=DevEx,5060.1

[95] "The Insolvency Legislative Guide." *Secured Credit and the Harmonisation of Law*. doi:10.4337/9780857933454.00011.

3. Single economic unit doctrine of EU competition law

The Case Law of the European Court of Justice (ECJ) regarding Articles 101 and 102 state that an undertaking is "every entity engaged in economic activity, regardless of the legal status of the entity and the way in which it is financed."[96] Accordingly, competition law focuses on the economic identity of an undertaking rather than its legal status. This implies that despite consisting of separate legal autonomous bodies, it is economic integrity that constitutes a single undertaking.[97] Consequently, if a group of companies is characterised as a single undertaking, the interests of the respective group of companies are equally recognised, based on the fact that they act collectively instead of autonomously. The 'decisive influence' is a key factor that diminishes legal autonomy of the undertaking to pursue their interest. Furthermore, the group of companies can under EU competition law be defined as single economic unit.

3.1 The decisive influence test

To determine whether a group of companies is a single entity a 'decisive influence test' is performed. If a private limited liability subsidiary does not possess economic autonomy and freedom to act, then an undertaking is presumed to belong to another entity. The parent company, exercising decisive influence on the subsidiary, establishes the single entity with a respective subsidiary.[98]

According to the doctrine of the legal autonomy of entities, the parent company has a very restricted ability to influence the market conduct of their subsidiaries because of separate rights and duties. From the perspective of competition law, a legal personality is not necessarily entailed to freely exercise market conduct and represent separate legal entities as they might otherwise be in competition with themselves. The parent company and the subsidiary grow into one single competitive force on the market.[99]

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[96] Colino, Sandra Marco. *Competition law of the EU and UK*. Oxford: Oxford Univ. Press, 2011.
[97] Bailey, David, and Vivien Rose. "Bellamy and Child: European Law of Competition." 2013. doi:10.1093/law/9780199667871.001.0001.
[98] Colino, Sandra Marco. *Competition law of the EU and UK*. Oxford: Oxford Univ. Press, 2011.
[99] Odudu, Okeoghene and Bailey, David. 'The single economic entity doctrine in EU competition law' (2014) *Common Market Law Review*, Issue 6

The ECJ stated that the parent company exerts a decisive influence on directly or indirectly wholly-owned subsidiaries, and therefore can be categorised as a single entity.[100] Moreover, the ECJ also ruled that if the parent company holds 51 percent in a limited liability subsidiary, this share is sufficient enough to constitute it as a single economic unit.[101] For the same reason, the parent companies might choose to establish themselves as minority shareholders. The ECJ ruled on this matter that the parent company as minority shareholder may exert wide influence on its subsidiary, provided that the minority rights granted to them are greater than normal, which thus, as a result, allow them to protect and pursue their interests, therefore affecting the market conduct of the subsidiary.[102] However, the parent company and its subsidiary will not constitute a single economic unit if the parent company holds shares only temporarily or if it acts as an ordinary investor under normal market conditions, as it is legally prevented to act as controller of its subsidiary.[103] Furthermore, the parent company has "the right to use all or part of the assets of an undertaking" as well as the right to affect the "composition and decision making of [an] undertaking," which also establishes decisive influence.[104]

3.1.1 Concluding remarks on the decisive influence test

The parent company exercising decisive influence diminishes the legal autonomy of its limited liability subsidiary, in that it imposes the interest of the group upon it. If the parent company has decisive influence it also represents a single force on the market together with the subsidiary. They thereby implement the interests of the group, rather than allowing multiple independent interests to be carried out. Accordingly, the parent company can, through exercising decisive influence, assure that the interest of the group prevails over the interest of the individual company. The decisive influence test

[100] Ezrachi, A. "Competition Law and the State." *EU Competition Law : An Analytical Guide to the Leading Cases*. doi:10.5040/9781849468527.ch-007.
[101] Cases 7/73, Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation v Commission of the European Communities, 6 March 1974.
[102] Case T-132/07, *Fuji Electric System Co Ltd. v. Commission* 12 July.
[103] Kokott, Juliane. "Opinion of Advocate General Kokott Delivered on 26 March 2009." *European Yearbook of International Economic Law 2011*, 2010, 483-522. doi:10.1007/978-3-642-14432-5_25.
[104] "Regulation (Ec) No 139/2004 On The Control Of Concentrations Between Undertakings." *European Competition Law*: 455-593. doi:10.4337/9781783476879.00025.

can be used as a tool to establish the interest of the group.

3.2 Liability of the parent company under the EU competition law

Any market activities that are based on supply and demand and establish profits within the EU fall under the scope of EU competition rules, regardless their distinct legal status.[105] The Commission imposed obligations on individual persons who breached EU competition law. These obligations are enforceable and governed by the statutes of the member states (Article 299 of the TFEU).[106] This raises the question whether the parent company is liable for the interest of the group executed by the subsidiary under competition law.

Both the legal autonomy of legal entities and the establishment of private limited liability subsidiaries institute in general no liability for the parent company for the distinct activities of the business organisation (i.e. the subsidiary). Instead, the subsidiary has to abide by liability in isolation.[107] However, the ECJ has embraced the single economic unit-doctrine concerning the liability of the parent company for the execution of the interest of the group by the subsidiary.[108] The single economic unit-doctrine is applicable only if a decisive influence test was performed. Accordingly, if decisive influence exists between the parent company and the subsidiary, it can be assumed that the respective legal entities form a single economic unit and can both jointly and separately become liable for infringing EU competition law. Consequently, the parent company can be liable for any undertaking undertaken by the single

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[105] "EUR-Lex Access to European Union law." EUR-Lex - 61990CJ0041 - EN - EUR-Lex. Accessed May 17, 2017. http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61990CJ0041 .

[106] "EUR-Lex - 12012E/TXT - EN - EUR-Lex." Accessed May 17, 2017. http://www.bing.com/cr?IG=5C77DE6323CB4804815F66970AE4D7A0&CID=393D2100868F65D537E82B85871F643F&rd=1&h=GpyXOwJYJGPuNIXwguHmGwgQ7vDr5Ajagt3Y4picM&v=1&r=http%3a%2f%2feurlex.europa.eu%2flegalcontent%2fEN%2fTXT%2f%3furi%3dCELEX%3a12012E%2fTXT&p=DevEx,578.1.

[107] Worthington Gower. *Principles of Modern Company Law*, 8th ed. (Sweet & Maxwell, 2008)

[108] "EUR-Lex - 61998CC0279 - EN - EUR-Lex." Accessed May 17, 2017. http://www.bing.com/cr?IG=040DDBA7990E4C1E83DFC145D0D67891&CID=0A0D0FAE0855652F0F03052B09C564D6&rd=1&h=v9BW-7Nbo12MsETVXKunM3ZmuV-MTrdZlY4V54xQLo&v=1&r=http%3a%2f%2feur-lex.europa.eu%2flegalcontent%2fEN%2fTXT%2f%3furi%3dCELEX%253A61998CC0279&p=DevEx,5088.1 .

economic unit. The liability of the parent company can be attributed on the basis that the parent company participated in actions of the subsidiary or can be based on the presumption of participation in the actions of the subsidiary, which represent an infringment of EU competition law.[109]

Concerning direct participation, joint liability is applied if a wholly-owned subsidiary committed a violation of Article 101 under the instructions of the parent company,[110] based on the ground that a wholly-owned subsidiary does not exercise genuine freedom to act.[111]

In the case of presumption of participation, it has to be demonstrated that the parent company exercises decisive influence and that the subsidiary does not exercise independent market conduct but rather follows the interests of the group.[112] It is expressly acknowledged that under normal conditions the subsidiary will operate relatively independently. The parent company, however, may through exerting decisive influence at any time restrict the freedom of decision-making of the subsidiary.[113] Since the subsidiary cannot practice autonomy in operations that are based on decisive influence of the parent company, the distinct legal personality will not be respected.[114] On the contrary, the parent company through being an ordinary, rational financial investor holds shares temporarily. Ownership rights do not establish strict control and do not imply decisive influence; therefore the distinct legal personalities will be respected.[115]

Moreover, liability might also be attributed to the parent company, even in the absence of both types of participation, assuming that there is a breach of EU competition rules

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109 CURIA - List of results. Accessed May 17, 2017. http://curia.europa.eu/juris/liste.jsf?num=C-440%2F11 .
110 CURIA - List of results. Accessed May 17, 2017. http://curia.europa.eu/juris/liste.jsf?language=en&T%2CF&num=22%2F71 .
111 "COMMISSION DECISION of 20.X.2004 relating to a proceeding ..." Accessed May 17, 2017. http://www.bing.com/cr?IG=AD9009CE54184E169CF49AFA5A4D30BA&CID=1F38B253AD776B5A14A3B8D6ACE76A56&rd=1&h=R9psHCik88HA_TxYYjX-tejO_G-7V7FhMFUnBBJJwNQ&v=1&r=http%3a%2f%2fec.europa.eu%2fcompetition%2fantitrust%2fcases%2fdec_docs%2f38238%2f38238_249_1.pdf&p=DevEx,5032.1 .
112 Jonathan, Faull and Nikpay, Ali , *the EU law of competition*. Oxford: Oxford University Press, 2014.
113 "EUR-Lex Access to European Union law." EUR-Lex - 61969CJ0048 - EN - EUR-Lex. Accessed May 17, 2017. http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61969CJ0048 .
114 Ibid.
115 "The Opinion of the Venice Commission." *The Council of Europe*: 69-182. doi:10.1007/3-211-33506-4_4.

and the actions of the respective subsidiary are beneficial for the parent company. Decisive influence exerted by the parent company over the subsidiary also has to apply. Considering that any gains resulting from a violation of EU competition law can benefit the parent company, it is only fair that a liability for the illegal actions of the subsidiary can be attributed to the parent company, that has the power of influence.[116]

The ECJ ruled that officers and employees are considered part of an undertaking if they act within the scope of their employment. Hence, the board of directors of a limited liability subsidiary is also part of the group of companies if the parent company exercises decisive influence.[117] The parent company with decisive influence cannot escape liability by arguing that the board of directors of the subsidiary acted autonomously, since the management is part of the group of companies and thus acted under the scope of employment. Together with the board of directors the group of companies form a single economic unit.[118] Proof that the board of directors was instructed by the parent company or that the parent company was aware of possible consequences of acts of the management are not necessary to extend liability also to the parent company.[119]

The competition law approach balances the burden of liability between the board of

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[116] "CURIA - Documents." Accessed May 17, 2017. http://www.bing.com/cr?IG=B6D500FED2BF41DCB768401763BFA10D&CID=2A95B8DDB43B6AF50E8EB258B5AB6BF7&rd=1&h=eUv-qIC7zrQTB7RXWYXnW-oXknpW1bPkDHpT_h2yrSY&v=1&r=http%3a%2f%2fcuria.europa.eu%2fjuris%2fdocument%2fdocument.jsf%3fdocid%3d119007%26doclang%3den&p=DevEx,5073.1 .

[117] "EUR-Lex - 61973CJ0040 - EN - EUR-Lex." Accessed May 24, 2017. http://www.bing.com/cr?IG=FC19D91809574F42B3CEA1627AAC253A&CID=0ED1136E8D3768D71BFB19E28C316997&rd=1&h=gewfCTLBFtYS2tB12oUVw_oZrIFdKO4XtnlbSzTlkiY&v=1&r=http%3a%2f%2feur-lex.europa.eu%2flegal-content%2fEN%2fALL%2f%3furi%3dCELEX%3a61973CJ0040&p=DevEx,5035.1 .

[118] Amato, Giuliano, Claus Dieter. Ehlermann, and Assimakis P. Komninos. *EC competition law: a critical assessment*. Oxford: Hart, 2007.

[119] "EUR-Lex - 62012CJ0068 - EN - EUR-Lex." Accessed May 24, 2017. http://www.bing.com/cr?IG=4066797AC8BC485EB9F67D55A7A223D9&CID=33EAB32713F76E2635E5B9AB12F16F6E&rd=1&h=RhveVt2sp5jmUYARozg57CUJApApe1HIDZFFJoyU-_M&v=1&r=http%3a%2f%2feur-lex.europa.eu%2flegal-content%2fEN%2fALL%2f%3furi%3dCELEX%3a62012CJ0068&p=DevEx,5039.1 .
and
"EUR-Lex Access to European Union law." EUR-Lex - 61980CJ0100 - EN - EUR-Lex. Accessed May 24, 2017.
http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61980CJ0100

directors of the subsidiary and the parent company, and therefore recognises the interest of the group.

3.3 Does the EU competition law approach on the recognition of the interest of the group set a precedent for company law?

The company law approach produces legal autonomy and limited liability. Accordingly, given that the legal personalities of the parent company and subsidiary are distinct, an extension of liability to the parent company is restricted, despite the fact that the subsidiary is executing the interest of the group. However, in exceptional cases (especially in insolvency issues), the distinction of legal personalities and the attributed limited liability can be disregarded. This approach hampers an appropriate recognition of the interest of the group. On the one hand, the company law approach protects investors and facilitates investment efficiency. The parent company fostering the interest of the group should not be characterized as an ordinary, rational investor striving for profit and a sustainable development of the company. The competition law approach follows a different view, in that it follows the single economic unit-doctrine, which is based on economic reality. In spite of being established as separate legal personalities, the parent company and the subsidiary can still demonstrate organisational integrity, on the grounds that they can achieve decisive influence. Thus, these types of organisations can act as one single force on the market. Consequently, if acting as a single unit, the parent company should also be liable for actions carried out by the subsidiary. One can suggest that in wholly-owned subsidiaries the parent company is deemed to have decisive influence. In light of the aforementioned, the competition law approach is more supportive of the recognition of the interest of the group than the company law approach.

4. The concept of the interest of the group and its impact on the EU business environment

Group-related companies are a reality and widely used. Traditionally, national company law in EU-Member States has been based on the doctrine of legal autonomy. From the perspective of company law, the parent company and the subsidiary are identified as separate legal personalities, while from an economic perspective, they act as one single entity. On the one hand, shareholders and creditors have to be protected. On the other hand, economic reality determines that the parent company gives instructions and conduct transactions with subsidiary. However, this ability has to be balanced against duties of care and loyalty of the board of directors of the subsidiary. This balance induces a positive EU-wide business environment.

4.1 Management of the group of companies

A sophisticated management of central control on part of the parent company and autonomy granted to the subsidiary limit cross–border commercial activities, since the established legal system lacks flexibility in operations. The parent company has limited rights to instruct subsidiaries, and consequently also has restricted duties and liabilities. Moreover, a fragmented market causes a lack of clarity for the board of directors of both the parent company and the subsidiary, on which transactions they can carry out.[120] However, if the parent company expects the subsidiary to act in the interest of the group, it has the opportunity to establish a branch instead of a subsidiary. The advantage of the limited subsidiary is an increased investment efficiency. A fragmented market therefore drives the subsidiary towards the

[120] "Report of the Reflection Group - European Commission." Accessed May 22, 2017. http://www.bing.com/cr?IG=533C5D6791C448D8AA33628E7F0345CD&CID=0AE26E114D3964F12427649B4C3F6524&rd=1&h=POZG0mp1qxqEzoSkYnY6da_XHp-JaE4rqwaFJAqSpzo&v=1&r=http%3a%2f%2fec.europa.eu%2finternal_market%2fcompany%2fdocs%2fmodern%2freflectiongroup_report_en.pdf&p=DevEx,5062.1 .

establishment of branches having a detrimental affect on the overall investment environment.

4.2 Cost of doing cross–border business

Various Member State approaches towards the recognition of the interest of the group lack legal certainty, which as a result increases the cost of doing cross-border business. The parent company seated in an EU country, managing and entering into transactions with the subsidiary being seated in another state, has to analyse technicalities of the legislation of the respective state. The group companies, located in more than one state, create an (enormous) financial burden. A settled structure has an adverse effect on small and medium-size enterprises (SMEs), since bearing the cost of compliance for different legal systems is higher for them. Further, the lack of flexibility on part of the management of the group of companies to pursue of the interest of the group represents a hindrance for cross-border commercial activities between the parent company and the subsidiary, thus restricting the freedom of establishment. The separation of legal personalities in the group of companies also affects issues of transparency. Lack of, or even no disclosure of coherent and accurate information regarding the structure and relationship of the parent company and the subsidiary degrade the position of creditors and minority shareholders.[121]

4.3 Cash pooling

Based on the principal of the legal autonomy, the parent company and the subsidiary manage their liquidity separately. This, however, reduces the use of internal funds and increases the cost of capital.[122] The European business environment relies heavily on banks for financing, rather than capital markets. The financial market of the EU

[121] Ibid

[122] "Statistics Paper Series - European Central Bank." Accessed May 22, 2017. https://www.bing.com/cr?IG=5EB3EC843B35470BA30449D3FBE01B94&CID=2273320D75C56D4B38AF388774C36C13&rd=1&h=6VMQ-uVLsxl6PNUHKd-8-kU7CN6dOFqUeJLnIozLttM&v=1&r=https%3a%2f%2fwww.ecb.europa.eu%2fpub%2fpdf%2fscpsps%2fecbsp16.en.pdf%3f526875bba8ae1414b8d1fb417d30e883&p=DevEx,5062.1 .

therefore establishes measures for an efficient capital and risk allocation, as well as the mobilisation of savings, and the facilitation of SMEs.[123] However, cash pooling on part of the parent company and the subsidiary combines both balances under one bank account (i.e. master account). Each party may withdraw their contribution without the consent of the other party, in order to satisfy their own cash flow, thereby maximising the use of internal funds and the cost of capital.[124] Nevertheless, cash pooling is regulated by the legal frameworks of the Member State on matters of company law and therefore raises the questions whether a fragmented recognition of the interest of the group limits cash pooling.

The board of directors of French private limited liability subsidiaries can potentially face liability for an "abuse of corporate property" in the context of cash pooling arrangements that go against the interest of the company. The interest of the group might be different than the interest of the company. The so-called Rozenblum-doctrine suggests that the board of directors considering the interest of the group and that cash pooling between a group of companies does not immediately constitute the abuse of corporate property. Accordingly, if cash advances in cash pooling between a group of companies are paid at a sufficient rate and go conform with the framework of the policy of the group as whole, and if a company does not become insolvent, there is no ground for abuse of corporate property. On the contrary, through participating in cash pooling, the management of the private limited liability subsidiary can be liable for an "abuse of majority" under French law, if cash pooling goes against the interests of the minority shareholders. Minority shareholders can file a claim against the directors of the board who signed off on the respective action. However, the shareholder will never

[123] "Report of the Reflection Group - European Commission." Accessed May 22, 2017. http://www.bing.com/cr?IG=533C5D6791C448D8AA33628E7F0345CD&CID=0AE26E114D3964F12427649B4C3F6524&rd=1&h=POZG0mp1qxqEzoSkYnY6da_XHp-JaE4rqwaFJAqSpzo&v=1&r=http%3a%2f%2fec.europa.eu%2finternal_market%2fcompany%2fdocs%2fmodern%2freflectiongroup_report_en.pdf&p=DevEx,5062.1 .

[124] "The Informal Company Law Expert Group (ICLEG)." Accessed May 22, 2017. http://www.bing.com/cr?IG=4F57C50B8A794AD0949BDFFCAB956BFC&CID=29CED26DE3E76FF82302D8E7E2E16E21&rd=1&h=oBGz6olQT1Ths73d3GrsCNa5g3qWgEAZX3o8tRScldU&v=1&r=http%3a%2f%2fec.europa.eu%2fjustice%2fcivil%2ffiles%2fcompany-law%2ficleg_recommendations_interest_group_final_en.pdf&p=DevEx,5062.1

come to harm, if the director of the board acts as an honest and cautious businessman.[125]

In Germany, cash pooling arrangements always have to be in line with the principle of capital maintenance. According to this principle, company assets cannot be distributed to shareholders or companies affiliated with the shareholder, in order to preserve at all times the issued share capital, which would otherwise have devastating effects on the balancing of accounts of members of the group.[126] If, however, a company's liquidity is maintained, cash pooling does not impose a risk to the solvency of the legal entity. Moreover, strict rules on the protection of capital maintenance limit the possibility to reap all benefits from cash pooling.

The legal uncertainty of the interest of the group companies limits cross–border cash pooling arrangements, given the tension between the group management and the board of the subsidiary. Accordingly, any cross–border intra-group capital flow is restricted.[127] Consequently, the deficit balance offsetting the balance of the pool is narrowed, slowing down the circulation of funds, lowering the optimisation of net payments, and causing higher administrative costs of capital allocation.[128] An inconsistent recognition of the interest of the group limits the possibilities to fully realise external financing of the group of companies. Therefore, an appropriate recognition of the interest of the group would increase the overall stability of the EU financial market.

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[125] "Cash pooling." CMS | Publication | Cash pooling. Accessed May 25, 2017. https://cms.law/en/NLD/Publication/Cash-pooling

[126] Limited Liability Companies Act (Gesetz betreffend die Gesellschaften mit beschrnkter Haftung, GmbHG)", Article 30. Accessed April 27, 2017. http://www.gesetze-im-internet.de/englisch_gmbhg/

[127] Ibid.

[128] "Statistics Paper Series - European Central Bank." Accessed May 22, 2017. https://www.bing.com/cr?IG=5EB3EC843B35470BA30449D3FBE01B94&CID=2273320D75C56D4B38AF388774C36C13&rd=1&h=6VMQ-uVLsxl6PNUHKd-8-kU7CN6dOFqUeJLnIozLttM&v=1&r=https%3a%2f%2fwww.ecb.europa.eu%2fpub%2fpdf%2fscpsps%2fecbsp16.en.pdf%3f526875bba8ae1414b8d1fb417d30e883&p=DevEx,5062.1

4.4 Development of the Common Consolidated Corporate Tax Base (CCCTB)

Fragmented recognition of the interest of the group hinders the development of the CCCTB. CCCTB is:

> "a single set of rules to calculate companies' taxable profits in the EU. Further, CCCTB would establish system that would allow companies to comply with one, single EU system for computing taxable income."[129]

The parent company and the subsidiary are distinct legal personalities, and are therefore treated as separate legal entities. However, the reality is that the parent company and the subsidiary act as one single entity, in order to achieve the interest of the group. Negative integration of the interest of the group facilitates profit shifting and tax base erosion.[130] Consequently, EU-Member States introduce more ring-fencing regulations that even further restrain the ability of the board of directors of the subsidiary to take into consideration the interest of the group in an appropriate manner.

4.5 Forum shopping

In the Single Market the TFEU grants the right to freedom of establishment and the freedom to provide services, which therefore guarantees the mobility of the market participants, in order to fully benefit from the economy of scale.[131] Based on the principle of conferral, the EU has no general competence to regulate the company law of Member States in its entirety and lacks harmonisation from different national structures with regards to the recognition of the interest of the group. In particular, the disintegration of the interest of the group promotes regulatory arbitrage leading to

[129] "Common Consolidated Corporate Tax Base (CCCTB) - Taxation and customs union - European Commission." Taxation and customs union. Accessed June 19, 2017. http://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en .

[130] "Common Consolidated Corporate Tax Base (CCCTB) - Taxation and customs union - European Commission." Taxation and customs union. Accessed May 22, 2017. http://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en .

[131] "EUR-Lex - 12012E/TXT - EN - EUR-Lex." Accessed May 22, 2017. http://www.bing.com/cr?IG=CCB112A6D5B349B8868214A8EFF73EC5&CID=1A1BAAA3F60A69EB1F82A029F70C68FB&rd=1&h=GpyXOwJYJGPuNI-XwguHmGwgQ7vDr5Aja-gt3Y4picM&v=1&r=http%3a%2f%2feur-lex.europa.eu%2flegal-content%2fEN%2fTXT%2f%3furi%3dCELEX%3a12012E%2fTXT&p=DevEx,5062.1

regulatory competition. This creates tensions between the protection of minority shareholders and creditors, and attraction of more legal personalities to a jurisdiction. Accordingly, this raises the question whether different structures of national company law on the recognition of the interest of the group lead to a race to the top i.e. the removal of ineffective rules or a race to the bottom i.e. assisting the trade–off of the minority shareholder's and creditor's rights, in order to attract more investment to the jurisdiction.

Moreover, the establishment of the Single Market and Member State competence to regulate the recognition of the interest of the group have a spill-over effect, with the policies on one respective matter of one state having impact on the economy and the national legal system of another Member State.[132] Cerioni has argued that the national systems of Member States should establish neutrality, in order to retain the EU as an economically integrated Union. Consequently, the company law of Member States should not be the main concern of a business organisations on questions where to invest. As such, company law cannot deform economical efficiency by shifting investors' decision-making from "real" economical benefits and costs towards aspects of company law (that is, flexible management and limited liability for shareholders in the subsidiary).[133]

The mobility and low switching costs of legal entities within the EU sets up a system of regulatory arbitrage, in which firms select jurisdictions within the EU that allow them to operate efficiently. Operational efficiency comes from flexible management, in order to pursue the interest of the group and limit liability in the subsidiary. As a result, regulatory competition may occur. Member States compete with each other to attract legal personalities that operate within their jurisdiction, as they see a possibility for a potential gain a profit. Member States apply laws that encourage entities to choose jurisdiction that stands in opposition to other EU Member States.[134] In order to be competitive, Member States are pressured to provide a flexible management structure that allows to carry out the interest of the group and receive limited liability.

[132] Letto-Vanamo, P., n.d. Fragmentation and Coherence of Law – a Historical Approach. Coherence and Fragmentation in European Private Law. doi:10.1515/9783866539655.151
[133] Bartman, S.M. European company law in accelerated progress. Kluwer Law International. 2006.
[134] Murphy, D.D. The structure of regulatory competition corporations and public policies in a global economy. Oxford University Press, Oxford. 2006.

However, it is in the public interest to protect creditors and minority shareholders. Furthermore, regulatory competition can undermine the interest of the public in favour of establishing a flexible structure of the management and grant limited liability, thereby triggering a downward spiral. However, regulatory competition might also stimulate innovations where the regulations of Member State seek to correct market failures.[135]

As already discussed in section 1.1 on "Parental influence over private limited liability subsidiary companies," the parent company can become the controller over their subsidiary by being the shareholder, thereby pursueing the interests of the group companies rather than subsidiary's, even though the respective Member State might lack the relevant management flexibility to carry out the interest of the group due to a denial of respective interests (e.g. private limited liability subsidiary in Germany (see section 1.2.1). As a result, the spill–over effect facilitates regulatory competition, on account of the possibility of regulatory arbitrage. A race to the bottom may be triggered, since what the legal entities demand is not only a flexible management but also to be granted fully limited liability to pursue the interest of the group. Under these circumstances the rights of minority shareholders and creditors can be strongly undermined.

In light of the aforesaid, it can be concluded that in order to achieve investment neutrality between Member States the appropriate recognition of the interest of the group represents a necessity to safeguard the economical integration of the Union.

4.6 Conclusion on the concept of the interest of the group and its impact on the EU business environment

Fragmented recognition of the interest of the group shapes the market, which, as a consequence, lacks stability and increases the cost of cross-border business activities. The cost of cross-border business is substantial for SMEs. SMEs represent 97 per cent of the EU business industry and provide 67 per cent of the total employment. It is thus not just economically but also socially and politically important to facilitate their

[135] Easterbrook, F.H., 2008. Is corporate law still a race to the top? Center for Business Law and Regulation, Case Western Reserve University School of Law, Cleveland, OH.

well–being.[136] Moreover, the EU market with its disintegrated recognition of the interest of the group restricts reliance on capital markets, since the ability to realise cash pooling is narrowed and having an adverse effect on the development of the CCCTB, and promoting forum-shopping that can frustrate the protection of minority shareholders and creditors. Moreover, fragmented integration of the recognition of the interest of the group puts obstacles on the freedom of establishment and might lead to the development of further branches rather than subsidiaries. It thus can be detrimental to investment efficiency. All things considered, appropriate recognition of the interest of the group would facilitate a positive EU business environment.

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[136] "What Is an SME?" - European Commission. Accessed May 23, 2016. http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index_en.htm .

5. Conclusion on appropriate recognition of the interest of the group

The group of companies rather than the single company has become the predominant structure of large–sized enterprises in the EU, in which business operations are conducted and organised through a network of the parent company and several limited liability subsidiaries in several Member States. The main reason for this seems to be that central control is exercised by the parent company and local autonomy granted to the subsidiary. Success of the group of companies depends on sophisticated and flexible management that provides an optimal combination of central control and local autonomy. Accordingly, EU law would do well to not ignore this significant aspect.[137]

However, a failure to liaise between the respective interests of the group creates islands of unified company law within the sea of differing approaches of national law on the issue of the recognition of the interest of the group.[138] On the one hand, some Member States ensure strict integrity and autonomy of the management of private limited liability subsidiaries in order to safeguard the interest of that company (e.g. Germany establishes such rules). This approach reflects the understanding that the rights of minority shareholders and creditors have to be strictly protected. Consequently, the board of directors cannot consider the interest of the group in an adequate manner, as the interest of the company prevails. The main goal of this is to keep shareholders from micro–managing the company, since the board of directors performs actions in line with the interests of the company. Nevertheless, flexible management of private limited liability subsidiaries establishes that shareholders ultimately have a say in the main business decisions of legal entities. On the other hand, different Member States follow different approaches towards recognition of the interest of the group. The board of directors of solvent private limited liability subsidiaries can take into consideration the interest of the group of companies (e.g.

[137] Antunes, José Engrácia. Baums, Theodor. Clarke, Blanaid J. Conac, Pierre-Henri. Enriques, Luca. Hanak, Andras I. Hansen, Jesper Lau. Kluiver, H. J. De. Knapp, Vanessa , Noëlle Lenoir, Linnainmaa, Leena. Soltysinski, Stanislaw and Wymeersch, Eddy O.. "Report of the Reflection Group on the Future of EU Company Law." *SSRN Electronic Journal*. ADD PAGE NUMBER doi:10.2139/ssrn.1851654.
[138] Hartkamp, A. S., and Von Bar, Christian. *Towards a European Civil Code*. Nijmegen: Ars Aequi Libri, 2011.

France follows such an approach towards the interest of the group). It recognizes that some damages and disadvantages may occur as a result from being in the group of companies. On a greater scheme, it still proves beneficial to be part of the group of companies with the goal of financial well–being as a group. This approach reflects the differing views of creditor and minority shareholder protection because pursuing the group interest does not necessarily violate the interest of the company. This is also the legal outcome of different perspectives on questions of hierarchy of the management of a company. While the German approach allows the board of directors to administer and supervise the company with autonomy, the French approach has shareholders and the board of directors run a company together.[139]

Different systems of the recognition of the interest of the group lead to fragmentation within EU company law. The aftereffect of this is that the general creditor protection is deteriorated, minority shareholders might never reap all benefits from their contribution to the company, a weak balance between the liability of the board of directors and the parent company, and a limited possibility to reorganise the group of companies, leading to a less effective and less attractive EU business environment for commercial cross–border activities. The lesson that can be learnt from the single economic unit doctrine of competition law is that regardless of the statutory order of shareholders and the board of directors, the parent company can wield great influence on the private limited liability subsidiary and act as a single force on the market. These types of organisations thus have to be characterized as one single entity, in which each member executes the interest of the group as a whole. Moreover, in the sphere of competition law we find a common and unified recognition of the interest of the group in all Member States.

The main objective of the Single Market is to further economic integration, so that market participants can act freely across borders without being hindered by any barriers and obstacles, in order to benefit fully from the economy of scale. Thus,

[139] "The Informal Company Law Expert Group (ICLEG)." Accessed May 26, 2017. http://www.bing.com/cr?IG=2798D889E29C4D32A9D27AB2C9B6BD04&CID=0058FBCC8BC365F9306CF1428AC56436&rd=1&h=oBGz6olQT1Ths73d3GrsCNa5g3qWgEAZX3o8tRScldU&v=1&r=http%3a%2f%2fec.europa.eu%2fjustice%2fcivil%2ffiles%2fcompany-law%2ficleg_recommendations_interest_group_final_en.pdf&p=DevEx,5062.1 .

company law of all Member States has to be coherent. Weatherill and Beaumont have argued that the "heart" of the Union has been and will be economic integration. Therefore, substantive law of the EU safeguards against any measures that pose a threat or weakens economic integration of the Union.[140] A lack of certainty, increased costs of cross–border business, regulatory competition leading to a downward spiral of creditor and minority shareholder protection, obstacles are set against the development of the CCCTB, and the participation in cash pooling limits the freedom of establishment since the group of companies is forced to form branches rather than the more investment-efficient private limited liability subsidiaries. The EU has no general competence to regulate the company law of Member States in its entirety, but the principle of the subsidiarity provides that:

> "In areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level (Art. 5 para. 3 the Treaty of the European Union (TEU))."[141]

Member States cannot sufficiently achieve the objectives of the freedom of establishment, while the EU can only provide a common framework for the recognition of the interest of the group and thus limit the scope of the competence of Member States to freely determine the interest of the group. In light of all the above, the EU can and should intervene in how Member States recognize the interest of the group, which is why the EU has to form an appropriate recognition of the interest of the group and reduce legal fragmentation in order to facilitate the freedom of establishment.

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[140] Weatherill, Stephen, and Beaumont, Paul. *EU Law:*. London: Penguin, 1999.
Also: Craig, Paul, and Gráinne, De Búrca. "EU Law: Text, Cases, and Materials." 2011. doi:10.1093/he/9780199576999.001.0001

[141] "EUR-Lex - 12012M/TXT - EN - EUR-Lex." Accessed May 26, 2017. http://www.bing.com/cr?IG=86400E9DD25B44A4B1534888D53EE3D8&CID=363F26694C3C61A418642CE74D3A601E&rd=1&h=_qWu7swjMDFbUBn3oORXrwZAjQRXzTb62_UuE2t9-HA&v=1&r=http%3a%2f%2feur-lex.europa.eu%2flegal-content%2fEN%2fTXT%2f%3furi%3dCELEX%3a12012M%2fTXT&p=DevEx,5063.1 .

6. Recommendations

To strike a balance between the protection of creditors and minority shareholders and the establishment of flexible management with limited liability attributed to shareholders is not an easy task, given that there is no quick solution that would fit the company laws of all Member States. However, a first step should be to establish a common understanding that the group interest can be pursued and it is only then that it can be defined what can be characterized as the group interest and what its limits are.[142] A distinction between the group interest in wholly-owned and not wholly-owned subsidiaries should be made. Wholly-owned subsidiaries have no minority shareholders, so the parent company has decisive influence to impact the board of directors of the subsidiary to carry out the interest of the group. This seems to be a good starting point for an appropriate recognition of the interest of the group.

Providing framework rules that allow the group of companies to implement and adopt coordinated policies to balance between efficient creditor and minority shareholder protection and advantages for the parent companies would be the best solution in the author's opinion to form appropriate recognition of the interest of the group in the EU.[143] Nonetheless, strong opposition from Member States that follow the German system is to be expected (e.g. Austria, Croatia, Latvia, Lithuania, Portugal, Slovenia).[144] Recommendations could be understood as an alternative to framework rules to minimise opposition. More precisely, the European level recommendations should include provisions on the parent company's right to give instructions to the subsidiary's board of directors, as well as on a simplified regime on the group of companies transactions, increased transparency, and a list of good and bad business practices concerning the interest of the group.[145]

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[142] Ecgi.org. Accessed May 27, 2017. http://www.ecgi.org/commission/
[143] Ecgi.org. Accessed May 27, 2017. http://www.ecgi.org/publications/winter.htm
[144] "The Informal Company Law Expert Group (ICLEG)." Accessed May 27, 2017. http://www.bing.com/cr?IG=C01A51EFBEF444579C73C9AEE0A25152&CID=2A5F1295C786664835401818C6806740&rd=1&h=oBGz6olQT1Ths73d3GrsCNa5g3qWgEAZX3o8tRScldU&v=1&r=http%3a%2f%2fec.europa.eu%2fjustice%2fcivil%2ffiles%2fcompany-law%2ficleg_recommendations_interest_group_final_en.pdf&p=DevEx,5062.1
[145] Ecgi.org. Accessed May 27, 2017. http://www.ecgi.org/publications/winter.htm

One of the provided solutions would limit legal fragmentation in general EU company law and would facilitate the protection of creditors and minority shareholders, the establishment of a fair balance between the board of directors of the subsidiary and the liability of the parent company, an increase in opportunities of the reorganization of group companies, which would lead to legal certainty, decreased costs of cross-border business, limitation of the downward spiral of the protection of minority shareholders and creditors, as well as a removal of barriers and obstacles to the development of the CCCTB, and the participation in cash pooling.

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Annex 1 English Abstract

The present thesis examines appropriate recognition of the interest of the group in the European Union (EU). Given that the EU is based on the principal of conferral it has no general competence to regulate company law in its entirety. Member States therefore continue to operate in accordance with the legal systems of separate countries, resulting in legal fragmentation of the Internal Market, which in turn has adverse effects on consistency and thus represents a burden. It is the European Single Market that renders national systems of company law of the individual Member States to be coherent, while the Treaty of Functioning of the European Union (TFEU) provides the legal basis for harmonization. Accordingly, appropriate recognition of the interest of the group would safeguard the Union against legal fragmentation and foster a positive business environment within the EU. The group interest is defined as "organized group management through network of companies, where central control is exercised by a parent company and local autonomy granted to a subsidiary."[146]

The paper is divided into three sections: Piercing the corporate veil, single economic unit and positive EU wide business environment. The first section examines the distinction/difference between parent and the subsidiary companies. The second section looks into how competition law approaches the recognition of the interest of the group. The third section examines the influence of the recognition of the interest of the group on the Internal Market. The central research question is whether the EU should intervene depending on how Member States recognise the interest of the group. The scope is narrowed to private limited liability subsidiaries. The methodology used is that of legal doctrinal research.

The first section analyses the (degree of) autonomy of legal entities that are private limited liability subsidiaries and sets out to establish the difference between the interest of the group and that of each participant of the group. It further analyses the right of shareholders to influence the management of the company and the protection of creditors and minority shareholders.

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[146] Antunes, José Engrácia, Theodor Baums, Blanaid J. Clarke, Pierre-Henri Conac, Luca Enriques, Andras I. Hanak, Jesper Lau Hansen, H. J. De Kluiver, Vanessa Knapp, Noëlle Lenoir, Leena Linnainmaa, Stanislaw Soltysinski, and Eddy O. Wymeersch. "Report of the Reflection Group on the Future of EU Company Law." SSRN Electronic Journal. doi:10.2139/ssrn.1851654

The second section discusses the single economic unit doctrine.

The third section focuses on the issue whether an appropriate recognition of the interest of the group might improve the overall EU business environment, that is, clarity for directors, decrease in costs, facilitation of cash pooling, and the development of the CCCTB. Moreover, this section also discusses the effects on regulatory arbitrage and regulatory competition.

This paper concludes that that there is a need for an EU intervention in the context in terms of an appropriate recognition of the interest of the group, since the current system has to proven to be legally fragmented and demoting for a positive EU-wide business environment.

Anhang 2 Deutscher Auszug

Diese Arbeit beschäftigt sich mit der Berücksichtigung von Konzerninteressen innerhalb der Europäischen Union (EU). Angesichts der Tatsache, dass die EU auf dem Prinzip der begrenzten Einzelermächtigung beruht, hat sie keine allgemeine Kompetenz das Gesellschaftsrecht als Ganzes zu regulieren. Die Mitgliedstaaten agieren daher weiterhin autonom innerhalb der Grenzen ihrer eigenen Rechtsordnungen. Dies führt zu einer Zersplitterung der Rechtsordnungen innerhalb des Binnenmarktes und somit zu einer Belastung für die Unternehmen innerhalb des Marktes. Der europäische Binnenmarkt macht die nationalen Gesellschaftssysteme der einzelnen Mitgliedstaaten kohärent, während der Vertrag über die Arbeitsweise der Europäischen Union (AEUV) die Rechtsgrundlage für eine etwaige Harmonisierung bildet. Dementsprechend würde eine angemessene Berücksichtigung der Konzerninteressen die EU vor der Fragmentierung der Rechtssysteme schützen und so ein positives Geschäftsumfeld innerhalb der EU fördern. Das Konzerninteresse wird definiert als „ein organisiertes Netzwerk von Unternehmen, welches von einem Mutterunternehmen kontrolliert wird und trotzdem noch die Autonomie der einzelnen Tochtergesellschaften gewährleistet."[147]

Die Arbeit teilt sich in drei Teile: die Durchgriffshaftung, einzelne wirtschaftliche Einheiten und den Wirtschaftsstandort EU. Der erste Abschnitt beschäftigt sich mit der Differenzierung von Mutter- und Tochtergesellschaften. Der zweite Abschnitt untersucht wie das Wettbewerbsrecht sich der Berücksichtigung von Konzerninteressen annähert. Der dritte Abschnitt untersucht die Berücksichtigung von Konzerninteressen im Binnenmarkt. Diese Arbeit beschäftigt sich mit der zentralen Forschungsfrage: Inwieweit und ob die EU in das Gebaren von Mitgliedstaaten bezüglich der Anerkennung von Konzerninteressen einmischen soll. Der Fokus liegt hierbei auf GmbH Tochtergesellschaften. Die verwendetet Methodik ist die der Rechtslehre.

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[147] Antunes, José Engrácia, Theodor Baums, Blanaid J. Clarke, Pierre-Henri Conac, Luca Enriques, Andras I. Hanak, Jesper Lau Hansen, H. J. De Kluiver, Vanessa Knapp, Noëlle Lenoir, Leena Linnainmaa, Stanislaw Soltysinski, and Eddy O. Wymeersch. "Report of the Reflection Group on the Future of EU Company Law." SSRN Electronic Journal. doi:10.2139/ssrn.1851654

Der erste Abschnitt analysiert den Grad der Autonomie von juristischen Personen, genauer von GmbHs und erarbeitet die Interessensunterschiede des Konzerns und der einzelnen Konzernmitglieder. Weiters wird das Recht auf Einflussnahme der Gesellschafter auf die Geschäftsführer sowie der Schutz von Gläubigern und Minderheitengesellschafter näher beleuchtet.

Der zweite Abschnitt beschäftigt sich mit der „single economic unit" Theorie.

Der dritte Abschnitt konzentriert sich auf die Frage, ob eine angemessene Berücksichtigung der Konzerninteressen den Wirtschaftsstandort EU verbessern könnte. Das bedeutet mehr Klarheit für Vorstände, eine Senkung der Kosten, eine Erleichterung der Liquiditätsbündelung und die Entwicklung einer gemeinsamen konsolidierten Körperschaftssteuerbasis (CCCTB). Darüber hinaus beschäftigt sich dieser Abschnitt mit den Auswirkungen auf die Regulierungsarbitrage sowie den Regulierungswettbewerb.

Der Autor dieser Arbeit kommt zum Schluss, dass eine Intervention der EU im Hinblick auf eine angemessene Berücksichtigung von Konzerninteressen notwendig ist, da das aktuelle Rechtssystem fragmentiert ist und somit nachteilig für den Wirtschaftsstandort EU ist.