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Enforcing Self-Dealing Constraints on Dominant Shareholders in Continental Europe

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Extremely rough and preliminary.

Please do not quote.

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1. Introduction

All jurisdictions supply corporations and their stakeholders with various rules and remedies to prevent or punish asset diversion by those, whether managers or dominant shareholders, who are in control. Liability suits, disclosure provisions, challenges of shareholder resolutions, actions to have self-dealing transactions declared void, criminal sanctions and administrative intervention are available, often jointly, to protect the interests of minority shareholders and creditors against insiders' opportunism.

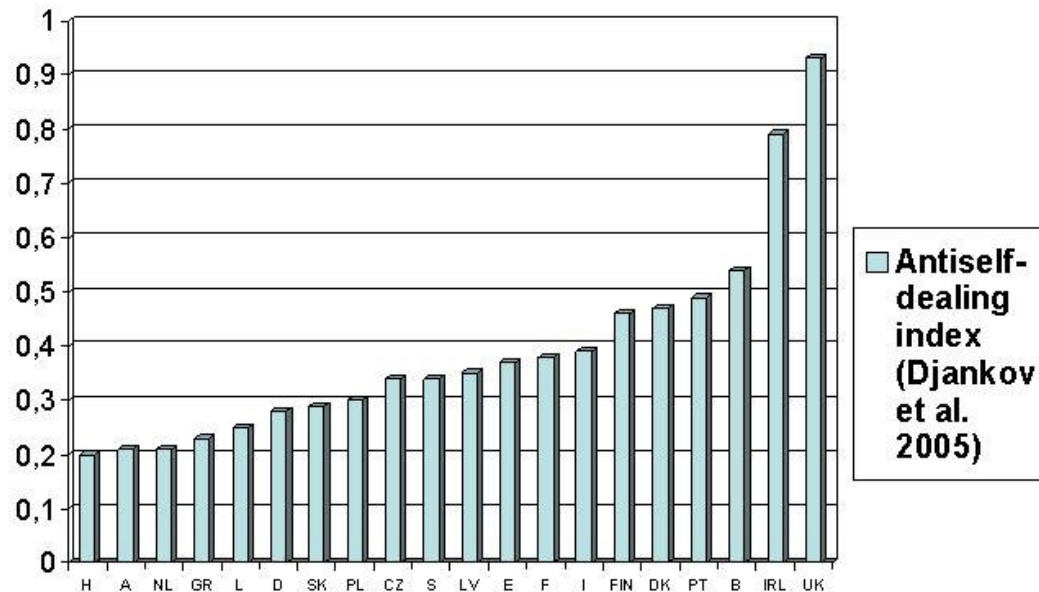
As previous research has shown, these rules, doctrines and remedies are far from uniform across jurisdictions, leading to significant differences in the degree of investor protection that they provide. For instance, Djankov et al. have conducted a comparative study on the regulation of self-dealing based on answers to a questionnaire sent to lawyers from 72 countries.¹ The questionnaire contains a number of questions on how the law on the books

¹ Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing*, December 2005, available at <http://ssrn.com/abstract=864645>. Their paper draws upon, and updates, the seminal articles written by a partly overlapping group of authors also known as LLSV from the family name initials of four of them (see especially Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 [1998]). LLSV work's influence on the literature and the policy debate has only been equal to the amounts of criticism it has drawn. See, most comprehensively, Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.'s 'Anti-Director Rights Index' under Consistent Coding*, HARVARD LAW SCHOOL OLIN FELLOWS' DISCUSSION PAPER NO. 7, 3/2006; see also Detlev Vagts, *Comparative company law – The new wave*, in Festschrift für Jean Nicolas Druey 595 (Rainer J. Schweizer, Herbert Burkert & Urs Gasser eds. 2002); (discussing LLSV's antidirector index from a more traditional comparative law perspective); Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers*, 30 DEL. J. CORP. L. 697, 704-736 (2005) (criticizing the LLSV index for France and Belgium); Mathias M. Siems, *What Does Not Work in Securities Law: A Critique of La Porta et al.'s Methodology*, 16 INT'L. COMPANY & COMM. L. REV. 300 (2005) (criticizing LLSV's more recent work on securities law on the grounds of principles of comparative law); Udo C. Braendle, *Shareholder Protection in the USA and Germany – "Law and Finance" Revisited*, 7 GERMAN L.J. 257, 265-277 (2006) (re-coding the antidirector index for Germany and the US). Djankov et al.'s more recent study (*supra*) eschews or alleviates some of the problems, but has some of its own. See e.g. Susanne Kalss, 3. *Kapitel: Kapitalverfassung*, in DIE REFORM DES ÖSTERREICHISCHEN KAPITALGESELLSCHAFTSRECHTS, VERHANDLUNGEN DES SECHZEHNTE ÖSTERREICHISCHEN JURISTENTAGS,

would treat a hypothetical self-dealing transaction involving a dominant shareholder. In order to conduct an econometric analysis of the correlation between corporate governance law (approximated by the treatment of self-dealing) and finance, they assign scores according to whether jurisdictions impose some procedural steps or disclosure duties and make some remedies available. Using these scores, they build an antiself-dealing index as a proxy for the quality of corporate law. Even looking at the European Union (EU) only, the dispersion among the 20 EU jurisdictions they cover is considerable: on a scale from 0 to 1, scores range from 0.20 for Hungary to 0.93 for the UK. Looking at continental Europe, where dominant shareholders are much more commonly in control of listed corporations and where their self-dealing is thus more relevant to corporate governance, the study finds scores of 0.38, 0.28, and 0.39 for the three main countries (respectively France, Germany, and Italy) (Figure 1).

BAND II/1 295, 370 n. 232 (Susanne Kalss & Martin Schauer 2006) (considering it as a severe methodological flaw that Djankov et al.'s study assumes that the hypothetical shareholder engaged in self-dealing is also a director of the firm, which creates a bias in favor of jurisdictions having special rules on conflicts of interest of directors, but misses the point with respect to self-dealing by large shareholders).

Figure 1. Antiself-dealing index for EU countries covered by Djankov et al.'s study.



Far less well established, and of course harder to gauge, is how these rules, doctrines and remedies work “off the books,” i.e. taking enforcement into account. The enforcement dimension may affect the substantive law’s ability to prevent self-dealing in various ways. First of all, it can exacerbate self-dealing problems, by making the law aimed to prevent it less effective, for instance as a consequence of hurdles to civil law suits or of a tendency by judges to defer to insiders’ business decisions even when tainted by self-interest.² Alternatively, at least in theory it can compensate for substantive law’s weaknesses thanks to judicial creativity in punishing wrongdoing or thanks to public prosecutors’ or government agencies’ zeal. Of course, enforcement may also confirm one jurisdiction’s self-dealing rat-

² One of us has analyzed a number of Milan court decisions between 1986 and 2000 and documented such an attitude by that court. See Luca Enriques, *Do Corporate Law Judges Matter? Some Evidence from Milan*, 3 EUR. BUS. ORG. L. REV. 765, 799-801 (2002).

ing, by overall mirroring the ability of its substantive law to tackle insiders' opportunism. Even in this case, however, it may do so in ways that make the legal system look different than if one looks at the law on the books only. For instance, the overall degree of investor protection may be the outcome of how well one single legal remedy works in practice, the other legal tools being totally irrelevant in the real world.

While everyone agrees that its understanding is crucial to the assessment of a country's corporate law and, by implication, corporate governance system, we know fairly little about enforcement of the law on self-dealing around the world.³ Further, what little we know may be distorted by an error of perspective that comparative corporate governance scholars risk making. It is in fact tempting to compare corporate laws by taking one benchmark jurisdiction, typically the US, and to assess the quality of other countries' corporate law systems depending on how much they replicate some prominent features of US law, such as for example Delaware Courts' emphasis on approval of self-dealing transactions by a majority of the minority shareholders in the merger context.⁴ This approach may provide a distorted picture of the effectiveness of other corporate laws, because it might fail to account for legal strategies and enforcement tools that, while unknown to the US corporate governance regime, allow countries to tackle self-dealing differently, but no less effectively than the US, or, in other words, to achieve functional as opposed to formal convergence.⁵

This paper provides an empirical analysis of how three main continental European countries (France, Germany, and Italy) enforce constraints on dominant shareholders' self-dealing by looking at all the possible rules, doctrines and remedies available there. We focus on dominant shareholders', as opposed to managerial self-dealing, because it is a well-known fact that in the three countries we consider even the largest listed corporations have

³ See e.g. Paul Davies, Gérard Hertig and Klaus Hopt, Beyond the Anatomy, in REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 215, 219-20 (2004).

⁴ See e.g. *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929 at 937-38 (Del.).

⁵ It seems very likely that some of the coding mistakes of Djankov et al's recent study (*supra* note 1) can be explained by this phenomenon. For example, to anyone familiar with German and Austrian corporate law it should be obvious that the sample transaction in their paper would qualify as a "concealed distribution" (*infra* section 2.1.B). It is thus mysterious why the rescission variable is coded as 0 for the two countries. Although the authors did not disclose their questionnaire, the variable definitions lend themselves to the conclusion that local correspondents were misled by questions aiming at an American-style duty-of-loyalty review.

often dominant shareholders.⁶ When this is the case, dominant shareholders are in the best position to monitor managers and prevent their opportunism, but they may abuse their power by extracting pecuniary private benefits of control in various ways.

Quite apart from outright theft, dominant shareholders can extract pecuniary private benefits, first of all, by entering into contracts with the corporation, whether directly or, more often, through other entities they control (related-party transactions). In continental Europe this is often done in the form of intra-group transactions. The dominant shareholder controls a number of companies, both listed and unlisted, and coordinates their businesses at varying degrees. She may have one company within the group pooling cash from the whole group and allocating it according to the liquidity and investment needs of the various entities within the group.⁷ She may have one company providing accounting services to the whole group. She may also allow the whole group to reduce its tax burden by transferring profits from highly profitable companies to ones that lose money via transfer-pricing.⁸ While this kind of coordination may serve legitimate business purposes, each intra-group transaction provides an opportunity for minority shareholder expropriation, if it involves companies in which the dominant shareholder owns a different stake, e.g. one listed company and a wholly owned subsidiary.

Dominant shareholders are often wealthy individuals or families, who might take up a direct role in the management of the companies they control. When this is the case, the shareholders in control, like managers in publicly held companies, might extract private benefits in the form of above-market compensation packages or through perquisites. Following Johnson et al., we use the term “tunneling” to refer to a transfer of resources out of a

⁶ See e.g. Luca Enriques & Paolo Volpin, Corporate Governance Reforms in Continental Europe, 21 J. ECON. PERSP. 117, 118-19 (2007). In fact, the empirical evidence shows that dispersed share ownership is prevalent only in two countries, the US and the UK. See Randell K. Morck, *Introduction*, in CONCENTRATED OWNERSHIP STRUCTURE 1, 1 (Randell K. Morck ed. 2000); Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Corporate Taxonomy*, 119 HARV. L. REV. 1641, 1645-1650 (2006) (both summarizing cross-country evidence).

⁷ See *infra* notes ##-## and accompanying text.

⁸ Some tax systems create additional incentives to create group structures by permitting the intra-group setoff of profits and losses if the group is closely integrated. For example, under KStG § 14 (Germany), group

company to a dominant shareholders (or a coalition of shareholders jointly dominating the firm).⁹

Further, dominant shareholders can enrich themselves at the expense of minority shareholders by having the corporation approve transactions that, while not involving any sale or purchase by the company, dilute minority shareholders' interests (stock dilution). In many cases, this is done either through mergers with entities also controlled by the dominant shareholders, or by issuing watered stock in their or their associates' favor.

Since in all of the above cases the dominant shareholder is, personally or through a controlled entity or an associate, on the other side of the relevant transactions with the corporation, we categorize all of these transactions as self-dealing.¹⁰

In order to assess corporate law in action in these three countries, we have searched three widely used case law databases for cases involving dominant shareholders' self-dealing. We have tried to cover all possible doctrines, remedies and procedures that the three countries make available to private and public enforcers to tackle self-dealing, coming up with an overall sample of 146 cases that should provide a picture of what goes on in France, Germany and Italy in terms of enforcement of self-dealing laws before courts, whether civil or criminal.

The paper proceeds as follows. Part 2 describes the legal strategies and the enforcement tools available in the three jurisdictions to react against dominant shareholders' self-dealing. Part 3 describes the methodology we use to conduct our empirical investigation on the case law in the three jurisdictions. Part 4 analyses the case law we have thus gathered,

members must undertake to transfer all of their profits to the dominant enterprise for a period of at least five years in order to qualify for this privilege.

⁹ Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Tunneling*, 90 AM. ECON. REV. (PROC. AM. ECON. ASSOC.) 22, 22-23 (2000).

¹⁰ Self-dealing, even thus broadly defined, of course does not cover all means dominant shareholders have to divert corporate value to themselves. They achieve the same outcome also by trading in the company's shares on the basis of inside information or otherwise exploiting inside information to their own advantage, by disseminating false information about the company, in order to raise new equity more cheaply to the detriment of the new shareholders, and by selling their controlling stake to someone else (*see* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U.PA. L.REV. 785 (2003)). However, we think that self-dealing as we have defined it is sufficiently broad a concept as to provide an accurate picture of how the laws constrain dominant shareholders' opportunism in the three sample countries.

Part 5 discusses our findings and Part 6 concludes.

2. Legal tools against self-dealing in France, Germany, and Italy

To avoid the perspective error we highlighted in part 1, we have adopted a “domestic” point of view for each of the three sample jurisdictions and drawn up a sort of checklist of rules, doctrines, remedies and provisions that a local practitioner would have to consider in providing advice on a self-dealing transaction by a dominant shareholder and in highlighting legal risks attaching to them.

Our checklist includes: (a) rules specifying whether and how some transactions can be entered into or some resolutions taken by the company; (b) general standards and doctrines that constrain managers’ and dominant shareholders’ behavior; (c) remedies and actions that a legal system supplies to private parties so as to react to self-dealing transactions; (d) criminal sanctions against self-dealing. Finally, due to their importance in each of the three sample countries we briefly treat separately the special rules, doctrines and remedies that apply to corporate groups. Our purpose here is simply to provide a complete picture of the variety of available legal tools in the three countries, rather than engaging in an in-depth analysis of each or any of them. Unless otherwise indicated, our description below focuses on public companies (Société anonyme or SA, Aktiengesellschaft or AG, and Società per azioni or Spa¹¹).¹²

1. Rules and standards

A. Rules on how to enter into self-dealing transactions.

Legal systems often impose procedural requirements as a condition to a self-dealing

¹¹ Until 2003, when a wide-sweeping company law reform was enacted in Italy, the legal regime for Italian limited liability companies (società a responsabilità limitata or Srl) was mainly drawn from rules on Spa, since the law on the former explicitly referred to the on the latter on most governance issues. Since most of the cases analyzed here were decided according to the regime in force prior to the company law reform, the solution to cases involving Srls would have been the same if the case involved a Spa.

¹² In our empirical study, with the exception of Germany, we deliberately searched only for cases involving public companies. Germany is an exception as the GmbH is frequently used for medium-sized businesses.

transaction's validity or anyhow encourage companies to follow a given procedure by making it harder for plaintiffs to challenge procedurally fair transactions. In France, all transactions concerning an SA in which a director, a shareholder with more than a 10 percent of the voting rights, or the company controlling such shareholder has an interest must be authorized ex ante by the board of directors and ratified by the annual shareholder meeting, following a special report by the statutory auditors (*commissaires aux comptes*).¹³ The interested party must abstain from voting both within the board and at the shareholders meeting.¹⁴ However, these rules do not apply to "current transactions entered into at normal conditions," which only have to be disclosed by the interested party to the chairman of the board, who must then provide a list of such transactions to the board and to the auditors.¹⁵

In order to protect minority shareholders, French law also prohibits some forms of self-dealing which are deemed to be too dangerous. This is the case of loans to managers or directors or guarantees for the benefit of managers or directors.¹⁶

In Italy, since 2004 directors have to disclose to other board members and to the members of the board of auditors any direct or indirect interest they have in any transaction. When it is the CEO or another executive director who has an interest in a transaction that he would have the power to decide on, she has to abstain and request for a board resolution on the transaction. Further, whenever the board decides on a transaction for which an interest has been disclosed or should have been disclosed, it has to adequately motivate the reasons for entering into the transaction and why the transaction is advantageous to the corporation.¹⁷

In Germany, while the management board of an AG normally has the authority to enter into contracts on behalf of the company, this is not the case in dealings with any of its

¹³ Articles L. 225-38 and L. 225-40, French C. COM.

¹⁴ Article L. 225-40, French C. COM.

¹⁵ Article L. 225-39, French C. COM.

¹⁶ Art. L. 225-43, French C. Com.

¹⁷ Article 2391, Italian C.C. Prior to 2003 disclosure was only required for transaction in which a director had a conflict of interest, but the director also had to abstain from voting on the board resolution relating to the transaction, which is not the case any more. However, these provisions were construed very leniently. See Enriques, *supra* note 2, at 771.

members. By contrast, the supervisory board represents the company vis-à-vis members of the management board.¹⁸ A transaction entered into by the management board with one of its own members is therefore void because of the lack of authority to bind the firm. There are no procedural rules comparable to the French ones addressing transaction with other related parties.¹⁹ The courts have been relatively restrictive in their interpretation of the provision described above, and have typically not applied it to other self-dealing situations by analogy (with the exception of cases of “economic identity” between the director and a third party). For example, one court of appeals refused to apply the provision to a situation where one company’s director held a significant stake in another firm to which he granted a loan in his capacity as a director of the first one.²⁰

Similarly, the manager of a GmbH does not have the legal authority to enter into a transaction with the company representing herself or another person.²¹ In order to enact such a contract, the other managers or shareholders must approve the transaction.²²

B. Rules on concealed distributions to shareholders

German law traditionally deals with self-dealing between dominant shareholder and the corporation by qualifying such transactions, whenever its economic terms are unfair to the corporation, as concealed distributions. AktG § 57 provides that capital contributions

¹⁸ AktG § 112.

¹⁹ Of course, a transaction can be void under general principles of civil law in cases of collusion (where directors and third parties consciously cooperate to the harm of the firm). *See generally* Eberhard Schilken, in J. VON STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH § 167, comments 93 et seq., 100 et seq. (Erstes Buch Allgemeiner Teil, §§ 164-240, 13th ed., Karl-Heinz Gursky, Frank Peters, Eberhard Schilken & Olaf Werner 1995). Furthermore, BGB § 181, under which an agent cannot enter into a transaction with his principal on his own behalf or on behalf of a third party unless permitted to do so, also applies to directors. *See* Klaus J. Hopt & Markus Roth, in GROßKOMMENTAR AKTIENGESETZ, § 112, comment 44 (4th ed., 24th installment, Klaus J. Hopt & Herbert Wiedemann eds. 2005).

²⁰ OLG Saarbrücken, 30.10.2000, 8 U 71/00, AG 2001, 483 = NZG 2001, 414. The majority shareholder of both firms was a partnership, and both firms shared their office space. *See also* Hopt & Roth, *supra* note 19, § 112, comment 43 (stating that, while there is universal agreement that § 112 does not apply to transactions with firms where a director holds a minority stake, the director might have a duty to disclose his conflict of interest to the supervisory board).

²¹ The general rule of BGB § 181 applies, which also provides some explicit and implicit exceptions. *See e.g.* Marcus Lutter & Peter Hommelhoff, in GMBH-GESETZ § 35, cmt. 19 (16th ed. Marcus Lutter & Peter Hommelhoff eds. 2004).

may not be repaid to shareholders. During the life of the company, only accounting profits may be distributed among them.²³ It may be somewhat surprising to learn that a doctrine related to legal capital, which is increasingly coming under attack as an inefficient mechanism of creditor (and not shareholder) protection,²⁴ can serve a useful purpose for the protection of minority shareholders. However, the basic idea of the doctrine, which has a long pedigree in case law going back at least to the 1920s, is quite simple: Whenever a corporation enters into a transaction with a shareholder (or a related party) on unfavorable terms, this constitutes a *de facto* distribution to that shareholder. In an AG, such a transaction is illegal irrespective of how much equity capital the company actually has, since all distributions must take the form of a dividend.²⁵ By contrast, a GmbH is only allowed to make distributions to shareholders as long as the firm's legal capital remains untouched.²⁶ As a result, the doctrine comes to bear in GmbHs typically only in situations when the firm is close to insolvency.

No such doctrine has received any considerable attention in Italy²⁷ or in France.²⁸ In both countries, like in Germany, though, in line with the Second directive, special rules on share buy-backs are in place.

C. *Stock dilution: safeguards against it and the perils of the “recapitalize or liquidate” rule*

All three jurisdictions, with due qualifications and exemptions, provide for safeguards

²² Lutter & Hommelhoff id. Concerning the special case of a single owner-manager, see Lutter & Hommelhoff id. at 21; GmbHG § 35(4).

²³ AktG § 57(3).

²⁴ See John Armour, *Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law*, 63 MODERN L. REV. 355 (2000); Luca Enriques & Jonathan R. Macey, *Creditors versus Capital Formation: The Case Against the European Legal Capital Rules*, 86 CORNELL L. REV. 1165, 1185-88 (2001); Peter O. Mühlert & Max Birke, *Legal Capital – Is There a Case Against the European Legal Capital Rules?*, 3 EUR. BUS. ORG. L. REV. 695, 732 (2002).

²⁵ AktG § 57(3).

²⁶ GmbHG § 30(1).

²⁷ Cf. Massimo Miola, *Legal Capital Rules in Italian Company Law and the EU Perspective*, in LEGAL CAPITAL IN EUROPE 515, 528 (Marcus Lutter ed. 2006).

²⁸ Cf. Holger Fleischer, *Disguised Distribution and Capital Maintenance in European Company Law*, in LEGAL CAPITAL IN EUROPE 94, 102-05 (Marcus Lutter ed. 2006) (describing the formalistic understanding of distributions in France).

against stock dilution in the form of targeted issues of new shares or of mergers with an unfair exchange ratio.

Following the Second Directive, all three countries grant shareholders a pre-emption right over new issues of shares.²⁹ However, with due qualifications the shareholder meeting can resolve to exclude such right with regard to specific new issues of shares. Typically, specific reporting requirements must be followed.³⁰ In Germany, courts have required an objective reason,³¹ which could e.g. be given when the company intends to recapitalize following a period of severe losses.

France and Italy impose the so-called “recapitalize or liquidate” rule. They require that, whenever losses cause a firm’s net assets to fall below some specified minimum level, the firm must either recapitalize or reorganize into a type of company that has a legal capital requirement no greater than the remaining net assets.³² As Jonathan Macey and one of us have noticed, “majority shareholders may use such rules in order to get rid of financially constrained minority shareholders. If the company’s capital falls to zero, a shareholder who is unable or unwilling to contribute more money to the venture will lose her shareholder status.”³³

There is no “recapitalize or liquidate” rule in Germany. The management board is required to call an extraordinary shareholder meeting if half of the firm’s legal capital is lost,³⁴ and may be subject to criminal penalties if it fails to do so.³⁵ The purpose of the rule

²⁹ Second Directive Art. 29(1)

³⁰ Art. L. 225-135 C. COM.; AktG § 186(4), with respect to which courts have required an objective reason. See also Article 2441, Italian C.C.

³¹ BGH 13.3.1978, II ZR 142/76 (“Kali+Salz”), BGHZ 71, 40; BGH 19.4.1982, II ZR 55/81 (“Holzmann”) BGHZ 83, 319.

³² The Italian Civil Code provides for dissolution if a company experiences losses greater than the minimum statutory capital, unless the company recapitalizes or converts into another kind of company with a lesser or nonexistent capital requirement. C.C., Article 2447 & 2448(4). Article L. 225-248 of the French Commercial Code provides for dissolution if a company experiences losses greater than half of the subscribed capital, unless the company reduces its capital correspondingly within two financial years and the resulting capital is higher than the minimum statutory capital. A company may also avoid dissolution by converting into another kind of company. *Id.* The French recapitalize or liquidate rule, however, does not apply if the company is already insolvent. See Versailles, June 13, JCP éd. E 2002, n° 50, p. 1992.

³³ Luca Enriques & Jonathan R. Macey, *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules*, 86 CORNELL L. REV. 1165, 1201 (2001).

³⁴ AktG § 92(1); GmbHG § 49(3).

is only to inform shareholders of the imminent crisis.³⁶ However, recapitalizations (a “simplified” reduction of capital where legal capital is reduced without payments to shareholders, followed by an effective capital increase) are not uncommon in Germany. When a firm has lost most of its equity, anyone contributing new capital will normally insist on it in order to receive a share in the corporation equivalent to the value of her contribution. Shareholders unable or unwilling to contribute may therefore face the same problems as in Italy and France.

D. *Disclosure of related party transactions.*

The three countries also provide for disclosure “per se” of self-dealing transactions, i.e. quite apart from the procedural rules that have to be followed in order to enter into them. Following EC provisions on annual accounts, Italian, German and French accounting rules require that individual annual accounts contain a separate indication of credits toward, and shares held in, affiliated undertakings³⁷ and undertakings with which the company is linked by virtue of participating interests³⁸, together with debts toward the same entities and, in Italy, shareholders in general.³⁹ Of course, listed companies in all three countries have to draw up their consolidated accounts according to International Financial Reporting

³⁵ AktG § 401; GmbHG § 84.

³⁶ See UWE HÜFFER, AKTIENGESETZ (6th ed. 2004), § 92, comment 1. However, directors are required to file for insolvency if the company is illiquid or overindebted under AktG § 92(2) and GmbHG § 64(1). For these duties, see Susanne Kalss, Nikolaus Adensamer & Janine Oelkers, *Director's Duties in the Vicinity of Insolvency – a comparative analysis with reports from Germany, Austria, Belgium, Denmark, England, Finland, France, Italy, the Netherlands, Norway, Spain and Sweden*, in LEGAL CAPITAL IN EUROPE 112, 114-116 (Marcus Lutter ed. 2006).

³⁷ Affiliated undertakings are defined in Art. 41 of the Seventh Directive, which refers to Art. 1, which sets out a complex definition when a firm must be included in consolidated accounts. In other words, “affiliated undertakings” are all corporations which must be included in one set of consolidated accounts by virtue of having a common controlling or parent company.

³⁸ Art 17 of the Fourth Directive defines a participating interest as “rights in the capital of other undertakings, whether or not represented by certificates, which, by creating a durable link with those undertakings, are intended to contribute to the company's activities.” Member states may set a threshold not exceeding 20% beyond which a participating interest is presumed. German law sets that presumption at 20% (HGB § 271(1)), Italian law generally at 20%, but only at 10% in the case of an interest in a listed company (Article 2359(3), Italian C.C.).

³⁹ Article 2424, Italian C.C.

Standards since 2005,⁴⁰ so that IAS 24 on related party transactions applies to them. A recent directive that has yet to be implemented in the Member States has amended the EU Accounting Directives to require extensive disclosures about related-party transactions as under IAS 24, and refers to IFRS with respect to the definition of the term “related party.”⁴¹

E. Standards.

In all three jurisdictions standards are in place that restrict directors’ ability to manage the company in the interest of dominant shareholders alone and the ability of dominant shareholders themselves to exercise control powers to the detriment of other shareholders. First, legal scholars and courts hold that directors in all countries owe their company a duty of loyalty that require them to disregard or even oppose dominant shareholders’ attempts to self-deal.⁴² Second, whether implicitly or explicitly, the three countries grant shareholders a right to be treated equally by the corporation, which might prevent it from granting unjustified benefits to its dominant shareholders.⁴³ Further, German courts have held that shareholders hold a duty of loyalty to each other. For example, in the seminal *Linotype* case of 1988, the 96 percent corporate shareholder of an AG had initiated a shareholder resolution to dissolve the firm in order to integrate its profitable business into its own. The Federal Supreme Court nullified that resolution, because it found that the majority shareholder had violated its duty of loyalty by using its voting right to obtain a special advantage to the det-

⁴⁰ Regulation (EC) No. 1606/2002, 2002 O.J. (L 243) 1.

⁴¹ Art 43(1)(7b) Fourth Directive and Art. 34(7b) Seventh Directive, as amended by Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006, 2006 O.J. (L 224) 1.

⁴² See e.g. Hopt & Roth, *supra* note 19, § 116, comment 181, 184 (stating that a supervisory board member violates his duty of loyalty if acting contrary to the interest of the company and to the benefit of another, even if she also holds a board position there); § 116, comment 188 (stating that instructions to the contrary must be ignored); § 116, comment (stating that supervisory board members must leave corporate opportunities to the firm). For France, such a duty has been recognized by case law. The duty of loyalty is owed to the shareholders (Cass. Com. 27 fev. 1996, JCP éd. E 1996, II, 838, n. D. Schmidt and N. Dion) and to the company (Cass. Com., 24 fév. 1998, Bull. Joly 1998, p. 913, n. B. Petit. For Italy see Francesco Barachini, *L’appropriazione delle corporate opportunities come fattispecie di infedeltà degli amministratori di s.p.a.*, in 2 IL NUOVO DIRITTO DELLE SOCIETÀ. *LIBER AMICORUM GIAN FRANCO CAMPOBASSO* 605, 605-06 (Pietro Abbadesse & Giuseppe B. Portale eds.) (2006).

⁴³ This is made explicit by Art. 42 of the Second Directive; AktG § 53a; Art. 1832 French C. civil. For Italy see Article 92, Legislative Decree 1998, No. 58 (for listed companies). For non-listed companies there is no explicit provision. But legal scholars tend to recognize that such is a principle valid also for non-listed ones. See Carlo Angelici, *Parità di trattamento degli azionisti*, 1987/I RIVISTA DI DIRITTO COMMERCIALE 1.

riment of the minority.⁴⁴ France and Italy provide for “abuse of majority powers” (*abus de majorité* in France; *abuso della maggioranza* in Italy) doctrines that restrict majority shareholders’ freedom to vote as they wish at general meetings. In fact, they may not exercise their voting rights in such a way as to pursue their own self-interest (and not the company’s) to the detriment of fellow shareholders.⁴⁵ In France, case law considers that there is an abuse of majority if a majority shareholder votes against the “corporate interest” of the company, in order to pursue her own personal interest and to detriment of the minority shareholders.

Finally, Paragraph 117(1) of the German AktG provides that a person using his or her influence on the company to instruct members of the supervisory or management board to act to the detriment of the firm or its shareholders will be liable for damages resulting from this conduct.

2. Remedies

A. Liability suits.

While in France, individual shareholders have traditionally been able to sue directors on behalf of the corporation (*action sociale ut singuli*),⁴⁶ in Germany and especially in Italy this has been far more difficult. Before 2005, in German AGs only a shareholder holding 5% or at least an amount of shares corresponding to € 500.000 could petition a court to appoint a representative to bring a suit on behalf of the company if the shareholder meeting decides not to authorize a liability suit⁴⁷ Under the new provisions, a representation of 1% or €100,000 is enough,⁴⁸ while a special “lawsuit admission procedure” (Klagezulassungs-

⁴⁴ BGH 1.2.1988, II ZR 75/87, BGHZ 103, 185; *also see*.BGH 22.6.1992, II ZR 178/90, NJW 1992, 3167 (discussing the duty of loyalty in the context of a capital increase).

⁴⁵ For Italy see e.g. Fabrizio Guerrera, *Abuso del voto e controllo «di correttezza» sul procedimento deliberativo assembleare*, 2002 RIVISTA DELLE SOCIETÀ 181. For France, see e.g. J.-P. Legros, *La nullité des décisions de sociétés*, REVUE DES SOCIETES, 1991, n°42, 297; J.-P. Sortais, *Abus de droit (Majorité, minorité, égalité)*, ENCYCLOPEDIE DALLOZ DROIT DES SOCIETES, 2003.

⁴⁶ Art. L. 225-252 French C. com.

⁴⁷ AktG § 147(3) (before 2005).

⁴⁸ AktG § 148(1), as amended by the Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG), of September 22, 2005, BGBl. I 2005, No. 60., p. 2802 (Sept. 27, 2005).

verfahren) was introduced to screen out abusive suits. Among other things, plaintiff shareholders must show that the firm failed to bring a suit within a reasonable period upon a demand by shareholders. The court must then decide whether there are indications that the company suffered a damage from dishonesty or from serious violations of the law or the charter, and whether a suit would be contrary to the preponderating interest of the company.⁴⁹ There is no statutory basis for derivative suits in GmbHs, although their possibility is generally recognized.⁵⁰ In Italy, derivative suits were first allowed in 1998 for listed companies only and standing to sue was only granted to shareholders owning at least 5 percent of the shares (2.5 percent since 2006; bylaws can provide for a lower threshold). The 2003 corporate law reform made derivative suits available to shareholders in unlisted corporations, but restricted it to those owning at least 20 percent of the shares (bylaws can provide for a lower threshold or for a higher one, up to one third of the shares).⁵¹

As a consequence,⁵² in Germany and Italy liability suits against directors have always been rare. Most often, they were brought by the company after a change in control or by the bankruptcy trustee after the company had gone bankrupt. One should note, however, that even in France derivative suits have always been fairly rare.⁵³

Under Italian law and French law⁵⁴, liability suits can be brought not only against directors formally elected, but also toward anyone *de facto* managing the company by exer-

⁴⁹ AktG § 148(2), as amended by the UMAG, *supra* note 48.

⁵⁰ See, e.g. Holger Altmeppen, in GESETZ BETREFFEND DIE GESELLSCHAFTEN MIT BESCHRÄNKTER HAFTUNG § 13, cmt. 15 (5th ed. Günther H. Roth & Holger Altmeppen 2005).

⁵¹ Since 2004 any Srl shareholder can sue directors for damages on behalf of the corporation. See Article. 2476, Italian C.C.

⁵² See Kristoffel R. Grechenig & Michael Sekyra, *No Derivative Shareholder Suits in Europe – A Model of Percentage Limits, Collusion and Residual Owners*, available at <http://ssrn.com/abstract=933105> (using a mathematical model to show how percentage limits destroy incentives to bring derivative suits).

⁵³ See Yves Guyon, *Droit des affaires- Droit commercial général et Sociétés*, Tome 1, n°462, p. 506, 2003 (stating that the “*action sociale ut singuli*” is rarely exercised).

⁵⁴ In French law, *de facto* directors and managers of solvent companies are subject to liability not by application of the specific provisions of the commercial code regarding liability, since they do not include *de facto* managers, but rather under the general civil principle of liability (Art. 1382 French civil code). See. Cass. com., March 21, 2005, Rev. sociétés 1995, p. 501, n. B. Saintourens. In case the company is insolvent, *de facto* directors and managers are subject to liability by application of specific provisions of the French commercial code. For Italy see e.g. Trib. Milano, 11 September 2003, 2003 DIRITTO E PRATICA DELLE SOCIETÀ, No. 23, 74. See also *infra* note ???.

cising powers that are typical of a director, like presiding over board meetings, individually making the main company's decisions, and so on.⁵⁵ Typically, this can be the case of a dominant shareholder.

Shareholders in all the three countries can also sue directors if they suffer damage qua individuals or qua investors as opposed to qua shareholders.⁵⁶ This is especially the case in the event of securities fraud, which might also take place by omitting to inform the public or by providing false information on self-dealing transactions.

In France, in the case of an insolvent company, a *de jure* or *de facto* director or manager can be held liable, partially or totally, for the debts of a company subject to a liquidation procedure (*obligations aux dettes*), if the insolvency results from, *inter alia*, the fact that she used the assets of the company as her own⁵⁷, abused of the corporate assets for her own interest⁵⁸, or misappropriated all or part of the debtor's assets⁵⁹. Further, a *de jure* or *de facto* manager can be subject to personal bankruptcy (*faillite personnelle*) for having misappropriated all or part of the company's assets⁶⁰.

B. Appointment of special auditor.

French law provides that shareholders representing at least 5% of the capital (down from 10 % before a 2001 reform) may petition the court for the appointment of a business expert (*expert de gestion*) in order to gather information about business decisions.⁶¹ Since these business decisions can sometimes be motivated by directors' self-interest, appointment of a business expert can help uncover such self dealing. Using this procedure is convenient for the minority shareholder since the judge can oblige the company to pay for the expert's compensation, which is not the case for the generally applicable procedure provid-

⁵⁵ German law has developed a doctrine of de facto managers ("faktischer Geschäftsführer"), who are subject to certain duties (e.g. to file for insolvency), but it is disputed and unclear how far these duties reach and whether provisions on derivative suits apply. *See. e.g.* Holger Altmeppen, *supra* note 50, § 43, comment 69; *see also* Kalss et al, *supra* note 36, at 115.

⁵⁶ Article 2395 Italian C.C.

⁵⁷ Art. L. 652-1 1° French C. COM.

⁵⁸ Art. L. 652-1 2° French C. COM.

⁵⁹ Art. L. 652-1 3° French C. COM.

⁶⁰ Art. 653-3 French C. COM. Before the 2006 reform, former Art. L. 625-3 French C. COM.

ing for the appointment of a pre-trial court expert (so-called *expertise in futurum*).⁶² Italian law grants minority shareholders a similar right, but where serious irregularities in the company's management are found, the court may take further measures, such as convening the general meeting or even removing the directors.⁶³

In Germany, AG shareholders holding 1% or an amount corresponding to € 100.000 of legal capital may petition the court to appoint a special auditor (down from 10%/€ 1,000.000 before the 2005 reform).⁶⁴ There is no equivalent provision for GmbHs.

C. Nullification of shareholder and board meeting resolutions.

In all three jurisdictions, shareholders have the right to challenge in court the validity of shareholder resolutions, if they violate the company's bylaws or the law.⁶⁵ Voting behavior violating either rules or standards of conduct for shareholders (such as the duty of loyalty in Germany or the "abuse of majority" prohibition in France and Italy) is considered a violation of the law and may result in nullification.

Challenges to the validity of shareholder resolutions have traditionally been used as a shareholder remedy in Italy and Germany, especially as a bargaining tool against the company and its dominant shareholders. In fact, thanks to the possibility of obtaining a court order requiring directors not to execute the transaction, shareholders might block important transactions. Of course, it is often alleged that this also allowed minority shareholders to blackmail companies into a lucrative settlement agreement and this is the reason why in 2003 Italy restricted standing to sue to shareholders representing at least 5 percent or 0.1 percent of the shares (for non-listed and listed companies respectively) (or the lower percentage provided for by the bylaws). To the same end, Germany recently introduced a so-called "clearance procedure" (Freigabeverfahren), which allows the court to allow an in-

⁶¹ Art. L. 225-231 French C. COM.

⁶² Art. 145 French NCPC (Code of Civil Procedure).

⁶³ Article 2409, Italian C.C.

⁶⁴ AktG § 142(2).

⁶⁵ For Germany, *see* AktG §§ 241 et seq. There are no equivalent provisions for GmbHs, but the possibility of a challenge is accepted. *See*. e.g. Günther H. Roth, in *GESETZ BETREFFEND DIE GESELLSCHAFTEN MIT BESCHRÄNKTER HAFTUNG*, *supra* note 50, § 47, cmt. 91 et seq.

crease or reduction of capital or a contract to enter a corporate group to proceed if the suit is obviously baseless, or if the alleged violations of the law are less onerous to the firm and its shareholders than the disadvantage of the transaction grounding to a halt.⁶⁶ Other than in Italy, a percentage requirement for challenge of shareholder resolutions was not introduced. In France, there are no restriction to standing to sue. For instance, a shareholder can request for nullification of a shareholder meeting resolution even if she was not a shareholder at the time of the vote on the resolution⁶⁷, and even if she voted in its favor.

Shareholders may also have standing to sue in order to obtain nullification of a company's board resolutions. This is the case in France with respect to self-dealing transactions for which the ex ante authorization of the board of directors was not obtained⁶⁸, whereas in Italy minority shareholders may not challenge the validity of board resolutions taken in violation of the similar Italian rules on directors' interests: only dissenting directors and the board of auditors may. Individual shareholders in Italy may only challenge the validity of board resolutions directly infringing their rights toward the corporation, such as when the board resolves not to pay a dividend that holders of preference shares would have been entitled to receive according to the bylaws. In Germany, shareholders cannot challenge board resolutions.⁶⁹

D. Nullification of conflict of interest transactions.

Under Italian law, if the person acting in the name of the corporation in a self-dealing transaction can be deemed to have a conflict of interest herself, possibly for her relationship with the dominant shareholder, then the transaction is voidable according to general agency law principles. The same is true if a board resolution is taken with no prior disclosure of a director's interest or by her vote or without motivation and the transaction is harmful to the corporation. However, in either case only the corporation itself has standing to sue, so that

⁶⁶ AktG § 246a, as amended by the UMAG (supra note 48) of 2005.

⁶⁷ Cass. Com. July 4, 1995, RJDA 8-9/95 n°994.

⁶⁸ CA Amiens, December 1st, 1966, Recueil Dalloz 1967, p. 234, n. Dalsace.

⁶⁹ However, the annual accounts established by the management board and the supervisory board (no shareholder resolution is required if the two boards consent) may be void under severe circumstances. See AktG § 256.

cases of this kind are usually brought either opportunistically, to renege on a company's obligations, for instance as a guarantor toward a bank, or in bankruptcy so as to disallow a claim.⁷⁰

In France, self-dealing transactions are voidable if they were not subject to a vote by the board of directors⁷¹, or if the interested shareholder or director exercised her vote at the board of directors' meeting authorizing them, no matter whether the contract would have been authorized without her vote.⁷²

Similarly, under German civil law, a contract may be voidable under principles of agency law if the agent colludes with a third party and abuses his power to the detriment of his principal.⁷³

E. "For cause" remedies in closely-held companies.

As we decided to include GmbHs in our search, we cannot fail to recognize that under rare circumstances self-dealing may become an issue in quite a different context. First, charters of GmbHs sometimes stipulate that a manager who is also a shareholder may only be removed from his position for cause.⁷⁴ Furthermore, it is commonly accepted that members of a GmbH have a right to exit the company for cause, to exclude another member for cause,⁷⁵ or to dissolve the company for cause.⁷⁶ Quite obviously, self-dealing might constitute cause for the purpose of each of these remedies under certain circumstances.

3. Criminal sanctions

Each of the three jurisdictions provide for criminal sanctions against abusive self-dealing. In France, the main criminal law tool against self-dealing is the provision against abuse of

⁷⁰ Until 2003, it was possible to renege on one's obligations also by invoking the *ultra vires* doctrine, under which the company's acts that went beyond the company's activity ("oggetto sociale") as identified in the memorandum of association were without effect toward the company. See Article 2384-*bis* Italian C.C., which was repealed by the 2003 corporate law reform.

⁷¹ Art. L. 225-42 French C. com.

⁷² CA Aix-en-Provence, 15 may 1991, Dr. Sociétés 1991, n°279.

⁷³ *Supra* note 19.

⁷⁴ This is explicitly allowed by GmbHG § 38(2).

⁷⁵ See e.g. BGH 13.1.2003, II ZR 227/00, BGHZ 153, 285; Altmeyden, *supra* note 50, § 60, comment 60.

corporate assets (“abus de biens sociaux”).⁷⁷ It punishes, among others, board chairmen, directors or managing directors of a public limited company or a limited liability company (SARL) who “use the company’s property or credit, in bad faith, in a way which they know is contrary to the interests of the company, for personal purposes or to favor another company or undertaking in which they have a direct or indirect interest.”⁷⁸ The minority shareholder, acting derivatively in the name of the company (*action sociale ut singuli*), can initiate a criminal prosecution by filing a criminal complaint (*plainte avec constitution de partie civile*) with the Dean of the Examining magistrates of the Civil first degree court (*Tribunal correctionnel*). In order for the complaint to be admissible, it is enough that the circumstances which gave rise to the complaint allow the examining magistrate to consider “possible” the existence of the damage to the company and the link with the alleged abuse of corporate assets⁷⁹. Therefore, the examining magistrate is not free to choose to investigate or not, as long as she considers satisfied this standard, which is not very demanding. Case law makes actually clear that the examining magistrate has a “duty” to investigate. This rule was created by case law as soon as 1906 and did not change since.⁸⁰ This remedy is very attractive for minority shareholder since the examining judge holds the ability to access documents, and at no or very little cost for the minority shareholder.

In Germany, the criminal code punishes “Untreue” (disloyalty), which is given when a person authorized to dispose over someone else’s property or to bind another person abuses that authority, or when a person subject to a duty to attend to someone else’s financial interests violates the duty, and when this results in a disadvantage to the other person.⁸¹ Most recently, a case of alleged *Untreue* created headlines in the course of the Mannesmann trial, where, following a takeover battle against a hostile bid by Vodaphone, the su-

⁷⁶ GmbHG § 61(1).

⁷⁷ Article L. 242-6 French C. COM.

⁷⁸ Id.

⁷⁹ Cass. Crim., 5 november 1991, Société Industrielle et Financière Bertin, Rev. sociétés 1992, n. B. Bouloc, p. 91. See also, E. Joly and C. Joly-Baumgartner, *L’abus de biens sociaux à l’épreuve de la pratique*, Economica, 2004, p. 288.

⁸⁰ Cass. Crim. 8 december 1906, *Laurent Athalin*, S. 1907.1.377 n. Demogue, D. 1907.1.207.

⁸¹ StGB § 266(1).

pervisory board granted an “appreciation award” to Mannesmann’s outgoing managing directors with the approval of Vodafone’s largest shareholder.⁸²

In Italy, directors and general managers are criminally liable for breach of trust if, “having a conflict of interest with the corporation, and with the purpose of making an unfair profit or of letting someone else make an unfair profit, they enter into, or take part in decisions relating to, transactions relating to corporate assets, thereby intentionally harming the corporation.”⁸³ For listed companies, a recent provision punishes directors who fail to disclose their interest in a transaction.⁸⁴

Finally, all three countries punish “banqueroute,” “bancarotta fraudolenta,” and “Bankrott”, a crime that includes asset diversion, whether through self-dealing or otherwise, in insolvent corporations or which are driven to insolvency as a consequence of it.⁸⁵

4. Corporate Groups

In this account of the law on self-dealing in the three sample jurisdictions, corporate groups deserve to be treated separately, for their importance in the three countries’ economies, for the presence in each of them of specific rules and doctrines, and because they will prove to be dealt with as a special case by the case law we analyze in part 4.

In Italy, legal scholars have long argued that self-dealing transactions involving companies of the same group (“intra-group transactions”) deserve special treatment, because the harm caused by one single intra-group transaction might find compensation in other transactions or group relationships, whether past or future (the so-called “teoria dei vantaggi compensativi” or theory of compensatory group advantages).⁸⁶ Courts have tended to up-

⁸² BGH 21.12.2005, 3 StR 470/04, BGHSt 50, 331 = AG 2006, 110 = JZ 2006, 560 (finding that the “appreciation award” constituted *Untreue*). The case ultimately did not result in a criminal conviction, but in the payment of a fine as result of a settlement.

⁸³ Article 2634, Italian C.C.

⁸⁴ Article 2629-*bis*, Italian C.C.

⁸⁵ For France, see Art. L. 654-2 2° French C. COM.; for Germany see StGB §§ 283, 283a; for Italy, see Articles 216 and 223, Royal Decree No. 267, of 16 March 1942 (punishing directors and general managers, but construed as applying also to shadow directors. See e.g. Cass., 12 July 2004, 2005 IMPRESA 501).

⁸⁶ See e.g. BERARDINO LIBONATI, *Gli atti compiuti dalla società controllata a favore della società controllante*, 1989 RIVISTA DI DIRITTO COMMERCIALE, II/220; PAOLO FERRO-LUZZI & PIERGAETANO MARCHETTI, *Riflessioni sul Gruppo Creditizio*, 1994 GIURISPRUDENZA COMMERCIALE, I/419, I/453-54;

hold such a theory in the last two decades.⁸⁷

Mainly following such scholarly and case-law developments, the 2003 corporate law reform has for the first time provided for specific rules on integrated groups and intra-group transactions, basically recognizing that the controlled companies can be managed as a division of the group-integrated business, but introducing procedural rules and an obscure standard for the ex post review of the group's management fairness to subsidiaries' minority shareholders and creditors. On the one hand, subsidiaries have to provide an "analytical justification" of transactions that are entered into under the influence of the parent company, by specifying the reasons and the interests that have been considered in deciding to enter into it, and account of such transactions must be given in the annual report. On the other hand, minority shareholders of subsidiary corporations can sue the parent company and its directors for damages suffered qua shareholders if the latter, according to the convoluted wording of a new Civil Code provision, "in carrying out their activity of management and co-ordination of the group, act in their own or others' business interests in violation of the principles of correct company and business management of those companies." However, the parent "shall not be held liable when the damage is lacking in light of the overall results of the management and co-ordination activity or when it has been entirely eliminated, even through transactions specifically aimed at such purpose."⁸⁸

Similarly, the provision punishing breach of trust also accepts the idea of "compensatory advantages:" while the crime requires intent to gain or let others gain an "unjust profit," a profit is not unjust if it is made by the group of companies, whenever the company's damage is offset by advantages deriving from the relevant company's being part of the group.⁸⁹

In France, there are some special rules on intra-group transactions but not a general

PAOLO MONTALENTI, *Conflitto di interesse nei gruppi di società e teoria dei vantaggi compensativi*, 1995 GIURISPRUDENZA COMMERCIALE,, I/ 710, I/731-32.

⁸⁷ See Vincenzo Cariello, *The "Compensation" of Damages with Advantages Derivino from Management and Co-ordination Activity (Direzione e Coordinamento) of the Parent Company (Article 2497, Paragraph 1, Italian Civil Code)*, 3 EUR. COMP. AND FIN. L. REV. 330, 331 (2006) for references. But see *infra* ###

⁸⁸ Article 2497, Italian C.C.

⁸⁹ Article 2634(3), Italian C.C.

regime like in Germany. For instance, on the civil side, the law allows loans to directors that are legal entities whereas they are prohibited when granted to individual directors⁹⁰. Further, a special provision allows cash pooling within groups, which otherwise would be prohibited to businesses other than banks.⁹¹ However, there are no special rules allowing to treat intra-group transactions less severely than other forms of self-dealing.

On the criminal side, French courts have created a special doctrine on abuse of corporate assets within groups (the so-called *Rozenblum doctrine*).⁹² This doctrine admits the group defense under certain conditions. First, there must be a group characterized by capital links between the companies. Second, there must be a strong, effective business integration among the companies within the group. Third, the financial support from one company to another company must have an economic quid pro quo and may not break the balance of mutual commitments between the concerned companies. Third, the support from the company must not exceed its possibilities. In other words, it should not create a risk of bankruptcy for the company.⁹³

German law distinguishes between contractual groups and de facto groups. A *contractual group* is created by a control agreement, under which an AG agrees to submit to the instructions of a controlling entity.⁹⁴ A control agreement (or a profit transfer agreement) requires the approval of a $\frac{3}{4}$ supermajority of shareholders in the controlled company and in the controlling entity (if it is also an AG).⁹⁵ Similar to a merger, certain reporting and auditing requirements have to be met before the agreement is recorded in the commercial register and can come into force. Among other things, a control agreement allows that distributions made or services rendered to the controlling entity do not constitute a violation

⁹⁰ Art. L. 225-42 French C. Com.

⁹¹ Art. L. Art. L. 511-7 3° French Monetary and Financial Code.

⁹² See Trib. Corr. Paris 16 May 1974, Soc. Saint-Frères, D. 1975, p. 37, Rev. Soc. 1975, p; 657, n.B. Oppetit, JCP éd. E. 1075, II-11816, p; 381; Court of cassation, Criminal Chamber, 4 february 1985, Rozenblum and Allouche, D. 1985, p. 478, n. D. Ohl, JCP éd. E 1997, I-639, JCP 1986, II-20585, n. W. Jeandidier, Rev. Sociétés 1985, p. 648, n. B. Boulloc.

⁹³ See Marie-Emma Boursier, *Le Fait Justificatif de Groupe dans l'Abus de Biens Sociaux: Entre Efficacité et Clandestinité*, 2005 REVUE DES SOCIÉTÉS 273.

⁹⁴ AktG § 291(1).

⁹⁵ AktG § 293.

of capital maintenance provisions⁹⁶, meaning that they cannot be qualified as concealed distributions.⁹⁷ Generally, instructions to the controlled firm are permissible even if they are to the benefit of the controller or other firms within the group.⁹⁸

To compensate for these disadvantages, the controlling entity must also absorb losses made by the controlled corporation.⁹⁹ Furthermore, there are rules intended to protect minority shareholders. First, the control agreement must stipulate an annual payment to minority shareholders (proportionate to the amount of shares held) depending on the controlled entity's prospects for future profit.¹⁰⁰ Furthermore, a control agreement (or profit transfer agreement) must include an offer to minority shareholders of the controlled firm to purchase their shares for an adequate compensation consisting of shares of the controlling entity if it is an AG or KGaA and consisting of cash otherwise.¹⁰¹ The shareholder resolution to accept the control agreement may not be void or nullified on the grounds that the annual compensation or the compensation for leaving the controlled firm is too low. However, shareholders may petition a court to stipulate an adequate compensation or share exchange ratio (so-called *Spruchstellenverfahren* – “award specification procedure”).¹⁰²

In the absence of a control agreement (i.e. in a *de facto group*), the controlling undertaking¹⁰³ may not instruct a controlled firm to enter into disadvantageous transactions unless any disadvantages are compensated for; the compensation must be fixed in the same business year at the latest.¹⁰⁴ The management board of the controlled company is required

⁹⁶ AktG § 291(3).

⁹⁷ *Supra* section 2.1.B0.

⁹⁸ AktG § 308.

⁹⁹ AktG § 302(1). It is unclear whether shareholders of the controlled entity may enforce this claim with a derivative action. See HÜFFER, *supra* note 36, § 302, comment 20; but see Gerard Hertig & Hideki Kanda, *Related Party Transaction*, in THE ANATOMY OF CORPORATE LAW, *supra* note 3, 101, 125 (claiming that a derivative suit is possible). However, it is without doubt the duty of the directors of the controlled company to enforce this claim, who may be subject to a derivative suit under regular rules (*supra* section 2.2.A) if they fail to bring one.

¹⁰⁰ AktG § 304 (1), (2).

¹⁰¹ AktG § 305 (1)-(4).

¹⁰² AktG §§ 304(3), 305(5).

¹⁰³ Group law does not apply of the controller is not an undertaking, the definition of which is not entirely clear. See KARSTEN SCHMIDT, GESELLSCHAFTSRECHT 935-939, 1212-1214 (4th ed. 2002). Individuals who are not engaged in business are not included in the definition.

¹⁰⁴ AktG § 311.

to prepare a report on relations with other group firms within the first three months of the year in which all intra-group transactions of the firm are described and compensation received is discussed. This “dependency report” (*Abhängigkeitsbericht*) must be audited by the statutory auditor and the supervisory board, which reports to the shareholder meeting.¹⁰⁵ A shareholder may petition a court to appoint a special auditor if the statutory auditor or the supervisory board found irregularities or if the management board itself declares that disadvantageous transactions were not compensated for. Otherwise, only a minority of 1% or € 100.000 may request a special audit.¹⁰⁶

Both in contractual and de facto groups, members of the management boards of both entities and of the supervisory board of the controlled entity may be liable to the controlled company; derivative suits may be brought by individual shareholders.¹⁰⁷

These rules do not apply if the controlled firm is a GmbH. The law of GmbH groups is characterized to a large extent by case law,¹⁰⁸ which, relies, among other things, on the majority shareholder’s duty of loyalty.¹⁰⁹

5. Special rules for mergers and squeezeouts

Parent-subsidiary mergers are the last important form of self-dealing discussed here. Minority shareholders of the subsidiary may be deprived of their share of firm value if the exchange ratio between shares of the parent and the subsidiary is unfair to the latter’s shareholders, i.e when the estimate of the subsidiary’s value is too low. It is well known that the Delaware Supreme Court is very strict in judging such transactions, having found that the majority shareholder is subject to the duty of loyalty when specifying the terms of a merger and having developed a very requiring “entire fairness test” to evaluate whether the parent violated such duty.¹¹⁰

¹⁰⁵ AktG §§ 313, 314.

¹⁰⁶ AktG § 315. This threshold was recently lowered by the UMAG, *supra* note 48.

¹⁰⁷ AktG §§ 309, 310, 317, 318.

¹⁰⁸ See Peter Hommelhoff, *Protection of Minority Shareholders, Investors and Creditors in Corporate Groups: the Strengths and Weaknesses of German Corporate Group Law*, 2 EUR. BUS. ORG. L. REV. 61, 69-75 (2001).

¹⁰⁹ BGH 5.6.1975, II ZR 23/74, BGHZ 65, 15.

¹¹⁰ *Weinberger v. UOP*, 457 A.2d. 701 (Del. 1983).

The laws of all three countries provide procedural and disclosure requirements that have been set forth in the Third Directive for public corporations.¹¹¹ Mergers are subject to a shareholder meeting resolution¹¹² following a report by the board of directors which must explain “the draft terms of merger and set[] out the legal and economic grounds for them, in particular the share exchange ratio.”¹¹³ According to the Directive, “[o]ne or more experts, acting on behalf of each of the merging companies but independent of them, appointed or approved by a judicial or administrative authority, shall examine the draft terms of merger and draw up a written report to the shareholders.”¹¹⁴ In the report, “the experts must in any case state whether in their opinion the share exchange ratio is fair and reasonable.”¹¹⁵

In Italy, shareholders can challenge the validity of the merger resolution if they have the minimum stake required in general for such challenges.¹¹⁶ However, once the merger act has been deposited in the companies register, the court may not declare the resolution null and void and shareholders may only obtain damages, e.g. following an unfair exchange ratio.¹¹⁷

Squeeze-out or cash-out mergers are not allowed under Italian law. The squeeze-out remedy is only available to majority shareholders of listed companies having crossed the threshold of 98 percent of the shares following a bid for all the outstanding shares.¹¹⁸

In France, the decision to merge, and indirectly the exchange ratio, cannot be challenged unless there is an abuse of majority, which is difficult to prove. Minority shareholders can also sue the expert in case of mistake.

A relevant flaw in the protection of minority shareholder is that if it is the subsidiary that incorporates its parent company, the parent company may vote on the merger resolu-

¹¹¹ Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies, 1978 O.J. (L 295) 36-43.

¹¹² Article 7, Third Directive.

¹¹³ Article 9, Third Directive.

¹¹⁴ Article 10, Third Directive.

¹¹⁵ *Ibid.*

¹¹⁶ See *supra* section 2.2.C.

¹¹⁷ Article 2504-*quater*, Italian C.C.

¹¹⁸ Article 111 Legislative Decree No. 58 of 25 February 1998.

tion, which is not the case if the parent incorporates the subsidiary.

Finally, squeezeout (*retrait obligatoire*) is only possible in listed companies¹¹⁹. The majority shareholder needs to hold more than 95 % of the capital or of the votes following a bid (*offre publique de retrait*).

In Germany, lawsuits seeking to nullify the merger resolution may not rest on the unfairness of the exchange ratio.¹²⁰ In this situation, shareholders have a claim to compensation in cash.¹²¹ If the compensation is too low, they may petition a court to set the amount (under the award specification procedure described in the previous section).¹²² Equivalent rules apply to transformations into a different legal form,¹²³ squeezeouts (which can be requested upon the petition of a 95% shareholder)¹²⁴ and organizational integrations of one corporation into another.¹²⁵ The consequence of these rules is that it is harder (typically impossible) for minority shareholders to block a merger. The idea is that the transaction should not be stopped by a (possibly frivolous) shareholder suit. Furthermore, members of the management and supervisory boards may be subject to liability.¹²⁶

3. Methodology

The main purpose of our paper is to assess the three countries' law in action with regard to self-dealing by dominant shareholders. In order to do so we have gathered a sample of recent court opinions relating to self-dealing and thus obtained some data on how often and how effectively the various remedies and doctrines are used to tackle self-dealing in the real world. We also wanted to test some more ambitious hypotheses on how the law on self-dealing really works in the three main continental European countries.

Based on well-known hurdles to standing to sue for minority shareholders, on previ-

¹¹⁹ Art. L. 433-4 French Financial and Monetary Code.

¹²⁰ UmwG § 14 (2).

¹²¹ UmwG § 15.

¹²² UmwG § 34.

¹²³ UmwG §§ 196, 212.

¹²⁴ AktG §§ 327a, 327f.

¹²⁵ AktG § 320b.

¹²⁶ UmwG §§ 25 et seq.

ous accounts of courts' decision-making in corporate law cases¹²⁷ and on insightful case law studies in the important area of groups of companies,¹²⁸ the hypotheses we wanted to test are the following:

1. Outside bankruptcy, the law in action rarely treats cases of self-dealing that are “moderate” in terms of size or unfairness (as to price) to minority shareholders. The intuition behind this is that hurdles to minority shareholders in liability suits make it almost impossible for shareholders to bring action against specific self-dealing transactions, unless either the self-dealing is egregious, which might prompt them to attempt even impervious routes or raise the interest of public prosecutors, or it involves transactions requiring shareholder meeting approval, which they may challenge through nullification actions. Since transactions requiring shareholder meeting approval themselves tend to be sizeable or have a strong governance impact,¹²⁹ it is unlikely that “petty” self-dealing transactions will ever come to the attention of courts;

2. The law in action tolerates “stylish” self-dealing, whether because the court is satisfied with (lenient) procedural rules having overall been complied with or because it finds that self-dealing taking the shape of an intra-group transaction deserve a special, more lenient treatment. The latter point on groups draws on the fact that according to legal scholars in Germany,¹³⁰ to the 2003 corporate law provisions in Italy,¹³¹ to Italian legal scholars¹³² even before the 2003 reform, and to the *Rozenblum* doctrine in France,¹³³ intra-group transactions deserve a special and more lenient treatment due to integrated groups' perva-

¹²⁷ See Enriques, *supra* note 2.

¹²⁸ See Marie-Emma Boursier, *Le Fait Justificatif de Groupe dans l'Abus de Biens Sociaux: Entre Efficacité et Clandestinité*, 2005 REVUE DES SOCIÉTÉS 273, *passim* (providing vivid illustrations of how French Courts are ready to sacrifice individual companies' - and shareholders' - interests whenever the solvency of the corporation and the jobs of its employees are at stake).

¹²⁹ See Edward Rock, Hideki Kanda & Reinier Kraakman, *Significant Corporate Actions*, in THE ANATOMY OF CORPORATE LAW, *supra* note 3, 131, 131-32.

¹³⁰ Cf. Forum Europaeum Corporate Group Law, *Corporate Group Law for Europe*, 1 EUR. BUS. ORG. L. REV. 165, 203-204 (2000) (comparing German law to the more group-friendly French *Rozenblum* doctrine and proposing to adopt the latter in Europe; the Forum Europaeum Corporate Group Law is a group of academics from various EU countries, with a strong representation of prominent German academics. See *Id.* at 165).

¹³¹ See *supra* note 51 and accompanying text.

¹³² See *supra* note 86.

siveness in the three countries' economies and the physiological frequency of inter-corporate relationships within such groups.

3. Finally, the law in action intervenes more often and is less tolerant of the extraction of private benefits of control if the company has gone bankrupt or if its financial safety has been endangered. On the one hand, bankruptcy trustees have strong incentives to initiate legal proceedings against directors and dominant shareholders, because they stand to recover assets if they win, but are immune from any negative consequence if they lose, since they use the bankrupt company's money to finance their suits. Further, in stakeholder societies like continental European ones, judges tend to be more sympathetic to creditors' (and employees') interests than to minority shareholders' ones.

We first describe how we built the samples of cases for the three countries. Next, we present the findings for each country. Finally we discuss the findings and draw some implications.

An important caveat needs to be made with respect to a possible selection bias resulting from the use of databases. In all three countries, cases are selected on the basis of their inclusion in journals or because they are considered to be "interesting" from a legal perspective. Fact-intensive cases with no meaningful legal issues to be decided may never be published, and they are less likely to reach higher courts. For example, several of the German cases in the database take the illegality of the granted and are more or less only concerned with technicalities of interpretation. Similarly, with respect to the Italian sample, it is highly likely that for instance court decisions on Article 2409 petitions, in which the court typically has to inquire into whether a suspicion of a given violation of directors' duties is well-founded, will be underrepresented.

1. France

For France, the search covers the period 2004-2006 and was done using mainly two databases. Both databases include all cases from the French Supreme court, but not all cases from lower courts.

¹³³ See *supra*, section 2.3.

The first database is Lexbase.¹³⁴ The Lexbase database includes all cases from the French Supreme court (Cour de cassation) and cases from some courts of appeals. Concerning courts of appeals, the Lexbase database includes all business law cases and all criminal cases from the Paris court of appeals since 2002, all business law cases from the Court of appeals of Lyon, which is France's second largest city, since 2005, and all business law cases from the Court of appeals of Bordeaux since 2005. Therefore, the database covers fully all business law cases (whether bankruptcy or not) from three major courts of appeals since at least 2005. Only a limited selection of the other courts of appeals cases appear in this database. Therefore, in order to get a wider view of court of appeals cases, a complementary search was made on another widely used database called Lexis-Nexis.com/fr. This database includes all French courts of appeals, but offers only a selection of cases.¹³⁵ Many cases in the Lexis-nexis database come from the courts of appeals of Aix-en-Provence, Montpellier, Riom, and Versailles. The Versailles court of appeals, which also appeared regularly in the Lexbase database is very important since it is the court of appeal for the Nanterre first degree commercial court, which has jurisdiction over the business center of La Défense, where many major listed and non-listed companies are headquartered. This area accounts for a significant amount of French national GDP.

As to first degree commercial courts (*Tribunal de commerce*) and first degree criminal courts (*Tribunal correctionnel*), the two databases offer a very limited selection of cases. However, the Lexbase database offers all business law cases for the Nanterre first degree commercial court since January 2006, excluding bankruptcy cases.¹³⁶ The Lexisnexis database also offers a limited number of cases from other first degree commercial courts.

In order to widen the search, all cases from the Paris first degree commercial court, which have been annotated by authors are included in the database. The search to identify

¹³⁴ www.lexbase.com.

¹³⁵ Note that a few decisions in the LexisNexis database had been poorly scanned, so that some or all of the pages except the first one were missing.

¹³⁶ Nota that the there is no first degree criminal court in the Nanterre district.

such cases was done through a third database called DoctrinalPlus,¹³⁷ which lists all cases which have been commented upon by legal scholars in any French law review or periodical.

The search terms (see Appendix) covered the remedies used by courts in order to fight self-dealing, the procedures aimed to prevent self-dealing, and the situations where self-dealing can occur (e.g. mergers).

2. Germany

For Germany we used the *juris* database¹³⁸ This database currently covers about 835.000 court decisions, the oldest ones having been decided in 1878. With about 2 million court decisions being handed down in Germany every year, cases are included on the basis of two criteria. First, judges themselves are asked to indicate whether they consider a decision they issue as worthy of documentation. Second, *juris* covers about 600 journals and collections (including the official ones).¹³⁹ The database includes opinions by the Supreme Federal Courts since their existence and decisions by the courts of appeals (Oberlandesgerichte) since 1976.¹⁴⁰ Beginning with the year 2002, the database includes the full text of all decisions by courts that were published in a journal or collection or determined to be worthy of documentation by the court itself.¹⁴¹

Searches were performed during the period of November 2006 through February 2007, either as text searches or as searches for a specific section of the AktG or GmbHG, or as a combination of the two types (see Appendix). The period covered is 2004 to 2006, with all courts being included in the search. The total number of searches for each year was 23, most of which combined certain keywords often associated with self-dealing (e.g. “Treupflicht”) with the AktG and GmbHG. The searches covered the full texts. While some of the

¹³⁷ www.doctrinal.fr.

¹³⁸ <http://www.juris.de>.

¹³⁹ <http://www.juris.de/jportal/navigation/Produkte/juris+Select/Rechtsprechung.jsp>.

¹⁴⁰

<http://www.juris.de/jportal/navigation/Produkte/juris+Select/Rechtsprechung/juris+Rechtsprechung.jsp>.

¹⁴¹ E-Mails by Mr. Ulrich Gawlitza of juris GmbH to Martin Gelter of March 6, 2007 and March 19, 2007 (on file with the authors).

searches were quite broad and yielded more than 100 results for each year, only cases with fact patterns relating to self-dealing by shareholders were included (on the basis of the authors' judgment). A number of other 2006 cases that were apparently not covered by the database yet (or where some search fields, most of all the relevant statutory sections were still missing) were added. Cases by courts other than the civil and criminal courts (i.e. by tax, administrative and labor courts) were ignored. Cases relating to squeeze-outs and parent subsidiary mergers have not yet been specifically searched for, but were included in the database where they turned up. Still, mergers and (especially) squeezeouts are very strongly represented in the sample.

3. Italy

For Italy the search has been conducted using one of the most popular case law databases, the "Repertorio del Foro Italiano."¹⁴² It includes all opinions (other than criminal law ones) issued by the Italian Supreme Court (Corte di Cassazione) from 1997 to 2005, and all of the "maxims" (headlines)¹⁴³ of the Criminal Supreme Court (Corte di Cassazione) opinions and the "maxims" of lower courts opinions having been published in Italian law journals¹⁴⁴ from 1981 to 2005.

The database classifies cases according to the subject matter under specific headings, so that searches can be restricted to cases involving corporate law issues and it is possible anyhow to identify cases in which corporate law issues have been solved. For search strings that would have patently yielded a high number of decisions unrelated to corporations if no restriction had been applied, we have restricted the search to the heading "Società" (Company).

The search was done in the sub-database containing the maxims (and not the full text, even when available) of all of the opinions mentioned above. It included all court decisions since 2004¹⁴⁵ and decisions issued by the Supreme Court and the Milan and Rome Appel-

¹⁴² June 2006 Edition (DVD).

¹⁴³ On the use of maxims in Italian legal practice and scholarship see Enriques, *supra* note 2, at 791.

¹⁴⁴ The database is built by screening 284, or virtually all, Italian legal journals every year.

¹⁴⁵ Decisions by the Constitutional Court (one) and by tax courts (a few) were ignored.

late and First Instance courts since 2000. Milan and Rome are the two main business centers in Italy: among Italian provinces, Milan and Rome rate respectively first and second in terms of GDP.¹⁴⁶

We have used 35 search strings covering all of the relevant doctrines and remedies highlighted in part 2 (see Appendix). An important caveat about the Italian sample is that many of the cases, even among those decided after January 1, 2004, i.e. after entry into force of the 2003 broad-sweeping corporate law reform, were decided according to the previous rules, since the suits had been initiated prior to that date. Therefore, and inevitably, the sample might provide a picture of the law in action in Italy that will likely prove somewhat outdated soon.

4. Data and findings

1. France

A. Overview

For the French Supreme court, the search terms returned around 80 cases for business law terms (almost all in non-bankruptcy situation) and around 60 cases for criminal law terms (mostly abuse of corporate assets cases). For the court of appeals, the search returned around 100 cases for business law terms, in non-bankruptcy situation, and around 30 cases in bankruptcy situations. For the criminal cases, the search returned around 150 cases, most of them dealing with abuse of corporate assets and the remaining dealing with criminal bankruptcy. For the Nanterre and Paris first degree commercial courts, the search returned around 100 cases.

However, many court of appeals cases appeared twice or even more. Also, many abuse of corporate assets cases involved self-dealing by the CEO or the manager, especially in the form of excessive managerial compensation in wholly-owned companies in bankruptcy or in financial trouble. Many other cases were only very loosely related to minority

¹⁴⁶ ISTAT data for 2003 (on file with the author).

shareholder protection and many of them involved self-dealing by dominant shareholders in non-business corporations (*sociétés civiles*) or condominiums (*copropriétés*) as opposed to business corporations. Besides, many case dealing with abuse of majority had to do with the dismissal of a manager in a privately held company during the shareholder meeting. Concerning abuse of corporate assets, many cases had to do with verbal allegation of abuse of corporate assets by an employee against an employer, in the course of a dismissal proceeding, or just contained a reference to another previous proceeding dealing with abuse of corporate assets. We ignored all these cases.

We also ignored cases that did not involve *Sociétés anonymes* or SA, partnership limited by shares (*Société en commandite par actions* or SCA), Limited liability companies (*Société à responsabilité limitée* or SARL), or “simplified joint stock companies” (*Société par actions simplifiée* or SAS), a highly successful corporate form established in 1994.¹⁴⁷ We thus ended up with 40 court decisions involving self-dealing.

Of the 40 decisions, three were on the same case (two court of appeals decisions and one Supreme Court decision). There are also two instances in which we have one court of appeals decision and one Supreme Court decision for the same case. Therefore, the number of self-dealing cases we have identified is 36.

Of these 36 cases, only 4 dealt with listed companies. Of these four cases, two proceedings were initiated by active investors having acquired a blockholding, one being a foreign shareholder. Of the two remaining cases, one dealt with a very well known sophisticated minority shareholder who sues, often successfully, major listed companies as a matter of principle if he feels that minority shareholders have been unfairly treated. The other case dealt with a squeeze-out situation by a parent company; here, a well-known shareholder association (ADAM) acted on behalf of minority shareholders.

Of the 36 cases, 31 occurred in a non-bankruptcy context and only five occurred in a

¹⁴⁷ Cases dealing with minority shareholder of SAS are very rare. The reason is probably that this corporate form is used for 100% subsidiaries of groups or by sophisticated shareholders. Because of the risks associated with being a minority shareholder, a transformation of an SA into a SAS requires an unanimous voting by the shareholders (Art. L. 233-16 Commercial code). Therefore, minority shareholders are presumably

bankruptcy context (including one case of voluntary liquidation of a company which was on the verge of bankruptcy). Therefore, it appears that the number of cases in a bankruptcy context is low.

Minority shareholders brought a majority of the suits (27 cases out of the 36 cases). The company brought suit only twice, and each time in order to renege on a contract passed on unfavorable terms with a former majority shareholder. No more than four suits were brought by the bankruptcy liquidator. Only two cases were brought by the State Attorney (*Ministère Public*). In one case, it was uncertain who was the plaintiff.

Almost all criminal cases were brought by minority shareholders. The State Attorney only initiated one criminal case and was appellant in another criminal case. In the former case, the CEO had evaded tax and in the latter case it actually brought appeal in order to *defend* the CEO and dominant shareholder of two listed companies (Matra and Hachette) against a suit for abuse of corporate assets. Therefore, it appears that generally the State Attorney is not a party in self-dealing cases in France, except in very specific circumstances.

The two most recurring remedies invoked are nullification for abuse of majority (16 cases)¹⁴⁸ and abuse of corporate assets (seven cases). The other cases involve request for damages by minority shareholders, again for abuse of majority (three cases), “management mistake” (*faute de gestion*) (four), contracts with shareholders that had not been authorized by the board of directors under Art. L. 225-38 of the Commercial code (three), actions to have a court-appointed expert or to have access to certain documents in order to prepare for a trial (three), squeeze-outs (three decisions all relating to the same case), and share-buy backs (one case).

The courts found for the plaintiffs in 19 decisions and for the defendants in 20. In one decision, the court upheld a plaintiff’s claim, but rejected two other allegations of self-dealing. In terms of cases, the plaintiffs won 50 percent of the cases.¹⁴⁹

rare in SAS. Also, they are presumably more sophisticated and can protect themselves through bylaws provisions or shareholders agreement, thereby reducing the risk of litigation in case of abuse.

¹⁴⁸ In four of them minority shareholders requested damages at the same time.

¹⁴⁹ However, in an abuse of corporate assets case, the minority shareholder action was rejected because he was claiming damages for which he had already been indirectly indemnified.

These figures can be further categorized according to the type of action and according to the type of majority shareholder's behavior.

In abuse of majority cases, the plaintiff won six cases and lost 12, while one case was both won and lost on different grounds by the parties. This result shows that it is not easy for a minority shareholder to win by using a civil action. To the opposite, in abuse of corporate assets cases, the plaintiff won 4 cases and lost 2. Besides, one of the cases was lost because the plaintiff had already been indemnified. Therefore, minority shareholders seem to have a higher chance of success if they can allege an abuse of corporate assets rather than if they can only allege an abuse of majority.

Further, the plaintiff won all cases in which the majority shareholder had not requested the authorization of the board before entering into a self-dealing transaction (Art. L. 225-38 Commercial code). For "management mistake" cases, the plaintiff won in three cases, which happened all to be cases involving an insolvent company. The only case in which the plaintiff lost involved a solvent company.

As to the petition to have an expert appointed by the court, the plaintiff lost in two cases and won in one. In the squeeze out case, which gave rise to three court decisions, the minority shareholder lost.

The success rate of minority shareholder suits can also be analyzed according to the type of action. The results are interesting in term of judicial behavior towards certain types of abuses, regardless of the type of remedy used.

There might be several type of abuses alleged in one single case. For instance, in a typical case, a minority shareholder will both allege that compensation of the manager who is at the same time the majority shareholder is excessive and challenge the validity of a contract to the detriment of the company. Therefore, the number of self-dealing allegations is higher than the number of cases.

In the four cases involving a protracted policy of no dividend payments, a strategy often used by majority shareholders in non-listed companies in order to force minority shareholders to sell their shares to the former, the plaintiffs always lost.

As to stock dilution cases, the plaintiff lost in six cases and won in four. In two of the four cases, there were strong indications of fraud on the part of the majority shareholders.

In one case the issue was simply one of interpretation of the bylaws. The cases occurred generally in situations where the company was close to bankruptcy and the “recapitalize or liquidate” rule had to be complied with.

As to excessive compensation cases, the Courts tend to reject minority shareholders’ claims. They rejected such claims in three cases out of four. In the case won by the plaintiff, the majority shareholder had voted himself an outrageous compensation compared to the results of the company, and the company was later liquidated.

Finally, as to contracts with majority shareholders and loans to the majority shareholder or to related companies, the plaintiff won nine out of sixteen cases. It is worth noting that the plaintiff always lost (5 cases), unless one of the three following situations occurred: that the company is in bankruptcy; that no authorization from the board had been obtained; that the case is a criminal one for abuse of corporate assets. On the contrary, the plaintiffs won both cases in which the company ended up in bankruptcy and the three cases in which there was no authorization from the board. When the action was criminal, the plaintiff won four cases won and lost two.

B. Most relevant tunneling cases

Table 1: Classification of tunneling cases (France 2004-2006).

	Type of suit	Main doctrine	Total	Favorable to ¹⁵⁰		
				Minority ¹⁵¹	Majority ¹⁵²	Unclear
Non-insolvent company	Nullification of shareholder resolution	Abuse of majority	7	0	6	1
	Nullification of related Parties transactions	Absence of request of a board of director authorization	3	3	0	0
	Action for damages	Management mistake	1	0	1	0
	Petition for a court appointed expert (Art. 225-231 C. Com.)	Not applicable	3	1	2	0
	Criminal prosecution	Abuse of corporate assets	6	4	2	0
	Total		20	8	11	1
Insolvent company	Nullification of shareholder resolution	Abuse of majority	1	1	0	0
	Action for damages	Management mistake	3	3	0	0
	Total		4	4	0	0

The 2004 *Société du Louvre* case provides a good illustration of French courts' atti-

¹⁵⁰ Cases are classified as favoring the minority when the minority's victory is affirmed by the highest court decision available, or when the case is remanded, but given on the basis of the higher court's reasoning, an outcome favoring the minority seems most likely.

¹⁵¹ Or prosecution, or other person or entity seeking to challenge self-dealing.

¹⁵² Or other person controlling the company and allegedly engaging in self-dealing.

tude towards self-dealing.¹⁵³ In this case an American activist shareholder, Edelman, brought a derivative suit against directors of a family-run luxury listed company (*Société du Louvre*). He claimed that the company had been run for the benefit of the controlling family, alleging several facts, including the following: executive positions were given to family members, the compensation granted to them was excessive, there were several intra-group contracts with no apparent justification, and several contracts had been made with companies in which members of the family had interests in conflict with the company's. At the court of appeals level, the minority shareholder had requested 30 Millions euro of damages. The minority shareholder's claim was rejected by the Cour de cassation, which upheld the court of appeal's holding that the plaintiff had failed to prove that the company was run against the interest of minority shareholders, that the compensation granted to family members was excessive or unjustified, or that the intra-group contracts were fictitious transactions. From the opinion it is clear that most of the executive positions were held by family members and that they also appropriated the company's most interesting business opportunities. However, the Court held that it was unproven that this was contrary to the interest of the company itself or minority shareholders'. This shows how difficult it is to meet the burden of proof in self-dealing cases, which in turn means that the law in action easily allows moderate self-dealing to go unchecked. Therefore, the case is a good illustration of how reluctant French courts are to sanction (moderate) self-dealing (outside bankruptcy).

Another case¹⁵⁴ illustrates the tendency of courts to tackle excessive compensation only if the company is close to bankruptcy. A small SARL experienced financial difficulties and the majority shareholder, who was also the manager, decided to liquidate the company. The manager had received compensation of approximately 20,000 euro for the 1998-1999 financial year, 20,000 euro for 1999-2000 (as manager, and then as a liquidator), and, as liquidator, 20,000 euro for 2000-2001. At the same time, the company had profits of approximately 1,200 euro for the 1998-1999 financial year, and losses of 37,400 euro and of

¹⁵³ Cass. com. 21 septembre 2004 n° 1243 F-D, Sté Muséum Partner LL P Delware et a. c/ Taittinger et a.

¹⁵⁴ Aix-en-Provence, November 17, 2006, SARL Faure & Sauteyron.

6,500 euro at the end of 1999-2000 and of 2000-2001 financial years, respectively. The compensation amounted to half of the losses in the 1999-2000 financial year and largely exceeded the profit for the 1998-1999 and the losses for the 2000-2001 financial years. The Commercial Code leaves it to the by-laws to decide how the compensation of the manager of a SARL is to be decided. According to the by-laws of this SARL, the compensation had to be decided by the shareholder's meeting. Nothing in the law prevented the majority shareholder/manager from voting on his compensation. The resolutions on compensation were in fact always approved by the manager at the shareholders' meeting. A minority shareholder decided to sue for abuse of majority. The Aix-en-Provence court of appeal decided that the compensation had been excessive. According to the Court, although the amounts were limited in size, they were either unjustified for the work to be done as liquidator or very high in relative terms since they represented more than half of the losses for 1999-2000. Contrary to workers, whose compensation is fixed and rigid, compensation of the manager was decided every year by the shareholders of this SARL and could have easily been adjusted to the financial situation of the company. The case shows how courts tend to be more severe when compensation is not adjusted to results in a company which is moving towards bankruptcy.

As to criminal cases, an interesting decision is the Matra-Hachette 2006 decision.¹⁵⁵ The case is interesting since it concerns an intra-group management contract, which is very usual in French groups. Two major French listed company (Matra and Hachette¹⁵⁶) signed a management agreement with another company (*Arjil groupe*), which was owned by the CEO of Matra and Hachette and his son. According to the management contract, the two companies would pay *Arjil groupe* an annual management fee of 0.2% of each company's consolidated turnover, subject to revision in case of sudden and noticeable change of the consolidated turnover. The management agreement, which was subject to Article L. 225-38 of the commercial code, since there were common directors between *Arjil groupe* and the

¹⁵⁵ Cass. crim., 25-10-2006, n° 05-85.998, *Procureur Général près la Cour d'appel de Versailles*, FS-P+F, section I

¹⁵⁶ Matra and Hachette were later merged into Lagardère SCA.

two listed companies, was approved by the shareholders in 1989. The CEO of the two listed companies was also a dominant shareholder since he controlled the shareholder meeting in the two listed companies and was therefore easily able to have the contract approved. A minority shareholder requested a criminal prosecution for abuse of corporate assets against the CEO, arguing that the price paid was too high compared to the services provided. The French Supreme Court upheld the claim. Several important points were taken into account by the court. First, the court pointed to the high cost of the contract for the companies (14.3 million euro) and noticed that the contract brought no benefit to them. The *Arjil groupe* paid the compensation of the two listed companies' executives and also hired a high level consultant. However, the court pointed out that these transactions did not justify the gains the *Arjil group* was making out of the contracts, since the two listed companies could also have paid their executives and hired the consultant directly. The magnitude of the management fee paid to the company owned by the manager was an important element in deciding that this self dealing situation was an abuse of corporate assets. Therefore, the case illustrates how courts do react to self-dealing, even if the company is neither in bankruptcy nor close to it, provided that the private benefits extracted are significant. The case also seems to show that courts are more severe with self-dealing through related-party transaction than through excessive compensation.

C. *Most relevant stock dilution cases*

Table 2: Classification of stock dilution cases (France 2004-2006).

Form of dilution	Type of suit	Number	Favorable to minority	Favorable to majority	Outcome unclear
Recapitalize or liquidate	Abuse of majority	5	1	5	0
Increase or reduction in capital		4	2	2	0
Squeezeout		1	0	1	0
Total		10	3	8	0

Minority shareholders lost all stock dilution cases involving the recapitalize or liquidate rule, with the only exception of one in which the court found a fraud directed at squeezing-out the minority shareholder. An illustrative case of this tendency not to second

guess the decision of the majority shareholder can be found in a 2005 decision by the *Cour de cassation*.¹⁵⁷ In this case, a company owning a perfume shop ran into financial trouble and control of the company was sold to a third party, with the former owner becoming a minority shareholder. Due to the magnitude of the losses, the company was obliged to reduce its capital to zero and to issue new shares (so-called *coup d'accordéon*) with pre-emptive right in favor of the previous shareholders. However, the minority shareholder was diluted in the process because he did not have enough money at the time to fully subscribe the new shares. Therefore, he alleged that the real objective of the recapitalization was to dilute him. Since the company was already bankrupt, the recapitalize or liquidate rule did not apply.¹⁵⁸ However, the court held that the fact that net assets were negative was enough to justify a recapitalization, in order to regain credibility with sellers and to succeed in the restructuring of the company. This is a classical outcome for cases of this kind.

Besides, when there is a legal duty to recapitalize, courts do not second-guess the timeframe of the decision¹⁵⁹. Minority shareholders who get diluted in the process (because they are unable to subscribe the new shares due to lack of funds) allege that the decision (and hence the dilution) could have been avoided if the company had waited the two year period before it is mandatory, further arguing that the financial situation of the company was in fact improving at the time of the recapitalization. In this situation, however, courts leave the company free to decide when to recapitalize. Therefore, the majority shareholder can choose the best possible time for her to recapitalize and possibly squeeze-out minority shareholders with no compensation.

That courts do not second-guess the timing of stock dilution transactions also appears in the only squeeze-out case in the sample,¹⁶⁰ where the majority shareholder (*France Telecom*) listed its mobile phone subsidiary (*Orange*) in February 2001 and made a squeeze-out offer in October 2003 at the IPO price, at a time when the prospects of the subsidiary were

¹⁵⁷ Cass. com., 25-01-2005, n° 02-18.269, M. Christian Alberti c/ société Kharys parfums, F-D.

¹⁵⁸ See *supra* note 32.

¹⁵⁹ Art. L. 225-248 French. C. com.

¹⁶⁰ Cass. com., 22-11-2005, n° 04-15.336, *Association pour la défense des actionnaires minoritaires, (ADAM) c/ société France Télécom*, F-D, section 2.

improving. The minority shareholder alleged an “abuse of the right to (de)list”. The French Supreme court rejected the claim, holding that the shares had been evaluated by an expert. Therefore there could be no abuse of the right to (de)list. This shows that even in the context of squeeze-outs the majority shareholder is largely free to decide when to recapitalize or to delist. This can be done at the most favorable time for the majority shareholder and is not considered abusive by French courts, which will tend to defer to the company-appointed experts’ evaluation.

French courts’ attitude towards majority shareholders’ voting in conflict-of-interest situations is also telling. They tend in fact to admit it, unless it falls under one of the instances in which the law expressly prohibits it. For instance, in two cases in the sample, the courts did not object to shareholders’ voting in the presence of a conflict of interest. In the first case, the shareholder voted on the conversion of his founder’s shares (*parts de fondateur*) into ordinary shares. The *Cour de cassation* refused to find that he should have abstained from voting.¹⁶¹ Similarly, the Paris court of appeals refused to rule that board members should have abstained from voting in a resolution by which the company decided not to exercise its pre-emptive rights on shares newly issued by one of its subsidiaries, thereby allowing those directors to take themselves control of the subsidiary.¹⁶²

Some clear patterns can be identified. First, one can notice that courts tend not to nullify decisions to recapitalize when the company is close to bankruptcy and the only issue is shareholders’ dilution. The majority shareholder keeps control of the timing. He can therefore extract some benefit by deciding to recapitalize at a time when the minority shareholder does not have sufficient funds to bring new money in, or before an improvement in the company’s performance is expected. Courts will not second guess this decision, unless it appears that the real goal of the recapitalization was to get rid of the minority shareholder. It is however very difficult to satisfy such burden of proof. Also, French courts, like

¹⁶¹ Cour de cassation Commercial Chamber, September 19, 2006, n° 04-14.372, *société Groupe Par-touche*, F-D.

¹⁶² Paris court of appeals, June 22, 2005, *Yogendra Gupta v. SARL Indirect Montparnasse et alii*.

in Italy,¹⁶³ tend not to second-guess the conclusion of the experts involved in the merger procedure. This was the case in the France Telecom-Orange squeeze-out case. This might explain why there are so few cases challenging squeeze-outs despite their high number.¹⁶⁴ This deference towards experts is of course justified only if the expert is really independent. Although experts are supposed by law to be independent, they are selected and paid by the company. The only checks on their independence is their liability and, for listed companies, control by the securities regulator. The very limited number of cases dealing with an alleged unfair exchange ratio or the liability of experts in evaluating an exchange ratio can probably be explained by this judicial self-restraint which deters potential plaintiffs.¹⁶⁵

More generally, it appears that French courts do not want to disrupt the business of companies or second-guess business decisions, even when self-dealing is apparent. French courts are in fact extremely reluctant to appoint an expert. In four cases out of five the court refused to grant the appointment of an expert. Also telling is the fact that we found only one suit for “management mistake” involving a dominant shareholder’s self-dealing in a solvent company (*Société du Louvre*), and that the suit was rejected for failure to meet the burden of proof.

2. *Germany*

A. *Overview*

Not counting appeals¹⁶⁶, the database covers 64 cases as of March 4, 2007. 22 cases involve fact patterns of possible tunneling,¹⁶⁷ The other 42 “stock dilution” cases involve some sort of reorganization, recapitalization, merger or squeezeout. Among the latter, the

¹⁶³ See *infra*, section ###.

¹⁶⁴ The AMF reports 36 squeeze-outs in 2004 and 29 in 2005. *Autorité des Marchés Financiers 2005 Annual report*, p. 101.

¹⁶⁵ For one rare example of such suit, see. Paris Court of appeals., 19 february 1999, SA Media System c/ Segretain, Bull. Joly, 1999, n°6, p. 674.

¹⁶⁶ Cases where there were several decisions of courts on different levels were included in the database, but only the highest were included in the quantitative analysis.

¹⁶⁷ Cases on de facto groups are included among tunnelling ones, because provisions of de facto groups merely add to the possible remedies against self-dealing in particular situations. Contractual group cases are

largest group (22 cases) relates to squeezeouts. Ten cases addressed issues of other types of mergers and transformations where the majority may have acted to the detriment of the minority. There are four cases involving the creation of a contractual corporate group, which resembles a merger (both in its effects and in the legal safeguards intended to protect minority shareholders), as it fundamentally changes the status of the company and triggers an exit right. In one case, the main issue of the dispute was the qualification of a contract as an agreement to create a contractual group. Six decisions discuss preemptive rights.

The large number of squeezeout cases could have been higher still if we specifically searched for them. However, this was not done because the pattern of the cases found without doing such specific search is very similar in most cases. The most likely reason for the high number of cases is that the relatively recent introduction of the squeezeout procedure under AktG §§ 327a et seq. in 2002¹⁶⁸ may mean that many issues of legal interpretation are still open. Second, the squeeze-out remedy itself is litigation-intensive, because it implies the forced sale of shares at a price on which parties have not agreed to. Furthermore, majority shareholders of companies where a squeezeout may have since long made sense were only able to make use of this opportunity after 2002. Since the law allows petitioning the court in order to set an adequate compensation for the shares of squeezed-out shareholders,¹⁶⁹ the issue in most cases is the valuation of the company. Still, minority shareholders sometimes challenge such resolutions on other grounds.

There are 47 cases involving AGs and 17 involving GmbHs, which may at first be surprising, as the number of GmbHs is much greater.¹⁷⁰ While GmbHs account for about two thirds of the tunneling cases (GmbH: 15; AG: 7), AGs almost completely dominate

akin to mergers, since the safeguards to shareholders are similar and the controlling entity is explicitly permitted to harm the controlled corporation. *Compare* sections 2.4 and 2.5.

¹⁶⁸ This procedure allows a shareholder owning 95% to force the minority shareholders transfer over their shares to a single majority shareholder against adequate compensation.

¹⁶⁹ *Supra* section 2.5.

¹⁷⁰ Roth & Altmeppen (in GMBH-GESETZ, *supra* note 50, Einl, comment 6) report the existence of 452,688 GmbHs and 5,526 AGs for 2002. However, these data includes only firms exceeding an annual turnover of € 16,617 and therefore subject to sales tax. There is a much larger number of very small and inactive firms. *See* Udo Kornblum, *Bundesweite Rechtstatsachen zum Unternehmens- und Gesellschaftsrecht*, *Stand*

stock dilution cases (AG: 40; GmbH: 2). Specifically, the squeezeout procedure, which has produced the largest number of cases, does not apply to the GmbH.

In 38 of the cases concerning AGs, the company was listed, while in 5 it was not.¹⁷¹ In 4 cases, the listing status of the company remained unclear. While in some cases the fact pattern describes the firm's listing status, some effort is required to obtain reliable data since the names of the parties are anonymized by the courts. Occasionally, journals publishing the opinions give the name of the company, so that it was possible to determine listing status by looking up the anonymous case found in *juris* in a journal. The firms with unclear listing status are most likely non-listed ones, because journals would presumably have reported the name if the company would have had some public notoriety.

I.1.2006, 98 GMBH-RUNDSCHAU 25, 26 (2007) (reporting a number of 995,940 *registered* GmbHs, as of January 1, 2006, but not providing data on AGs).

¹⁷¹ Only AGs can be listed, since GmbHs cannot issue tradable shares (they may issue bonds).

B. Tunneling and related-party transactions

Table 3: Classification of tunneling cases (Germany 2004-2006).

	Type of suit	Main doctrine	Total	Favorable to ¹⁷²		
				Minority ¹⁷³	Majority ¹⁷⁴	Unclear
Non-insolvent company	Nullification of shareholder resolution	Duty of loyalty / special advantage	2	2	0	0
		Concealed distribution	1	1	0	0
		Shareholder's right to information	1	0	1	0
	Claim to liability or restitution by company	Failure to obtain authorization	1	1	0	0
		Director's duties	1	1	0	0
	Derivative suit	Disadvantageous transaction (de facto group)	1	0	1	0
	Liability to shareholders	Duty of loyalty / special advantage	1	0	0	1
		Disadvantageous transaction (de facto group)	1	0	1	0
	Injunction	Failure to obtain authorization	1	1	0	0
	Nullification of exclusion by self-dealer	Director's duties / legality of exclusion clause	1	0	1	0
	Criminal prosecution	Disloyalty	1	0	1	0
	Total			12	6	5
Insolvent company	Criminal prosecution	Criminal bankruptcy	1	1	0	0
		Disloyalty	1	0	0	1
	Claim to li-	Concealed distribution	3	1	2	0

¹⁷² Cases are classified as favoring the minority when the minority's victory is affirmed by the highest court decision available, or when the case is remanded, but given on the basis of the higher court's reasoning, an outcome favoring the minority seems most likely.

¹⁷³ Or prosecution, or other person or entity seeking to challenge self-dealing.

¹⁷⁴ Or other person controlling the company and allegedly engaging in self-dealing.

	ability or restitution by company	Director's duties	1	1	0	0
	Liability claim against supervisory board members	Duty to investigate	1	1	0	0
	Claim for D&O insurance sum	Concealed distribution	1	0	1	0
	Derivative suit	Duty of loyalty / special advantage	1	1	0	0
	Liability claim by creditor	Veil piercing (Existenzvernichtung)	1	1	0	0
	Total		10	6	3	1

1. Outside insolvency

Among the 22 tunneling cases, fifteen involved GmbHs and seven involved AGs. One of the original theories underlying our paper was that self-dealing was rarely (if ever) sanctioned outside insolvency. This seems theory cannot be confirmed on the basis of our findings. There are twelve “tunneling” cases in the database not involving an insolvent company (besides ten cases of insolvent firms).¹⁷⁵ Four cases involve publicly traded AGs, the other GmbHs. Among the eleven civil opinions, the person allegedly involved in self-dealing lost (or was likely to lose in cases that were remanded) in six and got away (or seemed poised to get away) in four cases, one case seeming undecided.

A variety of remedies are used. The remedy used by shareholders most frequently in the sample (four times) is the suit to nullify a shareholder resolution.¹⁷⁶ In three cases, a minority shareholder sought to nullify a shareholder resolution authorizing some kind of (possible) self-dealing, all of which were won by plaintiffs.

¹⁷⁵ Among these, there is one criminal case which the defendant is likely to win, because all other shareholders were family members who would be required to assent to criminal prosecution for a conviction unless the company is endangered by the defendant's crimes.

¹⁷⁶ *Supra* section 2.2.C.

In one of these cases,¹⁷⁷ the defendant¹⁷⁸, I.M. AG, was a publicly traded company¹⁷⁹ in the consumer electronics business. It had three subsidiaries, I.M. Distribution GmbH in Munich, I.M. GmbH in Vienna and I.M. AG Switzerland in Hünenberg. These were to be sold to I.M. AG's majority shareholder, I. Holding GmbH. The objective of the suit was to nullify the resolution (which was of course supported by the majority shareholder) approving the transaction at a specific price. The court of first instance (Landgericht) upheld the resolution with respect to the Austrian and Swiss subsidiaries, but nullified it with respect to the German one. Both parties appealed, but the OLG München upheld the decision.

The main issue of the case was the subsidiaries' value. The basis of the valuation had been an expertise by (apparently) "D[eloitte] & T[ouche]." The Landgericht appointed another public accountant, Dr. M., to revisit it, who disagreed with respect to the valuation of I.M. Distribution GmbH (apparently Deloitte & Touche had failed to take certain transactions before the relevant date of reference into account). With respect to the other subsidiaries (which were much smaller companies), he found that their value was in fact lower than the price paid by I.M. Holding. The plaintiffs provided an expert opinion by another accounting firm (T.U. GmbH), arguing that the value of the Austrian and Swiss subsidiaries was also higher. However, both the Landgericht and the OLG found the opinion of Dr. M. most convincing (possibly because he had been appointed by the court and not by one of the parties).

Doctrinally, the sale of I.M. Distribution GmbH was considered a concealed distribution because I.M. AG did not receive adequate compensation. The defendant argued that the prohibition against distributions was not applicable in a *de facto* group because the special provisions for groups took precedence. However, the courts rejected this argument and found that this is only true as long as the parent company compensates the group companies

¹⁷⁷ OLG München 15.12.2004, 7 U 5665/03, NZG 2005, 181 = AG 2005, 486.

¹⁷⁸ The defendant in a suit seeking to nullify a shareholder resolution is the company (and not the other shareholders).

¹⁷⁹ The firm later went private and was transformed into a GmbH in 2003.

for the disadvantages it incurs (see above section 2.4),¹⁸⁰ which the sales contract did not adequately provide for.

One of the interesting issues of this case is why the transaction was submitted to shareholders for approval, which opened a judicial avenue against self-dealing. The *Holz Müller* doctrine, established by the BGH in 1982¹⁸¹, requires a shareholder vote if a sale touches upon the core of the company's business.¹⁸² The doctrine was apparently narrowed by the BGH in the *Gelatine*¹⁸³ case that was decided after the facts of the case discussed here took place. While the precise extent of the *Holz Müller* doctrine is still not entirely clear,¹⁸⁴ the number of cases submitted to the shareholder meeting may be dwindling down as a result of *Gelatine*.

The other two cases dealt with managerial compensation in GmbHs. In one of them,¹⁸⁵ the 60% shareholder (Mr. I) issued a shareholder resolution to increase his own compensation. The court judged the managerial compensation to be excessive and thus considered it to be a concealed distribution to Mr. I. Although concealed distributions are not outright illegal in a GmbH (other than in an AG) unless the firm's legal capital is affected, the court found that these violate the principle of equal treatment of shareholders and the majority shareholder's duty of loyalty. The material substance of the claim that Mr. I's compensation was excessive was again answered by drawing upon the judgment of an expert appointed by the court. He found that compensation had risen dramatically over the past years (from DM 243,000 in 1999 to DM 544,474.25 in 2002) and stood in no relation to the development of the firm's profitability, even without taking into account perks such as insurance fees paid on behalf of Mr. I, a financial allowance for his wife, and the use of a

¹⁸⁰ The practical difference is that the transaction is void of the prohibition against distributions applies, whereas the *de facto* group law requires the parent only to compensate the subsidiary.

¹⁸¹ BGH 25.2.1982, II ZR 174/80, BGHZ 83, 122.

¹⁸² See Marc Loebbe, *Corporate Groups: Competences of the Shareholders' Meeting and Minority Protection – the German Federal Court of Justice's recent Gelatine and Macrotron Cases Redefine the Holz Müller Doctrine*, 5 GERMAN L. J. 1057, 1061 (2004).

¹⁸³ BGH 26.4.2004, II ZR 155/02, BGHZ 159, 30 (finding that "unwritten competences of the shareholder meeting are only recognized exceptionally and within narrow boundaries").

¹⁸⁴ See Loebbe, *supra* note 182, at 1075-76.

¹⁸⁵ LG Bonn, 4.11.2004, 14 O 211/02.

car owned by the company. The expert witness also referred to a report issued by a human resources consultancy, according to which the manager of a firm of this size and industry should typically have received compensation between DM 201,000 and 330,000 in 2002.

Shareholders have attempted to use other remedies, including derivative suits. A recent case,¹⁸⁶ with an appeal is still pending before the BGH, alleged self-dealing by the Federal Republic of Germany, which held 43% of publicly traded Deutsche Telekom AG beside some indirect shareholdings. One of Telekom's subsidiaries successfully bid for a UMTS license for about DM 16.6. Billion in 2000. The plaintiff claimed the government authorities had induced Telekom to participate in the auction, while the UMTS standard had not become financially profitable at the time of the trial. The plaintiff brought a derivative suit under the law of de facto groups, arguing that Telekom had incurred a disadvantage within the meaning of § 311 for which it was entitled to be compensated by the controlling "business." While the courts recognized that the Federal Republic of Germany can be considered a controlling business under the law of corporate groups, it found that the bid did not result in a disadvantage to the firm. Most of all, both the LG Bonn and the OLG Köln emphasized that the decision to submit a bid was well within the business judgment of reasonable directors, as UMTS technology offered a lot of opportunities from an ex ante perspective. Apparently Telekom's directors had convinced the courts that they had taken a well-grounded decision on the basis of an adequate information set.

In two cases, shareholders requested damages to be paid to themselves by the alleged self-dealer; in the more interesting one (which was remanded to collect further evidence), the claim was that the plaintiff had sold his shares to a third party at a depressed price because a restitution claim against the alleged beneficiary of self-dealing was not taken into account in the balance sheet.¹⁸⁷

However, some cases in the sample were decided not on fairness, but on procedural grounds. In a case involving a GmbH with four shareholders, the courts granted an injunc-

¹⁸⁶ OLG Köln 27.4.2006, 18 U 90/05, ZIP 2006, 997 = NZG 2006, 547 = AG 2006, 586= DK 2006, 541.

¹⁸⁷ BGH 11.12.2006, II ZR 166/05, DB 2007, 276 = WM 2007, 257 = GmbHR 2007, 260..

tion against the payment of allegedly excessive managerial compensation that lacked the unanimous shareholder approval required by the firm's charter.¹⁸⁸ In another case,¹⁸⁹ a minority shareholder attempted to nullify the resolution to "discharge" directors of a company (so-called *Entlastung*), arguing that the information given to shareholders was insufficient. The company was part of a de facto group where shareholders must receive a "dependency report" from the board of directors about the firm's relationship to the entity controlling the group. The main issue was whether individual shareholders still have the right to request information about relationships to affiliated undertakings in the shareholder meeting under AktG § 131, or whether this provision was superseded by the obligation to submit a dependency report. The court of appeals found that that right existed also in a de facto group and proceeded to evaluate the substantive content of the information given to shareholders. Substantively, the issue seems to have been transfer prices paid within the group, where the board stated that OECD guidelines had been followed. The court found that the substantive amount of information given to shareholders was sufficient for the discharge of directors not to be invalidated. The decision is also interesting as it may constitute a case of "ostensible shareholder litigation", as described in the section on Italy.¹⁹⁰ The "discharge" of directors is voted upon by shareholders annually, but not particularly meaningful in an AG, where it does not preclude liability suits against directors.¹⁹¹

Besides these cases, there were a few where the suit was not brought by shareholders. In two cases the company itself sued for damages or restitution of assets or used such a claim to counter a suit by the alleged self-dealer. The first suit was presumably brought after a change of control in the firm.¹⁹² The plaintiff GmbH, which produced and distributed pipes and electrical installations was owned partly by R GmbH, partly by the Czech firm F a.s. The plaintiff GmbH's manager, S, was at the same time the manager and 10% shareholder of R GmbH. Acting concurrently on behalf of the plaintiff firm and a newly created

¹⁸⁸ BGH 22.3.2004, II ZR 50/02, ZIP 2004, 804 = DB 2004, 973 = BB 2004, 906 = WM 2004, 879 = NZG 2004, 516 = GmbHR 2004, 739.

¹⁸⁹ OLG Stuttgart, 11.08.2004, 20 U 3/04, DB 2004, 2094 = NZG 2004, 966 = AG 2005, 94.

¹⁹⁰ See *infra* section ###.

¹⁹¹ AktG § 120(2).

subsidiary of R GmbH, he entered into a transaction selling most of the plaintiff GmbH's assets. The courts found that S lacked the legal capacity for the transaction, as a shareholder resolution would have been required to dispense with the prohibition of acting on behalf of two principals in the same deal.¹⁹³ Apparently, there had been a sham resolution in which F a.s. had not been given the opportunity to participate. The case illustrates how courts can tackle self-dealing relatively easily when self-dealers violate procedural rules in an unsophisticated way.

Finally, there was one case with a criminal remedy (even though the firm was not insolvent). However, the decision was based on a fact pattern of very obvious embezzlement. The BGH found that, since the theft did not result in the firm's insolvency, a request by any of the other shareholders was required in order to prosecute the directors, since all of the victims of the crime – the other shareholders – were close family members of his.¹⁹⁴ There almost certainly would have been a conviction if the other shareholders had not been family, or if the company had become insolvent.¹⁹⁵

A variety of doctrines were used as the main argument against self-dealing: one case (already described above)¹⁹⁶ rested on the manager's lack of authorization for personal self-dealing. Similarly, in another case,¹⁹⁷ the courts only had to discuss whether the firm's charter required a unanimous shareholder decision.

However, in a number of other cases courts had to use doctrines where the issue was not merely the violation of procedural rules, but the substantive fairness of the transaction. In three cases, the doctrine used was the shareholder's duty of loyalty, and in two cases it was the manager's standard to conform to the duty of a "proper businessman" or to act in the interest of the company. In three of these five cases the alleged self-dealer lost (or

¹⁹² BGH 30.5.2005, II ZR 236/03, DStR 2005, 1066.

¹⁹³ BGB § 181.

¹⁹⁴ Under the German criminal code, certain crimes against property are not prosecuted if the victim is a family member unless upon request. *See* StGB § 266(2) referring to § 247.

¹⁹⁵ In another case (listed among cases where the company was insolvent), the question whether a request was required was answered to the negative, as creditors were apparently hurt. BGH 10.01.2006, 4 StR 561/05, wistra 2006, 229-230.

¹⁹⁶ *Supra* note 192.

¹⁹⁷ *Supra* note 188.

seemed very likely to lose). Two cases, both of which were lost by plaintiff minority shareholders, the objective was the requirement to compensate the company for any disadvantages resulting from being a member of a de facto group. Both of them were lost by plaintiff shareholders.¹⁹⁸ In one case the argument rested on the concealed distribution doctrine, although the firm was not insolvent.¹⁹⁹

On the basis of the sample it is hard to discern any consistent patterns. These cases do not indicate a bias in favor or against plaintiff shareholders. To the contrary, German courts do not seem to hesitate to conduct a detailed review of the substantive fairness of the transaction where required, and seem to be doing a good job at it. Quite naturally, a substantive ex post evaluation of a transaction makes it likely that courts need to rely on expert opinions to a strong degree, and creates a danger of hindsight bias. However, there seems to be awareness of that problem. In some cases lost by the alleged self-dealers the outcome rested on the violation of procedural rules (such as failure to obtain the required shareholder resolution stipulated in the charter), which is of course the easier way of resolving a case for a court. However, given the detailed substantive review in some other cases, the “in style” hypothesis is probably not an accurate description of what German courts are doing.

The sample is of course biased in that it only includes cases where shareholders had standing to sue. With the exception of the situation where the firm itself sues (typically as a consequence of a change in the firm’s ownership or management), enforcement rests on whether minority shareholders have a remedy.

While this is unlikely to be a problem in GmbHs it, it probably is in AGs, where the existence of a remedy hinges on whether a transaction requires a shareholder resolution, which allows a nullification suit (as in one of the cases described above²⁰⁰), or whether a derivative suit is possible. The access to derivative suits is limited to shareholders holding 1% or the equivalent of € 100.000 of the company’s stated capital outside corporate groups. This may mean that in some cases a suit will be practically ruled out irrespective of the

¹⁹⁸ *Supra* notes 186 and 189.

¹⁹⁹ *Supra* note 177.

²⁰⁰ *Supra* note 177.

substance. While our case analysis does not allow an estimate of whether this is an important obstacle, it may be one given collective action problems. Furthermore, the requirement to have a transaction approved by shareholder resolution brings a transaction “out into the open”. Without disclosure, potential plaintiffs may never learn about a potential violation of the law.

Furthermore, minority shareholders will often not have an incentive to sue, because their share in the expected financial gains is outweighed by their personal cost. Litigation costs have been often considered the main disincentive against derivative suits, both inside and outside the law of corporate groups, as the losing plaintiff was typically required to reimburse the defendant.²⁰¹ The recent UMAG reform of 2005 may have alleviated this problem to some degree.²⁰²

Given all of this, the “do it in moderation” thesis probably has merits in AGs, but not in GmbHs.

2. In insolvency

It may be surprising that the search yielded only ten tunneling cases where the firm was insolvent. As a matter of theory, this need not be taken to indicate that these are rarer, but may also be explained with these cases reaching higher courts less frequently. In any case, the sample is too small to draw any conclusion.

Among the ten cases, three concerned AGs, one of these a (formerly) listed firm, and another with unclear listing status.

Two of the cases were criminal ones, both of which involved obvious embezzlement or schemes to hide assets from creditors by parking them in another company.²⁰³

Four of the cases were suits brought by the insolvency administrator, the outcome of two of which was detrimental to the administrator. The small sample does not conclusively

²⁰¹ See Hans C. Hirt, *The Enforcement of Directors' Duties Pursuant to the Aktiengesetz: Present Law and Reform in Germany: Part 1*, 16 INT'L. COM. & COMPANY L. REV. 179, 189 (2005).

²⁰² AktG § 148(6), described *supra* in section 2.

prove that courts are stricter or subject to a hindsight bias. For example, one of the cases lost by the administrator resembles the pattern of substantive review identified in the previous section.²⁰⁴ X GmbH, which later became insolvent, provided logistical services to companies within the Y group, which was controlled by AB GmbH, which was the “grandparent” of X GmbH. The core issue was whether the compensation for these services passed a third-party test. The insolvency administrator’s suit was rejected, among other things, because he had failed to meet the burden of proof in that respect, and because an expert opinion commissioned by the court found that the price was still within a reasonable range (although close to its lower boundary).

In another suit, the insolvency administrator brought a liability suit against members of the supervisory board.²⁰⁵ M. GmbH had given various loans to i. GmbH and i.T. GmbH, which were controlled by M. GmbH’s majority shareholder-manager. Under the charter, the supervisory board would have been required to approve any transactions exceeding DM 100,000. After all firms had gone bankrupt, the court held the supervisory board members of M GmbH responsible for the loan and found that they had failed to investigate the prospects of the recipient firms and the risk of default.

Finally, in one case self-dealing resulted in a veil piercing suit.²⁰⁶

²⁰³ As shown by table 1, there was one “Untreue” case and one “Bankrott” case. BGH 10.01.2006, 4 StR 561/05, wistra 2006, 229-230; OLG Karlsruhe 07.03.2006, 3 Ss 190/05, NJW 2006, 1364 = NZG 2006, 354 = GmbHR 2006, 598.

²⁰⁴ OLG Stuttgart 27.09.2006, 14 U 11/06, ZIP 2007, 275.

²⁰⁵ BGH 11.12.2006, II ZR 243/05, DB 2007, 275 = ZIP 2007, 224.

²⁰⁶ BGH 13.12.2004, II ZR 204/02, ZIP 2005, 117 = DB 2005, 218 = BB 2005, 232 = WM 2005, 176 = GmbHR 2005, 225 = NZG 2005, 177 = DK 2005, 169 = DZWIR 2005, 206 (finding that the majority shareholder is personally liable to creditors as a result of appropriating the firm’s corporate opportunities, thereby destroying the basis for its existence).

C. *Stock dilution cases*

Table 4: Classification of stock dilution cases (Germany 2004-2006).

Form of dilution	Type of suit	Number	Favorable to minority	Favorable to majority	Outcome unclear
Squeezeout	Valuation	7	3	4	0
	Nullification	8	3	5	
	Preliminary clearance	7	3	4	0
Other merger or restructuring	Valuation	4	1	3	0
	Nullification	3	0	3	0
	Preliminary clearance	2	0	2	0
	Declaratory	1	0	1	0
Creation of contractual group	Valuation	2	1	1	0
	Nullification	1	0	1	0
	Compensation claim by insolvency administrator	1	0	0	1
Exclusion of preemptive right	Nullification	5	1	3	1
	Injunction against authorized issue	1	0	1	0
Total		42	12	28	2

1. Squeezeouts

The sample contains 22 squeezeout cases, all of which involve AGs, 19 of these publicly traded, one not traded and two with unclear trading status. Seven are decisions issued in the procedure where the court only investigates the adequacy of the financial compensation allotted to minority shareholders.²⁰⁷ No bias in favor of either side can be discerned, as in three cases the court decided that the compensation was to be increased. The details of these cases as such are not particularly interesting for our study, as the fact pattern is necessarily always the same. However, it is interesting to note that the courts seem to be taking their job very seriously, discussing valuation methods in great detail. There seems to be

very little reluctance to replace the majority shareholder's judgment (and that of his expert) with that of the court (after hearing more expert witnesses). For example, in a recent case,²⁰⁸ the acquirer had recently submitted a mandatory bid at a price of € 5.29 per share (by means of which he had crossed the 95% threshold required for a squeezeout) and offered the same price in the squeezeout. While the court of first instance had rejected the plaintiff's request to raise the price, the OLG Stuttgart found that € 5.38 was appropriate. Among other things, the court's reasoning rested on a judicial estimate (after gathering various expert opinions) that a risk premium of 4.5% and a beta of 1.2 (based on the risk of the general population of firms listed in the *Neuer Markt*) should be used in the valuation model. Hence, it probably can be said that the "in moderation" thesis does not hold in these cases.

Eight court decisions resulted from suits seeking to nullify the shareholder resolution initiating the squeezeout, three of which went in favor of the plaintiff. The "in style" hypothesis in principle holds here because the law explicitly prohibits nullifications on the basis of inadequate value. Courts have also found repeatedly that the decision to initiate a squeezeout is not abusive as such. Still, three nullification suits were won by the minority. Two cases could be classified as obvious violations of the "in style canon." In one of these two cases, the majority shareholder only exceeded the 95% threshold by borrowing some shares from a third party, which the court considered a circumvention of the law.²⁰⁹ The third decision won by shareholders²¹⁰ also seems to have been the result of an obviously abusive attempt to obtain a special advantage. The majority shareholders first made an offer to buy the minority's stock and then attempted a squeezeout after crossing the 95% threshold. However, at the same meeting where the squeezeout was decided upon, the majority shareholder initiated a resolution to pay a special dividend. This dividend was now to be deducted from the stock price in the calculation of the squeezeout compensation. Minority shareholders were discontent because the expected drop in the stock price was lower than

²⁰⁷ *Supra* sections 2.5.

²⁰⁸ OLG Stuttgart 26.10.2006, 20 W 14/05, NZG 2007, 112.

²⁰⁹ OLG München 23.11.2006, 23 U 2306/06, ZIP 2006, 2370 = DK 2006, 862..

the special dividend itself. The court invalidated all resolutions, finding that the majority had violated its duty of loyalty and gained a special advantage, and it had also violated a voting prohibition (i.e. it would not have been allowed to cast a vote in the shareholder meeting because of the specific conflict of interests).

By contrast, the cases lost by plaintiffs typically discussed whether the squeezeout procedure as such was incompatible with the German constitution (which was unanimously denied), and found that squeezeouts as such were not abusive, thereby ruling out nullification suits. Seven additional squeezeout decisions were issued in the preliminary clearance procedure.²¹¹ Again, there appears to be no obvious bias, with the squeezeout being allowed to be registered in four cases on the grounds that the nullification suits were apparently baseless.

2. Other mergers and restructurings and the integration of firms into contractual groups

Patterns are similar for other parent-subsidary mergers (including the “integration” of a subsidiary into a parent under §§ 319 et seq. AktG, and the integration of a firm into contractual group). All of the merger cases concern AGs, seven of which were publicly traded; two were not, with one company’s listing status remaining unclear. Among the four cases on contractual groups, two involved publicly traded AGs, one an AG with unclear listing status, one a GmbH. Four merger and two contractual group cases were exclusively concerned with valuation, as shareholders requested a better exchange ratio or higher appraisal of their shares. Among all of these, only one merger case was lost by the majority shareholder, i.e. the compensation was considered inadequate by the courts. These cases are very similar in style to the “valuation” cases following squeezeouts.

All three suits seeking to nullify the merger decision and the single contractual group suit were unsuccessful. These cases are also very similar to their squeezeout equivalents.

²¹⁰ LG Frankfurt 12.10.2004, 3-5 O 71/04, DB 2004, 2742 = AG 2005, 545.

²¹¹ *Supra* section 2.2.C.

Maybe the T-Online decision²¹² best summarizes the philosophy behind the law (as applied by the courts). T-Online International AG, which had gone public only a few years earlier, was to be merged into its parent, Deutsche Telekom AG. The OLG Frankfurt explicitly states that the duty of loyalty does not require courts to engage in a detailed substantive review whether a merger is justified, as there are other safeguards. Initiating a merger is, as such, not a violation of the duty of loyalty. Hence, nullification is only possible in exceptional cases.

3. Pre-emptive rights

Six cases concern preemptive rights (five cases of publicly traded AGs and one GmbH case). In five of the six cases, minority shareholders sought to nullify the resolution excluding preemption. In three out of six the plaintiffs lost. In the most interesting case,²¹³ a GmbH with four shareholders was rearranging its capital structure as a result of an extended period of losses. The capital was to be reduced to zero (to eliminate the losses from the balance sheet) and new capital was to be issued.²¹⁴ One of the four shareholders did not want to take his proportionate share, but only part of it, while the other shareholders gave him the option to take either all or nothing (thereby effectively excluding him from the firm). The BGH conceded that the duty of loyalty may require the other shareholders to allow him to take only a smaller amount in the new issue. However, at the time when the minority shareholder brought his suit, the one-month limitation period to nullify the resolution had already expired. Hence, he only could have won if the violation of the law would have so been grave that the decision would have been outright void. The court found that, as a rule, a violation of the duty of loyalty is not necessarily sufficiently severe.

²¹² OLG Frankfurt 08.02.2006, 12 W 185/05, DB 2006, 438 = ZIP 2006, 370 = AG 2006, 249 = DK 2006, 276.

²¹³ BGH 18.04.2005, II ZR 151/03, ZIP 2005, 985 = BB 2005, 1241 = DB 2005, 1267 = WM 2005, 1126 = NZG 2005, 551 = GmbHR 2005, 925.

²¹⁴ Unlike in France and Italy, recapitalizations are not mandatory under any circumstances. However, as described in section 2.1.C, the reduction of legal capital to eliminate balance sheet losses before new capital is paid in is made necessary by the system of legal capital.

3. *Italy*

The Italian search yielded 220 corporate law decisions.²¹⁵ Of these decisions, we ignored 138 that are patently not about self-dealing in light of the maxims. We then collected the remaining 82 decisions and identified 48 court decisions directly or directly involving (alleged) dominant shareholders' self-dealing.²¹⁶ In two instances we have two court decisions for the same case. Therefore the overall number of self-dealing cases is 46.

Of the 46 Italian cases, 38 were brought in civil law courts, and eight were criminal cases (five of them for “fraudulent bankruptcy” and three for “Breach of trust”). Among the civil ones, 21 had (minority) shareholders as plaintiffs, in fourteen it was the company itself that brought suit (or resisted in suits brought against it by third parties), and in three cases the plaintiff was the bankruptcy trustee. A majority of the cases (28) dealt with Srl, while eighteen concerned Spas, of which ten were listed.

Sixteen out of the 38 civil cases were actions challenging the validity of shareholder meeting resolutions. Six out of these sixteen cases involved parent-subsidiary mergers between listed companies. In such cases, minority shareholders also claimed damages related to the allegedly unfair exchange ratio and unsuccessfully tried to block the merger via a court injunction. In six other of these challenges, shareholders asked the judge to declare the invalidity of shareholder meeting resolutions approving, as required by Italian law, annual accounts either for failure to disclose self-dealing transactions (two cases) or for other reasons, in connection with some form of alleged self-dealing (four).

Seven out of the 37 civil law cases were liability suits against directors and one was a liability suit against the voluntary liquidator, with two of these eight suits brought by the

²¹⁵ For search purposes we have identified as corporate law cases those categorized under the subject matter “Società” (Corporation), “Fallimento” (Bankruptcy), “Borsa” (Stock Exchange), “Bancarotta” (Fraudulent Bankruptcy); “Intermediazione finanziaria” (Financial Intermediation); Impresa (Firm); “Liquidazione coatta amministrativa e amm. straordinaria” (special bankruptcy proceedings for banks and other regulated businesses). In doing so, we may have failed to track enforcement actions, whether private or public, in which exclusively procedural issues were decided. However, we have included three decisions reported under different headings but clearly identifiable as corporate law ones. Further, we found one decision that the search did not yield but was published in the relevant law journal together with an almost identical one. We included it as well in the 220-case sample.

bankruptcy trustee, three by minority shareholders and three by the company itself. Of the three cases brought by the minority shareholders, two were rejected for lack of standing to sue,²¹⁷ and the other one, which was against the voluntary liquidator, was rejected on procedural grounds.

In eleven cases it was the company itself that brought suit against third parties or resisted in suits brought by third parties. Invoking a conflict of interest or, more often, the ultra vires doctrine, the company used doctrines against self-dealing to renege on its obligations toward the third party. From the fact patterns of these cases, it is clear that at least in six of them, it was an opportunistic move, while in five it looks like a genuine attempt by the company to invalidate a harmful transaction (although it is unclear in one of the four cases whether the suit was taken after a change in control or following other developments). In one case it was the bankruptcy trustee who brought a similar suit.

Finally, in three cases, the plaintiff shareholder petitioned the court under Article 2409 (inspection following suspicion of serious irregularities).

Interestingly, the total number of cases involving bankrupt companies is not particularly high (eight).

Of the 46 cases, seven were stock dilution ones (the six merger cases and one involving the “recapitalize or liquidate” rule) and the rest are more or less traditional tunneling cases (including three cases dealing with allegedly excessive compensation), with slightly less than half of them (17 out of 39) involving intra-group relationships.

As to the outcomes of the cases, convictions are the rule in the event of fraudulent bankruptcy (five out of five cases) and whenever the plaintiff is a bankruptcy trustee, the plaintiff wins (three out of three). In cases in which companies try to renege on their obligations alleging self-dealing, the outcome of the case is closely related to whether the claim is

²¹⁶ Among the 82 opinions, four report the facts in such a way as to be impossible for the reader to understand whether it was a self-dealing case: we ignored them.

²¹⁷ These two suits, which involved one Srl and one non-listed Spa, were brought before the corporate law reform allowed qualified minorities to bring derivative suits in non-listed corporations. In other words, they were basically desperate suits, in which they plaintiffs either knew they would never win, but wanted at least to ask for a court’s intervention for want of a better remedy or had hired very bad attorneys with no specialization in corporate law.

opportunistic: if it is, the company loses in five out of the six cases,²¹⁸ while in the opposite case it wins four out of five times.

Despite being relatively so common, challenges to shareholder meeting resolutions are far from an easy route: plaintiffs won in five cases and lost in ten, while in the remaining case the Supreme Court referred the case to a lower court instructing it on which facts to find in order to judge on the case. Three of the winning cases involved challenges to resolutions approving annual accounts, with two of them being identical cases pertaining to the annual accounts of two consecutive financial years giving insufficient account of the same transaction with a related company. Almost desperate are suits involving parent-subsidary mergers, in which shareholders won only on the damages claim in just one instance, and lost on all claims in the other five.

Although the number of relevant cases is low, these raw findings already tell a few interesting things about enforcement of self-dealing laws in Italy. First, shareholder litigation in Italy, at least when it involves self-dealing, often takes the form of a challenge to the validity of shareholder meetings resolutions (16 of the 22 suits brought by shareholders were actions of this kind). The fact that until 2004 there was no limit on standing to sue in terms of shareholdings for such suits, while until then minority shareholders had no standing to sue in liability suits (unless, in listed companies, they held 5 percent of the shares) explains this finding and, incidentally, tells much about the impact on minority shareholders' access to justice of the 2003 reform's choice to restrict standing to sue in challenges to the validity of shareholder meetings resolutions.

The relatively high number of cases in which shareholders challenge the validity of

²¹⁸ The sixth case is a highly suspicious one: the Tribunale di Roma (10 Jan. 2001) decided on a case where, in the context of a debt restructuring of the Costanzo group (a large Sicilian construction business often associated with the mafia: see e.g. <http://wikipedia.kataweb.it/wiki/Catania>), Im.It. srl, a company wholly owned by the wife of one of the members of the Costanzo family, following an unanimous resolution by the shareholder meeting, mortgages its real estate (comprising the Costanzos' villas) to the banks involved in the restructuring. Once the debt restructuring is executed, Im.It., after a sale of all its shares to another company (so as to make it less apparent that there was a link btw Im.It. and the Costanzo group) brings suit in order to have the mortgage act declared *ultra vires*. The Rome Court finds for the plaintiff, because Im.It. was not part of the Costanzo group, it being irrelevant that there was a personal relationship between the sole shareholder

shareholder meeting resolutions approving annual accounts is also impressive. This is the clearest case of what one of us has elsewhere dubbed as “ostensible” shareholder litigation, that is, suits by which shareholders, “lacking the standing to ask a court to judge the specific behavior that purportedly harmed them, ... challenge other courses of action or decisions,” thus hoping “to strengthen their bargaining position against insiders.”

of Im.It. and the Costanzo group: banks should have known that such a personal relationship was not enough to exclude *ultra vires*.

A. *Most relevant tunneling cases*

Table 5: Classification of tunneling cases (Italy 2000-2006; opportunistic claims of self-dealing by the company itself in order to renege on its obligations – six cases – are omitted).

	Type of suit	Main doctrine	Total	Favorable to ²¹⁹		
				Minority ²²⁰	Majority ²²¹	Unclear
Non-insolvent company	Nullification of shareholder resolution	Conflict of interest/abuse of majority	6	1	4	1
		Violation of substantive corporate law provisions	3	2	1	0
		Shareholder's right to information/other rules on shareholder meeting	0	0	0	0
	Claim to restitution/nullification of contract by company	Agent's conflict of interest/Ultra vires doctrine	4	3	1	0
	Company's liability suit against director	Director's duties	3	1	2	0
	Derivative suit	Directors' duties	2	0	2	0
	Liability toward shareholders	Directors' duties	1	0	1	0
	Petition for inspection (Article 2409)	Not applicable	3	1	2	0
	Criminal prosecution	Disloyalty (Breach of trust)	3	2	1	0
		Total		25	10	14
Insolvent company	Criminal prosecution	Fraudulent bankruptcy	5	5	0	0
	Liability claim against directors/parent/parent's directors	Directors' duties	2	2	0	0

²¹⁹ Cases are classified as favoring the minority when the minority's victory is affirmed by the highest court decision available, or when the case is remanded, but given on the basis of the higher court's reasoning, an outcome favoring the minority seems most likely.

²²⁰ Or prosecution, or other person or entity seeking to challenge self-dealing.

²²¹ Or other person controlling the company and allegedly engaging in self-dealing.

	Claim to restitution/nullification of contract by company	Ultra vires doctrine	1	1	0	0
	Total		8	8	0	0

Even in cases to be decided under the rules in force prior to the introduction of special rules on groups in 2003, Italian judges tend to distinguish between generic self-dealing and intra-group transactions, and, paying lip service to leading legal scholars' view on corporate groups, seem to be ready to reserve a better treatment to the latter. Whenever self-dealing takes place between a company and a third company that is connected with shareholders of the former, either following the defendants' arguments or spontaneously, courts are keen to engage in a discussion of how being part of a group may justify entering into transactions that, individually taken, are harmful to the corporation, but beneficial to the whole group. In the words of the Italian Supreme Court, courts should not evaluate such transactions "in isolation;"²²² instead, they should evaluate them "in a more general context allowing to take into account the effects that each transaction can have on the overall economy of the relevant set of companies."²²³ However, *per se* harmful transactions can only be justified if a benefit to the individual company can be identified, that follows from the overall benefits that the transaction has brought to the whole group, as the Supreme Court has clarified in a leading case that first acknowledged that directors owe a duty of loyalty to their corporation.²²⁴

In that case, Scotti Finanziaria S.p.a. sued former directors for damages deriving from a number of transactions from which the controlling company and other companies controlled by the same had profited. The Milan Tribunal and Appeals Court had rejected the plaintiff's demand.

The plaintiff's appeal to the Supreme Court specifically addressed the sale by Scotti of a 100 percent shareholding in Arvedi to another company for approximately 100,000

²²² See e.g. Cass. 26 September 2005, No. 18792.

²²³ *Ibid.*

euro. A few months before the sale Scotti had sold to Arvedi real estate property for approximately 30 million euro, a sum that had only been paid in small part. The remaining credit toward Arvedi had been used to guarantee loans granted to the parent company and other companies of the same group. Subsequently, Arvedi had gone bankrupt, and therefore, as the plaintiff company argued, the final outcome had been that the company had been stripped of a huge real estate receiving almost nothing in exchange.

The Court found that there appeared to have been a breach of the duty of loyalty by the director who structured the transaction. While recognizing that intra-group transactions which are per se harmful to the corporation but beneficial to the group as a whole can be legal (i.e. give rise to no directors' liability for damages) if the individual company can derive a compensatory advantage from "its being part of the group" and more precisely from "the positive effects ensuing from the company's taking part to the advantages that the transaction has brought to the group as a whole," it also argued that the burden of proving such advantage is on the defendant director and that in the specific case no such evidence had been offered by the defendant, because the guarantees had benefited the parent company and other companies in the group, while no evidence whatsoever had been provided of how Scotti had profited from such guarantees.

The Supreme Court also criticized the appellate court decision's argument that the plaintiff had failed to show that "the sacrifice imposed [on Scotti] would be unjustified, in that it would not be connected with the expectation of some future benefit."²²⁵ The Supreme Court clarified that the burden of proving that a per se harmful transaction would be justified under the theory of compensatory advantages is upon the defendant and that such advantages cannot be presumed even within groups.²²⁶

Interestingly, only one case in the sample appears to have sanctioned self-dealing transactions based on the group defense, but it was a case in which it was far from evident

²²⁴ See Cass. 24 August 2004, No. 16707.

²²⁵ *Ibid.*

²²⁶ *Ibid.*

that the relevant intra-group transactions had damaged the company.²²⁷

The case law in the sample is even less ambiguous in constantly rejecting the idea of justifying self-dealing transactions based on the group defense in the context of bankruptcy. The Zimo Explor case decided by the Milan Tribunal is telling in this respect.²²⁸ Zimo Explor srl, a captive subsidiary that sold its products exclusively to the parent (Chemetron), went bankrupt. For various years it had kept carrying out its business thanks to annual accounts recording inexistent assets (thus concealing the complete loss of its capital) and thanks to the parent's providing of the funds needed to carry out business. The bankruptcy trustee sued not only Zimo Explor's former directors for failing to liquidate the company when it lost its capital (thus increasing the company's losses and, hence, liabilities), but also Chemetron and its directors for the abuse of their unitary management of the two companies. The Court upheld the liability claim against Chemetron and its directors, holding that they had abused their supremacy powers vis-à-vis the subsidiary's directors by inducing them not to liquidate the company after the company had lost its capital. The opinion contains five pages discussing groups of companies, the relevant case law and the related scholarship. The Court paid lip service to the theory of compensatory advantages, albeit specifying that such advantages have to be real and not just hypothetical, but held Chemetron and its directors liable, since they had known about the subsidiary's financial troubles, and nevertheless had kept it alive (by providing it with the occasional funds needed to prosecute its activity) "with the sole purpose of obtaining a product that [Chemetron] could sell on the market, while not caring at all about the subsidiary's interests, and therefore negatively affecting its creditors."²²⁹

Similarly, four of the five cases dealing with the fraudulent bankruptcy crime explicitly deny that any group defense can apply with reference to such a crime, despite the fact that one of the hypotheses of "fraudulent bankruptcy" is described by the law as "causing the company's bankruptcy by" engaging in behavior that would otherwise fall under Article

²²⁷ App. Milano, 30 March 2001.

²²⁸ Tribunale Milan, 22 January 2001.

²²⁹ *Ibid.*

2634 of the Italian Civil Code (breach of trust), which exculpates directors acting in the interest of the group.²³⁰ Since Article 2634 entered into force in 2002 defendants in fraudulent bankruptcy cases have of course tried to argue that no fraudulent bankruptcy crime can be committed if the group defense applies. Courts have never accepted this defense,²³¹ although the Supreme Court appears to have recently taken a step in this direction.

So for instance in a 2002 case the Supreme Court held that the group defense cannot be used in the context of a fraudulent bankruptcy trial, because the link between the different companies in the group “is merely economic in nature and does not affect the principle that each company is an autonomous entity.”²³² Similarly, in a 2003 case the same Court stated that “once a company goes bankrupt, the only issue is creditor protection, because the group phenomenon does not affect the principle of legal personality (‘autonomia soggettiva’) of each company belonging to the group.” The only partial exception to this kind of holdings is a 2004 case in which the Supreme Court rejected on factual grounds the defendant’s argument that the two companies were part of the same group and that his behavior was justified from the point of view of the overall group’s interest. However, the Court also states *obiter* that it might have decided differently, if the same actions had been taken by a holding company exercising “direction and coordination” over the various entities of the group.

That creditor protection issues tend to prevail on considerations relating to group structures and policies was also made clear by the Supreme Court case deciding on an *ultra vires* claim brought against a bank by a bankruptcy trustee of a company which had guaranteed the debt owed to that bank by another company belonging to the same group.²³³ While recognizing that the two companies were part of the same group, with one distributing the other’s products, the Court applied the *ultra vires* doctrine in a very formalistic way, stating that an act can be *ultra vires* despite its being in the interest of the company, if the act has

²³⁰ See *supra* note ??? and corresponding text.

²³¹ See Cass. (Criminal) 1 July 2002; Cass. (Criminal) 24 April 2003; Cass. (Criminal) 5 June 2003; Trib. Piacenza, 18 May 2004; Cass., 18 November 2004.

²³² Cass. (Criminal) 1 July 2002.

²³³ Cass. 21 November 2002, No. 16416.

connection with a company's own activity as defined in the corporate articles of association.²³⁴

B. Most relevant stock dilution cases

Table 6: Classification of stock dilution cases (Italy 2000-2006).

Form of dilution	Type of suit	Number	Favorable to minority	Favorable to majority	Outcome unclear
Mergers	Nullification/damages	6	1	5	0
Recapitalize or liquidate rule	Nullification	1	1	0	0
Total		7	2	5	0

Until the 2003 corporate law reform restricted rules on standing to sue, one class of self-dealing transactions that minority shareholders of Italian listed corporations were able to challenge in court was parent-subsidary mergers. Since the merger has to be approved by the shareholder meeting, minority shareholders may challenge the validity of the resolution (trying to obtain an injunction against the merger before it has been executed by depositing the merger act in the companies register) and claim damages deriving from an unfair exchange ratio. In the past they have often done so, as the sample of Italian cases also shows.

The case law on this subject, with the exception of a Milan Tribunal decision finding in favor of the plaintiff and the Court of Appeals decision upholding that opinion,²³⁵ shows that Italian courts appear to use a lenient standard in the evaluation of procedural fairness issues, and far from ready to aggressively review the mergers terms on substantial fairness grounds. What is most striking about the cases is that Courts appear mostly indifferent to the fact that they are dealing with parent-subsidary mergers as opposed to mergers between independent parties.²³⁶

In the merger case involving Banca Toscana (the listed parent) and Banco di Perugia

²³⁴ *Ibid.*

²³⁵ Trib. Milano, 2 November 2000; App. Milano, 23 May 2003.

(the listed subsidiary),²³⁷ some minority shareholders of Banco di Perugia challenged the validity of the resolution approving the merger and at the same time asked for damages, alleging, *inter alia*, that the market share price had been ignored in determining the exchange ratio, that the exchange ratio should be rigorously reviewed by the courts in the event of a parent-subsiary merger and that the parent had voted in favor of the merger, thereby breaching Article 2373 of the Italian Civil code which prevents shareholders from voting whenever they have a conflict of interest with their corporation. The lower courts found against the plaintiffs.

In reviewing the case, the Supreme Court:

(i) finds that the Appeals court did not err in judging that the exchange ratio could not be reviewed by the court other than to found a judgment of “patent arbitrariness or deception to detriment of the minority.”²³⁸ In fact, the subsidiary had followed all the prescribed procedural requirements under Italian law, including a fairness opinion by an expert (an audit firm) appointed by the court, which happened to provide a joint fairness opinion for both the parent and the subsidiary, as permitted under Italian law (the Court finds nothing objectionable in this). Further, in order to found an arbitrariness or fraud on the minority claim, the court noted, it is not enough to state that the average market prices of the merging companies' shares had been ignored: the plaintiffs should have identified the precise methods and criteria that were used by the merging companies and the specific reasons for their unreasonableness. Since the law does not specify what criteria should be used in order to determine the exchange ratio, this is left to the directors' discretion and the court can only review the shareholder meeting resolution approving it if it is *arbitrary or based upon false or incomplete information*, which was not the case here;

(ii) holds that no conflict of interest between a shareholder and the corporation can exist with regard to the resolution approving a merger, because a conflict of interest is only relevant, according to Article 2373 of the Civil code, if the resolution may cause damage to

²³⁶ See e.g. Trib. Roma, 12 October 2001.

²³⁷ Cass. 11 December 2000, No. 15599.

²³⁸ “[E]vidente arbitrarietà o fraudolenza in danno dei soci di minoranza.” *Ibid.*

the corporation, which is not the case in a merger (basically, because the transaction is neutral to the corporation's assets).

Similarly, the Milan Court of Appeals found against the plaintiff who had challenged a parent-subsiary merger.²³⁹ The Court argued, first, that the procedural steps required by the law to approve a merger had been properly taken: in doing so, it gave no weight to the fact that the subsidiary's resolution had been taken by the parent's vote. Second, it argued that no conflict of interest between the parent and the subsidiary can occur in a merger, because the conflict is between majority and minority shareholders, while their personal relationships are indifferent to the corporation itself.

Finally, in another similar case,²⁴⁰ the holder of non-voting preference shares had challenged the validity of the resolution approving a merger alleging, *inter alia*, that the exchange ratio was unreasonable and arbitrary and asked for a damages award. The Court rejects the plaintiff's claim, finding that the plaintiff's argument that the exchange ratio had been based on "highly disputable criteria," i.e. on stock exchange prices during the three-month period prior to the boards decision to merge was too generic to provide "a well-grounded and reasoned critique of the sophisticated, well motivated exchange ratio criteria used by the merging companies." Possibly, the plaintiff's demand was poorly grounded, but this case also shows how burden of proof and fact-pleading (as opposed to notice pleading) can make challenges of merger resolutions difficult for minority shareholders. It is also interesting that the Court, contrary to German courts' practice, appointed no expert to evaluate the exchange ratio's fairness, as it might have done, according to Italian civil procedure rules, even in the absence of a demand by the parties.²⁴¹

Only one case²⁴² in the sample deals with an abuse of the recapitalize or liquidate rule.²⁴³ On October 12, 1995 Immobiliare Isabella's board resolved to anticipate the end of financial year from December 31 to September 30, at a time when the company's legal

²³⁹ App. Milan, 18 January 2001.

²⁴⁰ Trib. Milano, 8 July 2004.

²⁴¹ Article 61, Italian Civil Procedure Code.

²⁴² App. Milano, 18 April 2000.

²⁴³ See *supra*, section ###.

capital had been totally lost. On the next day, the company sold real estate for amounts that solved the financial troubles of the company. On December 4, the general meeting was convened to approve annual accounts and to recapitalize the company after reducing capital to zero to wipe out losses. In that occasion, not only no mention was made of the sale during the meeting, but notice of the meeting had been sent to one of the shareholders at an address where he clearly could not receive it (in fact, he was absent from the meeting).

A minority shareholder challenges validity of the resolution approving annual accounts and of the resolution to recapitalize the company, the latter as contrary to good faith and as an abuse of majority powers. The Appellate Court finds that the resolution was indeed taken with abuse of majority powers, showing that while each of the acts undertaken by the board was legal *per se*, taken together those acts clearly showed the intent to exclude the minority shareholder without even having to pay a fair price for his shares as it would be the case in a squeeze-out procedure.

5. Discussion of findings

Table 7: Identity of plaintiffs by country

	France	Germany	Italy
Minority shareholder	27	42	21
Company	2	2	14
Bankruptcy liquidator	4	6	3
Criminal prosecutor	2	3	8
Creditor	0	1	0
Alleged self-dealer	0	1	0
Unclear	1	0	0

1. Actions and remedies

The first important lesson we can learn from the comparative study of case law is that the remedies used against self-dealing are very different from the ones used under US law. Derivative suits are uncommon in Germany, France and Italy. There are various institutional factors discouraging them, such as percentage requirements and the risk of having to bear the defendant's legal expenses.

The single most important action used in all three countries is the suit to nullify shareholder resolutions. Continental European legal scholars have of course always been aware of the importance of these actions, which the comparative debate has however neglected.

There are three main reasons for the popularity of nullification suits. First, with the exception of France, derivative suits have traditionally required plaintiffs to exceed certain percentage limits.²⁴⁴ Such a requirement has not existed for nullification suits in any of the three countries until recently and was introduced only in Italy in 2003.²⁴⁵ An additional reason in Germany may have been that rules relating to costs are favorable to this type of suit. The law gives the courts broad discretion to specify the amount in dispute in a nullification suit, which may only exceed 10% of the firm's capital or € 500.000 if the dispute is of great importance to the *plaintiff*.²⁴⁶ The amount in dispute determines to what extent the losing party may be held to pay court fees and costs incurred by the opponent which is why a low amount is favorable to plaintiff shareholders.²⁴⁷

Second, the defendant in a derivative suit (as provided by the respective statute)²⁴⁸ is a director, who may or may not be the controlling shareholder herself. Otherwise, a derivative suit may not even be available, unless shadow directors doctrines or provisions can apply to the specific circumstances of the case. In corporate governance systems characterized by concentrated ownership, the potential wrongdoer is not primarily the director, but the controlling shareholder, who may use her voting power or her influence over the company's management to the detriment of the minority. Although technically the defendant in a nullification suit is the corporation, the actual target in such a suit is the majority share-

²⁴⁴ *Supra* section 2.2.A.

²⁴⁵ *Supra* section 2.2.C.

²⁴⁶ AktG § 247(1). § 247(2), which creates further benefits for parties whose economic position would be severely strained by a high amount in dispute, is only rarely used. See Theodor Baums, *Die Prozeßkosten der aktienrechtlichen Anfechtungsklage*, in Festschrift für Marcus Lutter zum 70. Geburtstag 283, 298 (Uwe H. Schneider, Peter Hommelhoff, Karsten Schmidt, Wolfram Timm, Barbara Grunewald & Tim Drygala eds. 2000) (explaining that courts typically use their discretion under § 247(1) to specify relatively low amounts in dispute).

²⁴⁷ See Baums, *id.* (criticizing that the current regime creates incentives for abusive suits).

²⁴⁸ *Supra* section 2.2.A.

holder. A suit that typically blocks a self-dealing transaction with a controlling shareholder is maybe the most obvious remedy in such a situation. It has already been astutely observed that suits aiming at a direct influence on corporate conduct, as opposed to suits aiming at cash payments, can be considered as an element of corporate governance systems characterized by explicit corporate control exerted by large shareholders, like the one predominant in continental Europe.²⁴⁹

Third, as we noticed in part 2, challenges to the validity of shareholder resolutions can be used as a bargaining tool against the company and its dominant shareholders: the risk that important transactions are blocked following a court order requiring directors not to execute the transaction may prompt the company or the dominant shareholders to make concessions to the minorities.²⁵⁰

However, the availability of the nullification remedy hinges on whether a transaction needs to be submitted to the shareholder meeting at all. In the three countries studied, all changes to the corporate charter require shareholder approval, including mergers,²⁵¹ split-ups and the increase or decrease of capital, which minority shareholders sometimes seek to invalidate. However, particularly in AGs, SAs and SPAs, less severe problems of self-dealing may simply stay below the radar screen because no shareholder approval is required. As indicated by the German *Holz Müller* doctrine, which has been narrowed by the courts in recent years,²⁵² specific changes in the law and the corporate charter can make an important difference here. As shown by the large number of cases in Italy where the minority challenged the validity of annual accounts, and by one German case where minority shareholders attempted to nullify the (relatively unimportant) “discharge” of directors in the shareholder meeting, shareholders may have to resort to “ostensible shareholder litiga-

²⁴⁹ Dirk Zetzsche, *Explicit and Implicit Systems of Corporate Control – A Convergence Theory of Shareholder Rights*, CBC RESEARCH PAPER 0001 (9_2004) 28, 49-51, available at <http://ssrn.com/abstract=600722>.

²⁵⁰ For this reason, as shown by recent legislative reforms in Germany and Italy (*supra* section 2.2.C), there have been efforts to screen out abusive suits that allegedly had as their main purpose to blackmail the company. However, it is not entirely unlikely that some of these reforms were motivated not so much by the desire to improve corporate governance, but rather by blockholders’ and managers’ rent-seeking.

²⁵¹ The same is true for squeeze-outs in Germany.

²⁵² *Supra* section 4.2.B.1.

tion”²⁵³ in order to obtain more bargaining power as long as the law does not permit them to directly tackle self-dealing. Still, the claim that German law provides almost no tools to enforce provisions against self-dealing²⁵⁴ is not supported by our analysis.

Besides nullification suits, there are also situations where shareholders brought other suits in tunneling, including derivative suits, although in our sample these were less successful. Furthermore, the French and Italian samples include some “exploratory” suits where minority shareholders petitioned the court to appoint an independent expert, with a view to finding evidence about self-dealing transactions.

Other than that, there is some justification for the thesis that enforcement against tunneling rests either on the company itself, particularly in a change in control (as shown by some cases in all three countries), on suits by the insolvency administrator, and on criminal prosecution. While our sample includes only a few criminal cases for Germany and some for Italy (both inside and outside of insolvency), there is quite a large number of criminal cases relating to the “abuse of corporate assets” crime in France outside bankruptcy. Quite obviously, these can be attributed to the possibility for shareholders to initiate criminal proceedings.²⁵⁵ The investigative powers of the *juge d’instruction* create a functional equivalent for the American discovery procedure, as they also make it possible that evidence is brought to light that leads to punishment of self-dealing.

For France, there are very few cases of suits on Article L. 225-38 of the French Commercial code, which imposes the approval of the board of directors before entering in certain types of self-dealing transactions. There are two possible explanations for the paucity of such cases, which are possibly cumulative. The first, optimistic explanation is that majority shareholders are deterred from entering into such contracts by fear of a refusal of the board of directors or disclosure to the shareholders. The second, more skeptical explanation is that those provisions are, in practice, strictly construed, so that a number of related-party transactions are entered into without complying with them and hence not even properly dis-

²⁵³ *Supra* section 4.3.

²⁵⁴ Hertig & Kanda, *supra* note 99, at 130.

²⁵⁵ *Supra* section 2.3.

closed to shareholders.²⁵⁶

With respect to stock dilution cases, the picture unearthed by our study is very different for each of the three countries. In France and Italy, courts appear to be very hesitant to second-guess the fairness opinion provided by the expert appointed by the majority shareholder. In Germany, while the law and the judicial practice strongly restrict nullification suits in these transactions, the courts charged with the task of evaluating the exchange ratio or the compensation received by minority shareholders in a squeezeout take their job very seriously, frequently finding in favor of the minority after an extremely diligent discussion of what valuation methods are appropriate. The same can be said about tunneling cases where the main issue is valuation. Other than Italian courts, German courts apparently do not hesitate to commission independent expert opinions (as opposed to fairness opinions provided by the company).

2. What about our hypotheses?

Our analysis aimed not only to find out which remedies and doctrines are used and how successfully, but also, and more ambitiously, to test three hypotheses on self-dealing enforcement in continental Europe: first, that courts only strike down extreme cases of private benefits extraction; second, that courts tend not to engage in substantive fairness review as long as (overall) lenient procedural fairness provisions are complied with; and finally that the two hypotheses do not hold in case of bankruptcy or when a company is in financial trouble, because courts tend to be more severe in such instances.

A. “*Moderation.*” As to the “moderation” hypothesis, we should first acknowledge that it is a hard one to operationalize and to falsify. However, the findings somewhat lend themselves to confirm it in part.

First of all, we have seen that in all three countries the most popular remedy is nullification of shareholder meeting resolutions. Shareholders have decision-making powers in corporations (at least in SA, SPA and AG), that are generally restricted to governance is-

²⁵⁶ Cf. Luca Enriques, *Book Review: The Comparative Anatomy of Corporate Law*, 52 AM. J. COMP. L. 1011, 1031-32 (2004) (describing how such provisions are strictly construed in practice). *See also*

sues and to corporate decisions that are “large relative to the value of the company.”²⁵⁷ Hence, this is the kind of decisions that courts will come to review. Conversely, since derivative suits are so rare in the three countries, “day-to-day” self-dealing transactions falling under the board’s or even the executives’ powers will rarely come to the courts’ attention.

In France, most cases of abuse of corporate assets involving self-dealing involved rather significant amounts. This seems to confirm the “moderation” hypothesis.

However, German courts are willing to perform a detailed substantive review in some non-insolvency tunneling cases, even where the theft is not excessive (as for instance in the case on GmbH managerial compensation²⁵⁸). Further, with respect to German stock dilution cases, the hypothesis seems to be falsified. The judicial procedure to set the exchange ratio or compensation in a squeezeout, especially in squeeze-outs, often yields results that are favorable to minority shareholders. Relying on expert witnesses, courts take their job of evaluating the exchange ratio or the compensation for squeezed-out minority shareholders very seriously.

This is definitely not the case in Italy, as we have seen: Italian courts are far from tough in judging fairness of the exchange ratio in parent-subsidary mergers. In France, the extremely low number of cases of this kind (two) seems to be telling in this respect.

B. “Do it in style.” The second hypothesis seems only to be confirmed for Italian merger cases. But for these, there seems to be no evidence that courts tend to defer to dominant shareholders decisions whenever they are taken in accordance with procedural rules or whenever they take the form of intra-group transactions. Even in Italy, despite legal scholars’ insistence on how groups are special and the lawmaker’s choices in the same direction in 2003, (Supreme Court)²⁵⁹ judges still appear to do no more than paying lip service to the idea that intra-group transactions should be treated more leniently. However, the

DOMINIQUE SCHMIDT, *LES CONFLITS D'INTERETS DANS LA SOCIETE ANONYME* 120-21 (2d ed. 2004) (same).

²⁵⁷ See Rock, Kanda & Kraakman, *Significant Corporate Actions*, *supra* note 129, at 131.

²⁵⁸ See note 185 and accompanying text..

²⁵⁹ The lower courts’ decisions in the Scotti case (see *supra* note ### and corresponding text) are quite telling of a tendency indeed to be lenient in the case of intra-group transactions, which however the Supreme Court has clearly distanced itself from.

chances are high that once cases are to be decided under the new rules,²⁶⁰ courts will take a more lenient approach (although the new law would still allow them to be rigorous in judging intra-group transactions).

In France, compliance with the procedural rules provided for self-dealing transactions in the Commercial Code is no defense in criminal law proceedings for abuse of corporate assets. Interestingly, there is only one case in the sample discussing the *Rozenblum* doctrine and rejecting its application to the case, which should mean that the group defense in abuse of corporate assets cases is not that frequently used (although it might also mean that, since investigating judges follow such doctrine, prosecutions are not even brought for intra-group transactions).

Finally, German courts clearly do not satisfy themselves with procedural fairness. They do engage in a substantive fairness review, often relying on the judgment of court-appointed expert witnesses.

C. Bankruptcy. Although our findings will have to be confirmed statistically [which we plan to do at a later stage], they do suggest that dominant shareholders engaging in self-dealing are more likely to lose in court or be punished in the event of bankruptcy. In fact, the “minority” success rate in cases involving bankrupt companies is much higher than for other companies. Further, both in France under the *Rozenblum* doctrine and in Italy according to cases in the sample, no group defense is available to dominant shareholders in criminal as well as in civil cases, if the company is bankrupt. In spite of the relatively strict substantive review, the problem in German AGs seems to be that there may be relatively little enforcement outside bankruptcy against tunneling, either because many self-dealing transactions stay below shareholders’ radar screen or because there are various legal and institutional factors hampering lawsuits.

6. Conclusion

This paper has provided an analysis of how the law in action treats self-dealing by

²⁶⁰ See *supra* section ###.

dominant shareholders in the three main continental European jurisdictions. After identifying all the possible standards, rules, doctrines, remedies and sanctions that may apply to self-dealing in the three countries, using some popular case law databases we have identified 146 self-dealing cases in the three countries. This has allowed us to highlight what enforcement tools are most used in practice and how successfully.

One of the most important remedies in all three countries is the suit to nullify shareholder resolutions. The problem with relying so much on this remedy appears to be that tunneling transactions that are not subject to a shareholder vote rarely enter shareholder's field of vision and are often hard to challenge. This is normally not a problem in stock dilution cases.

Our findings confirm only in part the substantive hypotheses we had in mind in analyzing the case law. The kind of suits that are most often brought (nullification of shareholder resolutions in all three countries, with derivative suits very rarely brought) implies that the self-dealing transactions courts deal with tend to be those that have to be brought to a shareholder vote under the domestic company laws, and therefore sizeable. Similarly, the other widely used enforcement tool in France is the abuse of corporate assets crime, which also seems to imply serious cases of self-dealing. However, German courts tend to review merger and squeeze-out transactions for substantial fairness in quite a strict way, which is inconsistent with the hypothesis.

Our analysis mainly belies the idea that courts tend to defer to corporate insiders as long as procedural rules are complied with or in case of intra-group transactions. It only seems to be confirmed for merger cases in Italy and possibly for similar cases in France. Otherwise, in all countries courts tend to engage in substantial fairness review despite compliance with procedural rules. However, in contrast with Delaware courts' case law,²⁶¹ at least in France and in Italy courts appear to require nothing more than compliance with (overall) lenient procedural rules in judging procedural fairness.

Finally, our analysis confirms that courts are inclined to be more rigorous with regard

²⁶¹ See e.g. *Gesoff v. IIC Industries Inc.*, 902 A.2d 1130, 1148-52 (Del. Ch. 2006).

to self-dealing occurring in companies that have subsequently gone bankrupt, reasonably reflecting a still diffused creditor-oriented, stakeholder approach to corporate governance issues.

APPENDIX 1: SEARCH TERMS

1. FRANCE

1. abuse of majority (*abus de majorité*);
2. derivative action (*action sociale ut singuli*);
3. section L. 225-38 of the Commercial code (section which subjects certain self dealing contracts in a *Société anonyme* to the authorization of the board of directors);
4. section L. 225-42 of the Commercial code (section which prohibits certain self dealing contracts in a *Société anonyme*);
5. preemptive rights;
6. section L. 225-231 of the Commercial code (section which allows a minority shareholder to have a court appointed expert in a *Société anonyme*);
7. section L. 223-37 of the commercial code (section which allows a minority shareholder to have a court appointed expert in a SARL);
8. management mistake (*faute de gestion*), since self-dealing can be sometimes qualified as a management mistake;
9. merger;
10. share buy-back;
11. squeeze-out;
12. personal bankruptcy (*faillite personnelle*) and management disqualification (*interdiction de gérer*). For both term, the word embezzlement (*détournement*) was added as a research term in order to identify specifically cases where self-dealing could have occurred. This is necessary since these sanction can also apply for situation where there is no self dealing such as failure to

keep accounts;

13. abuse of corporate assets (*abus de biens sociaux*);

14. fraudulent bankruptcy (*banqueroute*). For this latter search term, the word embezzlement (*détournement*) was also added as a research term in order to identify specifically cases where a self-dealing could have occurred.

2. GERMANY

1. Text (*Treupflicht* oder *Treuepflicht*) und Norm (AktG oder GmbHG) [duty of loyalty]
2. norm(57 AktG oder 30 GmbHG) [concealed distribution]
3. norm(147 AktG) [derivative suit against director]
4. text("actio pro socio") und norm(AktG oder GmbHG) [derivative suit]
5. Norm[266 StGB und (AktG oder GmbHG)] [criminal disloyalty]
6. text(*Sonderprüfer*) und norm(AktG oder GmbHG) [appointment of special auditor]
7. Text([*Vorstand* oder *Geschäftsführer*] und *Abberufung* und *wichtiger Grund*) und Norm (AktG oder GmbHG) [removal of manager/director for cause]
8. Text([*Austritt* oder *Ausschluss* oder *Auflösung*] und *wichtiger Grund*) und Norm (AktG oder GmbHG) [exit/expulsion for cause]
9. Norm(§ 53a AktG) [equal treatment of shareholders in AG]
10. Text(*Gleichbehandlung*) und Norm(GmbHG) [equal treatment of shareholders]
11. Text (*Konzern*) und Norm (AktG oder GmbHG) [corporate groups]
12. Text (*Bezugsrecht* und *Ausschluss*) und Norm (AktG oder GmbHG) [exclusion of preemptive rights]
13. Text (*Abhängigkeitsbericht*) [dependency report]
14. Norm (71 AktG oder 71a AktG oder 71b AktG oder 71c AktG oder 71d AktG oder 71e AktG) [share repurchase]
15. Norm (283 StGB oder 283a StGB oder 283b StGB oder 283c StGB oder 283d

StGB [criminal bankruptcy]

16. Norm (AktG 120 oder GmbHG 46) [discharge of directors/managers]
17. Norm (AktG 136); Norm (GmbHG 47 Abs 4) [violation of voting prohibition]
18. Text (*Missbrauch* und *Mehrheit*) und Norm (AktG oder GmbHG) [abuse of majority – included to align search with Italy and France]
19. Norm (AktG und § 93 oder 116); Norm (GmbHG 43) [liability of managers / directors]
20. Text (*faktischer Geschäftsführer*) und Norm (AktG oder GmbHG) [de facto manager]
21. Text (*Interessenkonflikt* und *Beherrschung*) und norm (AktG oder GmbHG) [conflict of interest and control – included to align search with Italy and France]
22. Text (*Verschmelzung Untauschverhältnis Konzern*) und norm (AktG oder GmbHG) [merger, exchange ratio, group – included to align search with Italy and France]
23. Norm (§ 117 AktG) [abuse of influence on corporation]

3. ITALY

1. Article 1394 Civil Code (transactions in which the agent has a conflict of interest) and (socio (close to) controllo) or gruppo?
2. Article 2373 Civil Code (Shareholders' conflict of interest in the shareholder meeting).
3. Abuso (close to) maggioranza:
4. Abuso and voto (under the heading "Società"):
5. Article 2395 Civil Code (actio uti singuli).
6. Article 2391 Civil Code (Directors' conflict of interests)
7. Article 2388 Civil Code (Invalidity of board resolutions)
8. Article 2392 Civil Code (directors' duties) and (socio (close to) controllo) or groups
9. Article 2393 Civil Code (non-derivative liability suit against directors) and

- (socio (close to) controllo) or groups
10. Article 2393-bis Civil Code (derivative liability suit against directors) and (socio (close to) controllo) or groups
 11. Amministratore di fatto (shadow director)
 12. Article 2409 Civil Code (appointment of special investigator) and (socio (close to) controllo) or groups
 13. Article 2634 Civil Code (Infedeltà patrimoniale, i.e. Untrue: criminal provision)
 14. Article 146 Bankruptcy Law (liquidator's action against directors) and groups
 15. Article 223 Bankruptcy Law or "Bancarotta fraudolenta" and Article 2634
 16. Article 223 Bankruptcy Law and "gruppi"
 17. Conflitto d'interessi and gruppi
 18. Conflict of Interest and Control and Corporation.
 19. Good faith and (maggioranza or control) and corporations
 20. Merger and exchange ratio or gruppi (for parent/subsidiary mergers)
 21. Diritto d'opzione (on the exclusion of pre-emption rights in new issues of shares)
 22. Company's object ("oggetto sociale")
 23. Intra-group transactions
 24. Lealtà and amministratori
 25. Fedeltà (close to) Dovere (Duty of Loyalty) restricted to cases relating to companies.
 26. Art. 2433 (on distributions to shareholders)
 27. Art. 2343-bis (on asset purchases from shareholders)
 28. Art. 2357 (on buybacks)
 29. Actio pro socio
 30. "Amministratore giudiziario" (court-appointed administrator) restricted to cases relating to companies.
 31. Amministratore and revoca "and giusta causa" restricted to cases relating to companies.

32. Esclusione and “giusta causa” restricted to cases relating to companies.
33. Parità di trattamento and soc? (Equal treatment and companies or shareholders)
34. Article 92, Consolidated Act on Financial Intermediation (Draghi Law): equal treatment of security holders of listed companies.
35. Grupp? (groups).

APPENDIX 2: Cases included

1. France

Cour de cassation, Commercial Chamber, November 30, 2004
Cour de cassation, Commercial Chamber, February 28, 2006
Court of appeals of Versailles, January 27, 2005
Riom Court of appeals, September 20, 2006
Rouen Court of appeals, September 21, 2006
Aix-en-Provence Court of appeals, November 17, 2006
Paris Court of appeals, July 6, 2006
Paris Court of appeals, October 3, 2006
Aix-en-Provence Court of appeals, April 5, 2005
Aix-en-Provence Court of appeals, May 5, 2006
Court of appeals of Versailles, June 20, 2006
Court of appeal of Paris, March 2, 2004
Cour de cassation Commercial Chamber, June 28, 2005
Rouen Court of appeals, July 6, 2004
Paris first degree commercial court, September 12, 2006
Cour de cassation, Commercial Chamber, January 25, 2005
Court of appeals of Versailles, December 16, 2004
Lyon Court of appeals, October 14, 2004
Cour de cassation, Commercial Chamber, July 11, 2006
Cour de cassation, Commercial Chamber, September 21, 2004

Cour de cassation, Commercial Chamber, March 10, 2004
Paris Court of appeals, March 28, 2006
Cour de cassation, Commercial Chamber, December 12, 2006
Paris Court of appeals, November 8, 2006
Paris first degree commercial court, June 20, 2006
Cour de cassation, Commercial Chamber, September 19, 2006
Paris Court of appeals, June 22, 2005
Paris Court of appeals Paris, May 28 2004
Paris Court of appeals, October 22, 2004
Nanterre first degree commercial court, July 25, 2006
Cour de cassation, Commercial Chamber, November 8, 2005
Cour de cassation, Commercial Chamber, May 10, 2005
Cour de cassation, Commercial Chamber, November 22, 2005
Paris Court of appeals, April 6, 2004
Cour de cassation, Commercial Chamber, October 25, 2006
Cour de cassation, Commercial Chamber, January 28, 2004
Cour de cassation, Commercial Chamber, May 5, 2004
Bordeaux Court of appeals, February 17, 2004
Rouen Court of appeals, April 12, 2006
Paris Court of appeals, January 25, 2006

2. Germany

BGH, 11.12.2006, II ZR 166/05
BGH, 11.12.2006, II ZR 243/05
OLG München, 23.11.2006, 23 U 2306/06
OLG Stuttgart, 26.10.2006, 20 W 14/05
OLG München, 26.10.2006, 31 Wx 12/06, 31 Wx 012/06 ("N-Ergie")
OLG München, 19.10.2006, 31 Wx 92/05, 31 Wx 092/05
KG Berlin, 16.10.2006, 2 W 148/01
OLG Düsseldorf, 04.10.2006, I-26 W 7/06 AktE, 26 W 7/06 AktE

OLG Sachsen-Anhalt, 02.10.2006, 2 U 14/06
OLG Stuttgart, 27.09.2006, 14 U 11/06
BGH, 18.09.2006, II ZR 225/04
OLG Düsseldorf, 11.08.2006, I-15 W 110/05, 15 W 110/05
BGH, 10.07.2006, II ZR 238/04
LG Frankfurt, 13.06.2006, 3-5 O 110/04
OLG München, 01.06.2006, 23 U 5917/05
OLG Köln, 27.04.2006, 18 U 90/05
BGH, 24.04.2006, II ZB 16/05
OLG Karlsruhe, 07.03.2006, 3 Ss 190/05
BGH, 13.02.2006, II ZR 392/03
OLG Frankfurt, 08.02.2006, 12 W 185/05 ("T-Online")
OLG Düsseldorf, 13.01.2006, I-16 U 137/04, 16 U 137/04
BGH, 10.01.2006, 4 StR 561/05
OLG Celle, 21.12.2005, 9 U 100/05
OLG München, 16.11.2005, 23 W 2384/05 (Lindner Holding AG)
BGH, 10.10.2005, II ZR 90/03 (Mangusta/CommerzbankII)
BGH, 10.10.2005, II ZR 148/03 (Mangusta/Commerzbank I)
OLG Brandenburg, 30.08.2005, 6 U 149/04
LG Hamburg, 15.07.2005, 414 O 99/01
OLG Stuttgart, 13.07.2005, 20 U 1/05
OLG Düsseldorf, 29.06.2005, I-15 W 38/05, 15 W 38/05
BGH, 30.05.2005, II ZR 236/03
LG Flensburg, 12.05.2005, 6 O 139/03 ("Mobilcom II")
BGH, 09.05.2005, II ZR 29/03
BGH, 18.04.2005, II ZR 151/03
LG Mannheim, 07.04.2005, 23 O 102/04
OLG Hamm, 17.03.2005, 27 W 3/05 (GEA Group)
OLG Hamm, 28.02.2005, 8 W 6/05
OLG München, 23.02.2005, 7 U 3204/04 ("Kirch") [appeal pending]

OLG Düsseldorf, 14.01.2005, I-16 U 59/04, 16 U 59/04
OLG Frankfurt, 22.12.2004, 13 U 177/02
OLG München, 15.12.2004, 7 U 5665/03
LG Wiesbaden, 14.12.2004, 1 O 180/03
BGH, 13.12.2004, II ZR 206/02
BGH, 29.11.2004, II ZR 14/03
KG Berlin, 25.11.2004, 2 U 44/03
LG Bonn, 04.11.2004, 14 O 211/02
LG Frankfurt, 12.10.2004, 3-5 O 71/04, 3/5 O 71/04
BGH, 30.09.2004, 4 StR 381/04
LG Stuttgart, 29.09.2004, 39 O 49/03 KfH
LG Mainz, 27.08.2004, 11 HK.O 16/04, 11 HK 16/04
OLG Stuttgart, 11.08.2004, 20 U 3 /04
OLG Saarbrücken, 28.07.2004, 7 I O 24/04
OLG Schleswig-Holstein, 27.05.2004, 5 U 2/04
LG Köln, 08.04.2004, 82 O 23/04
LG Dortmund, 01.04.2004, 18 AktE 2/03
BGH, 22.03.2004, II ZR 50/02
LG Hamburg, 15.03.2004, 414 O 123/93
LG Bonn, 09.03.2004, 11 O 35/03
LG Düsseldorf, 04.03.2004, 31 O 144/03
OLG Düsseldorf, 27.02.2004, 19 W 3/00 AktE, I-19 W 3/00 AktE
OLG Stuttgart, 28.01.2004, 20 U 3/03
LG Düsseldorf, 28.01.2004, 36 O 101/02
OLG Düsseldorf, 16.01.2004, I-16 W 63/03, 16 W 63/03
LG Regensburg, 16.01.2004, 2 HKO 2124/03 (1), 2 HKO 2124/03 (E.ON Bayern)

3. Italy²⁶²

Cass., 26/01/2006, No. 1525

Cass., 12/12/2005, No. 27387

Cass., 26/09/2005, No. 18792

Trib. Roma, 19/07/2005

Cass., 18/05/2005, No. 7303

Trib. Torino, 06/05/2005

Trib. Roma, 11/03/2005

Trib. Milano, 01/02/2005

Cass., 18/11/2004 (Criminal), No. 10688

Cass., 02/09/2004, No. 17678

Cass., 24/08/2004, No. 16707

Trib. Milano, 08/07/2004

Cass. , 24/06/2004 (Criminal)

Cass., 09/06/2004, No. 10895

Cass., 28/05/2004, No. 10271

Cass., 28/05/2004, No. 10271

Trib Picaenza, 18/05/2004, No. 291

Trib. Messina, 14/04/2004

Trib. Napoli, 16/01/2004, No. 516

Cass., 11/12/2003, No. 22519

App. Milano, 21/11/2003, No. 3186

Trib. Milano, 17/11/2003

Trib. Milano, 07/11/2003

Cass., 11/06/2003, No. 9353

Cass., 05/06/2003 (Criminal)

App. Milano, 23/05/2003

²⁶² Numbers of decisions not always available (but cases can be found by searching for the court and

Cass., 24/04/2003 (Criminal), No. 23241
Cass., 21/11/2002, No. 16416
Trib. Milano, 09/10/2002
Cass., 01/07/2002, (Criminal), No. 29896
Trib. Milano, 22/03/2002
Trib. Milano, 05/11/2001
Trib. Roma, 12/10/2001
Cass., 07/06/2001, No. 7736
App. Milano, 30/03/2001
Cass., 22/03/2001, No. 4075
App. Milano, 20/02/2001
Trib. Milano, 22/01/2001
App. Milano, 18/01/2001
Trib. Roma, 10/01/2001
Cass., 11/12/2000, No. 15599
Trib. Milano, 02/11/2000
Trib. Roma, 13/07/2000
Cass, 15/06/2000, No. 8159
App. Milano, 18/04/2000
Cass., 10/04/2000, No. 4505
Cass., 04/02/2000, No. 1228
Trib. Milano, 03/01/2000

the date in the Foro Italiano database).