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COMPANY GROUPS – THE EEC PROPOSAL FOR A NINTH DIRECTIVE IN THE LIGHT OF THE LEGAL SITUATION IN THE FEDERAL REPUBLIC OF GERMANY

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1. Introduction

The Commission of the European Economic Community ("EEC") is currently preparing the final draft of a "Proposal for a Ninth Directive Based on Article 54(3)(g) of the EEC Treaty on Links Between Undertakings and, in particular, on Groups" [1]. If adopted as a proposed directive, the proposal will be submitted for comments to the European Parliament, the Economic and Social Council and, finally, to the EEC Council [2]. The passage of the proposed directive by the EEC Council is not expected before early 1985.

If passed by the EEC Council in its current version, the proposal for the Ninth Directive will have far-reaching implications for the business activities of company groups domiciled within the EEC, and those domiciled outside the EEC with subsidiaries and/or affiliated companies within the EEC. This article provides a critical analysis of the draft proposal of the Ninth Directive ("draft proposal"), its objectives and the legal background. Particular reference is made to the present legal situation in certain EEC Member States, with emphasis on the Federal Republic of Germany ("Germany"). The most important provisions of the draft proposal are set forth in the appendix to this article [3].

2. Background and development

Efforts to harmonize the EEC legislation on company law, based on Article 54(3)(g) of the EEC Treaty, have been underway in the EEC for more than ten years [4]. Thus, a number of EEC measures that affect the activities of multinational enterprises [5] should be taken into consideration when evaluating the possible effect of the draft proposal. Most of these measures have not yet been enacted, however, apparently for two main reasons. First, the necess-

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ity for harmonization of laws on concerns [6] is not unanimously recognized [7]. Second, there is little agreement as to the essential principles on which such proposed legislation should be based.

The scope and meaning of harmonization, as set forth in Article 54(3)(g) of the EEC Treaty, have been the focus of dispute from the outset. It can be plausibly argued that Article 54(3)(g) must be interpreted on the basis of its position in the chapter of the EEC Treaty dealing with the "right of establishment". A coordination of company laws would only be deemed permissible if such harmonization is necessary for the removal of restrictions on freedom of establishment. On the other hand, the EEC Commission, supported by the EEC Parliament and the Economic and Social Committee, actually interprets Article 54(3)(g) in light of the other objectives of the EEC Treaty, such as promoting a harmonious development of economic activities, increasing stability, accelerating increases in the standard of living, and encouraging closer relations between the Member States. Harmonization thus may be extended well beyond existing company laws. This sort of extensive interpretation of harmonization of company laws may exceed the proper bounds of lawmaking and be explained only as legal expedience without proper authority [8]. Apart from the varying social, economic and political backgrounds of each Member State, one basic reason for this disagreement lies in the substantially different approaches to the issue of related enterprises in the laws of the EEC Member States.

2.1. German legislation on related enterprises

Of the ten Member States, Germany is the only country [9] which has legislation on related enterprises and enterprise agreements. The Konzernrecht ("German concern law") was introduced in the 1965 revision of the German stock corporation law, the Aktiengesetz ("AktG"). This law and the 1970 Working Report to the EEC Commission prepared by Professor Hans Würdinger [10] have greatly influenced the draft proposal, which is primarily based on the principles of German concern law. Thus, the draft proposal can only be understood and analyzed in the light of the German concern law and the experience gained from its application.

2.1.1. Objectives of the German concern law

The 1965 AktG contained the first provisions on "related enterprises" [11] in German corporate legislation. The phenomenon of legally separate entities which are actually dependent is not limited to Germany, but its prevalence in Germany is remarkable. In 1965 it was estimated that approximately 70% of all German stock corporations were related enterprises [12], and this proportion has probably increased since that time.

Many of the existing arrangements among German companies amount to de facto mergers. The most frequently used arrangements between related enter-

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prises are control agreements and profit transfer agreements. Accordingly, the official comment on the 1965 Government draft of the AktG stated:

As a consequence of this structural change reflecting the economic trend towards concentration, for a number of enterprises the legal form of a stock corporation only represents an external organizational form. In such companies, the ties to the related enterprise have replaced the corporate power structure among the bodies of a stock corporation. The decisions of such company are made outside the competence structure of a stock corporation, partially based on agreements with other enterprises, in a manner which is generally not subject to any legal standards [13].

The provisions of the German concern law are not an effort to restrict inter-company relations, nor are they antitrust legislation. Although the increasing trend toward further concentration has prompted investigations by the German Government, business conglomeration has not met with legislative disapproval and is, in fact, espoused by many who feel that concentration is necessary for effective competition with large multinational concerns [14]. The reporting requirements contained in the German concern law are designed to convey a clear picture of the extensive inter-relationships existing between German enterprises, and are a prerequisite for the protection of creditors and minority shareholders of dependent German stock corporations [15].

2.1.2. Requirements of the German concern law

Under the German concern law, arrangements and all types of actual influence between enterprises should be defined, regulated and made public for the protection of outside shareholders and creditors of the German dependent stock corporation. The regulations also apply to wholly-owned corporate subsidiaries, with the exception of those provisions which expressly presuppose the presence of outside shareholders of such subsidiaries.

2.1.2.1. Reporting of holdings. Section 20 of the AktG requires any "enterprise" [16] with holdings in a German stock corporation amounting to 25% or more to notify the latter in writing [17]. Further notification is required when the enterprise acquires a majority of shares or votes [18], or when the interests subsequently fall below these levels [19]. A German corporation receiving such notification is required to publish its contents [20], and to refer to it in the annual business report. Failure to comply with these reporting requirements suspends the shareholders' rights of the non-complying enterprise [21].

According to the official comment on the Government draft of the AktG, the purpose of these provisions is to inform creditors and the public of existing holdings and of substantial acquisitions, and to ensure the enforceability of all rules concerning related enterprises [22]. The rules differ depending whether the related enterprises have entered into an enterprise agreement. Moreover, the required consolidated statements [23] attempt to depict the true condition

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of the group as an economic entity and to prevent shifting of profits among subsidiaries. The annual statements must include each German-domiciled member of the group more than 50% of whose equity is held by the group members [24].

2.1.2.2. Related enterprises. The phrase "related enterprises", as defined in AktG section 15, is an umbrella term which includes enterprises held by a majority and enterprises holding a majority of another enterprise, dependent and dominating enterprises, combined enterprises, mutually participating enterprises and parties to enterprise agreements [25]. A corporation in which another enterprise holds the majority is assumed to be dependent on the latter ("dependent corporation") [26]. A combine, or group of companies, is defined as a single enterprise which dominates one or more dependent corporations joined by the uniform direction of management (*einheitliche Leitung*) of the dominating enterprise [27]. A uniform direction also exists in the case of a control agreement and in the case of integrated enterprises [28]. The combine may also exist between legally independent enterprises which are joined by a uniform direction or management [29].

2.1.2.3. Enterprise agreements. "Enterprise agreements" fall into two categories. The first category comprises contracts in which a corporation, or a partnership limited by shares, agrees to be managed by another enterprise ("control agreement"), or in which a corporation agrees to transfer all of its profits to another enterprise, or to conduct its business for the account of the latter ("agreement to transfer profits") [30]. These two types of contracts are usually combined in what is customarily referred to as an "Organschaftsvertrag". Agreements in the second category involve "profit pooling agreements", "agreements to transfer part of a profit", or "agreements to lease or surrender a business", which entail a more limited degree of dependency [31].

The German concern law provides formal requirements for these agreements because of their substantial effect on a corporation's independence. Enterprise agreements must be written [32], passed by a favorable shareholder resolution adopted by a three-fourths majority of the obligor corporation [33], and recorded in the respective commercial register [34]. In addition, control agreements and agreements to transfer profits must be approved by the same majority of shareholders of the obligee enterprise if the latter is a corporation [35]. Finally, the law requires a full explanation to the shareholders of the significance of pending enterprise agreements [36].

These enterprise agreements are not the legislature's creation. They have evolved in practice, as a result of corporate inbreeding and of peculiarities of German turnover and corporate income taxation [37]. Statutory recognition appeared desirable, in view of the widespread use of enterprise agreements and reliance on tax rulings and decisions concerning enterprise agreements. The

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AktG provisions clarify the legal effect of enterprise agreements by delineating permissible limits for exercising influence over a controlled company, as well as for establishing safeguards for creditors and outside shareholders (*i.e.* minority investors not connected with the controlling group).

2.1.2.4. Consequences of a given relationship. The most significant aspect of the German concern law is the attempt to achieve a balance in a statutory scheme between the conflicting interests of the dominating enterprise, on the one hand, and outside shareholders and creditors of the dependent corporation, on the other. First, if the related enterprises are parties to a control agreement, the management of the dependent corporation must carry out any and all directives, however detrimental to the corporation, as long as these serve the purpose of the dominating enterprise or an enterprise affiliated with it [38]. Absolute control is, therefore, conditioned on a formal agreement sanctioning its exercise.

The board of management of the dependent corporation and the legal representatives of the dominating enterprise are jointly and severally liable to the dependent corporation and to its creditors for damages if they violate their duty to operate as conscientious business managers [39]. In addition, the members of both the board of management and the supervisory board of the dependent corporation are liable for any violation of their duties [40].

The unrestricted discretion which a dominating enterprise enjoys under a control agreement with a corporation is checked by the specific safeguards protecting the creditors and shareholders of the dependent corporation. The dominating enterprise must underwrite the losses and maintain the statutory reserves of the dependent corporation in order to secure its creditors in the event of the termination of the agreement [41]; to guarantee minimum dividend payments to outside shareholders [42]; and to pay an indemnification to shareholders who want to sell their shares to the dominating enterprise [43]. If the dependent corporation is the obligor under an agreement to transfer profits, its creditors and outside shareholders essentially enjoy the same protection [44]. Enterprise agreements in the second category [45], however, are not required to provide for guaranteed dividends and appraisal rights to outside shareholders [46].

Second, in the absence of any enterprise agreement ("de facto concern"), the dominating enterprise must refrain from using its power or influence to cause the dependent corporation to enter into transactions or to take or omit measures, unless it specifically compensates the dependent corporation within the same fiscal year for any disadvantage which the latter may incur [47]. The failure to grant specific compensation renders the dominating enterprise liable in tort [48]. The dominating enterprise and its legal representatives are personally accountable to the dependent corporation, its creditors, and even its outside shareholders for damages, if no right to compensation has been

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granted, unless they prove that a conscientious manager of an independent corporation would have acted in the same manner [49].

The dominating enterprise is not accountable for losses or for the liabilities of the dependent corporation. To ensure an arm's-length compensation of the dependent corporation, however, the managing board of a dependent corporation which is not a party to a control agreement is required to report all of its dealings with the dominating enterprise every year ("report of dependence"). All transactions, measures taken and omissions induced by or serving the interest of the dominating enterprise must be reported [50]. The auditors and, thereafter, the supervisory board of the dependent corporation, must examine the report of dependence. The members of both boards are liable for damages resulting from neglect of their reporting duties [51]. The report of dependence is not published. Even the shareholders' meeting receives only the ultimate findings of the supervisory board of the dependent corporation. A shareholder may ask a court for a separate examination if the supervisory board or the auditors have raised objections to the report or if the board of management has reported that disadvantages have been incurred without providing for the necessary compensation [52].

2.1.2.5. Integration. The German concern law contains provisions on integration of corporations. These provisions permit treatment of a parent and a subsidiary corporation as one economic entity without the requirement of a merger [53]. Such integration is permissible when one corporation owns 95% or more of the shares of another [54]. It is effected by resolutions from shareholders of both the parent company and the subsidiary, and by a recording in the particular commercial register. The parent company's resolution must be passed by a three-fourths majority [55]. The subsidiary maintains its separate legal identity after the integration has been effected. For accounting purposes, however, it is treated as a mere division of the parent corporation. Under this scheme, the parent company is jointly liable for the obligations of the subsidiary [56] – a statutory piercing of the corporate veil.

2.1.3. Criticisms of the German concern law

The German concern law was drafted with deference to the interests of dependent corporations. As one commentator has observed, the perspective is "from below to above" [57]. Recognition of this sympathy for the perspective of dependent corporations is essential to an understanding of the AktG [58].

The German concern law concentrates on the dependent corporation, without making changes in the dominating enterprise [59]. Shareholder and creditor protection is its major objective, although the problem of enterprise groups, and specifically of multinational enterprises, reaches well beyond the interests of such shareholders and creditors. The affected German industrial associations strongly opposed the implementation of the concern law, and

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requested the entire deletion of the reporting requirements and the provisions governing de facto concerns. In practice, however, the German concern law has not proved unduly burdensome for related enterprises.

One reason for the ready adjustment to the new provisions may be that the decisive terms are not always clearly defined, providing an enterprise which dominates a dependent corporation de facto with a broad variety of means to exercise its influence without violating its obligations. This vagueness has been criticized and numerous proposals have been made to improve the provisions in order to strengthen shareholders' rights. Some of these objections demonstrate a dominating enterprise's current scope of influence.

One objection is that because of its majority share in the dependent corporation, the dominating enterprise can determine whether, at what time, and under which conditions an enterprise agreement is concluded. Since the majority holding of the dominating enterprise is decisive, it is argued that the enterprise agreements are not freely negotiated; that the dependent corporation has already become dependent prior to the conclusion of such enterprise agreements; that in most cases there are no arm's-length transactions; and that the dominating enterprise is free to choose a weak phase in the economic situation of the dependent corporation, in order to have a low going concern value as the basis for a low settlement and compensation value for the dividends to be paid to outside shareholders [60].

The procedure that outside shareholders must undergo to have the compensation and indemnity provisions of an enterprise agreement reviewed by German courts is time-consuming and burdensome; for this reason, the process has been criticized as insufficient protection of the interests of the outside shareholders [61]. On the other hand, this has given related enterprises some relief from constant exposure to court actions reviewing claims for small amounts of compensation and indemnity. In addition, although in theory complete indemnity must be granted to outside shareholders, judging the adequacy of indemnity and having it reviewed by a court creates enormous difficulties in practice [62].

Under AktG section 308, the dominating enterprise may, within the broad scope of the principle of good business judgment, give valid directives to the dependent corporation that, in the interest of the concern, obligate the dependent corporation to remove liquid reserves or personnel [63]. The provisions which prevent hidden dividend distributions do not apply in this case [64]. A dominating enterprise is required to compensate every annual loss of the dependent corporation. To the extent that this requirement is not already achieved through transfer from freely disposable capital reserves of amounts placed there during the life of the contract, the dominant enterprise will be able to comply by using the dependent corporation's pre-contractual hidden reserves. Use of such reserves has been criticized for depriving the dependent corporation of its assets and book value [65].

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It is the general view that foreign dominating enterprises may also enter into enterprise agreements [66]. The German concern law deals with corporations dependent on foreign dominating enterprises only by way of exception, however [67].

German industry has raised a number of objections to the required report of dependence for de facto concerns because the report is likely to require disclosure of internal affairs which are subject to strict business confidentiality. Whether such fears are justified is a controversial issue [68]; but it should be noted that the report of dependence is strictly confidential and unavailable to shareholders [69]. The confidentiality of this information is a major reason that outside shareholders may find it difficult to learn of inter-company relationships and disadvantageous transactions by the dependent corporation. Generally, the provisions governing de facto concerns need reform. Certainly, reform is needed in cases in which there is no enterprise agreement but the dominating enterprise effectively controls management of the dependent corporation through its ownership of a majority of shares. The most recent proposal for reform in the German concern law appeared in the Report of the German Commission on Enterprise Law [70]. At present, this proposal has little chance of adoption since other parts of the AktG would have to be reformed simultaneously [71].

2.2. French legal situation

In France, groups of companies are usually set up by means of share participations [72]. Enterprise agreements, which do not result in tax privileges under French tax law, are only used in rare cases [73]. Company groups are widespread in France, but the form is not sufficiently regulated by French law. "This is especially true for statutory law, [although] there is a certain body of relevant case law" [74]. Repeated parliamentary attempts to enact rules for groups of companies have been unsuccessful. "It seems that the French Government, as well as the Parliament, aware of the hostility of business towards such plans, would rather wait for the EEC to force the Member States by a directive to enact statutory provisions on enterprise groups" [75].

French law does not define a "group". The law merely defines a shareholding in another company of 10–50% as "participation" and a holding of more than 50% as "filiale" [76]. Groups with this structure must comply with certain requirements. A company which holds the shares of another must inform its shareholders and the public of this fact. Such restrictions can be circumvented by circular participations although possibilities for such cross holdings are somewhat limited.

The requirement under French law that a subsidiary should not be wholly owned by another company is not difficult to meet within a group. Other peculiarities regarding French regulation of groups of companies "concern the

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nationality of the subsidiary, its domicile, ... certain incompatibilities, the problem of abusive management and of possible justification on the grounds of the interest of the group as a whole, and the liability of the dominating enterprise for the debts of its subsidiaries..." [77].

2.3. The English legal situation

The principles of English company law do not adequately address the problems which corporate group activities present [78].

The general basis of English company law is the corporate entity doctrine. "[T]his doctrine applies whether or not the members of the company are individuals or another company or companies" [79]. A consequence of the entity doctrine is that "no constituent member of a group of companies [is] liable for the debts or obligations of any other constituent member of the group" [80]. In addition, directors are considered to owe loyalty to the company and not to the individual shareholders [81].

English company law recognizes a strong doctrine of majority rule. The Companies Act of 1948 provides that, under certain circumstances, the parent company may make a direct takeover bid to minority shareholders to buy their interest and that the minority shareholders in a subsidiary company may compel the parent company to purchase their shares [82].

During the debates on the Companies Act of 1980, the Labour Party spokesman proposed that a parent company be liable for debts of its insolvent or defaulting subsidiary unless the subsidiary's creditors have been specifically notified that such liability has been excluded [83]. As one commentator has noted:

> The Government rejected these proposals, primarily ... because it was uncertain as to their impact on the willingness of parent companies to become involved in high risk ventures; a point which, at least theoretically, has much validity, as the result of the proposals would be to put all the parent's resources at risk with respect to the trading activities of its subsidiaries [84].

2.4. The Belgian legal situation

The Belgian law does not refer to groups of companies, and each company is regarded as an independent entity. There is little statutory law on groups of companies in Belgium, but problems have been handled smoothly and efficiently by the Belgian Banking Commission [85].

The basic objectives of Belgian legislation on related enterprises are: "[first, to prevent] the general corporate law from becoming meaningless in situations where one corporation controls another [and] second, to acknowledge the existence and function of enterprise groups, and to develop an adequate special

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set of rules for them" [86]. The 1979–80 proposal for company law reform, which defined "controlling corporations" and introduced other provisions concerning controlling corporations, has not yet led to actual results. The Banking Commission has dealt with enterprise groups extensively, even though the legislature has chosen to ignore their existence. The Banking Commission, a legal entity in its own right, has specific powers to supervise holding companies by obtaining necessary information. Based on the principle of equal treatment of all shareholders, the Banking Commission has developed rules for protection of shareholders in cases of takeover transactions and transfers of controlling interests. The policy of extending bankruptcy to the "master of affairs" is aimed at protecting creditors [87]. Although the latter has only been applied by Belgian courts to individual controlling companies, it is argued in several pending cases that this doctrine should be extended to controlling enterprises as well [88].

2.5. Structure of concerns within the EEC

In addition to related enterprises on the national level of each Member State, there is a range of types of company groups within the EEC. The horizontal structure of groups of companies is a European phenomenon. This contrasts with the vertical structure, headquartering a centralized group composed of companies from several countries solely within one industrialized country, which is particularly prevalent in the United States and Japan. Almost all horizontal groups and combines were organized in the late 1950s and 1960s, in anticipation of expected progress with regard to modernization of European laws or with a view to a possible future uniform European corporation [89]. These horizontal groups, most of which are bi-national, have relied upon the traditional instruments of the respective national company and tax laws of EEC Member States, utilizing a variety of special contractual arrangements. Rather than setting up their own subsidiaries in other EEC countries, European companies regarded the establishment of bilateral ties with groups in other Member States as an adequate response to the future demands of the developing European market. More recently, however, these bi-national groups of companies within the EEC have begun to lose their bi-national character or separated, although economic integration continues to make progress within the Common Market [90].

The process of economic concentration, the establishment of a net of vertically integrated companies in different countries, has advanced rapidly. Except for the banking and insurance industries, which have retained their predominantly national characters, progress has been made toward a European branch structure in many areas. Such market penetration throughout the EEC has led to an increase in vertical groups of companies which must deal with a patchwork of differing legal structures [91]. From the point of view of the EEC

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Commission, this may have been the major impetus behind the drafting of a proposal on organizational law of concerns.

3. Development and analysis of the draft proposal

3.1. Events leading to the draft proposal

Based on the 1970 Working Report of Professor Hans Würdinger, special counsel to the EEC Commission [92], in 1974 the EEC Commission issued Part I [93] and in 1975, Part II [94], of a pre-draft for a Ninth Directive concerning legislation on groups of companies.

Part I of the pre-draft primarily contained amendments to EEC directives proposed or already enacted, as well as general definitions and rules pertaining to groups of companies. Part II concerned the actual statutes for groups of companies. The general distinction, derived from the German concern law, between de facto concerns and company groups formed under enterprise agreements was incorporated into the proposed statutes. Each national legislature could either accept this distinction or vote for the more stringent concept of a European stock corporation law [95].

The Member States did not comment officially on this pre-draft. A number of comments were made by interest groups within the EEC, however. The business associations of each Member State except Germany disputed the notion and the necessity of harmonized legislation on groups of companies [96]. Only the Federal Association of German Industries ("BDI") accepted the need for the pre-draft, although it criticized many substantive details of the provisions [97]. The subsequent legal discussion in Germany did not reveal a significantly different point of view [98].

As a result of critical comments, the EEC Commission revised the pre-draft entirely, producing a draft proposal in 1980. All along the draft proposal has been regarded by the EEC Commission as an internal working paper. This working paper has nonetheless been the basis of a hearing of the Association of Industries within the European Community ("UNICE") [99]. The EEC Commission postponed the final passage date for its draft proposal from October 1981.

3.2. Analysis of the draft proposal

Comments available on the proposal thus far include only the 1981 UNICE comment and a brief summary by the BDI [100]. All other comments refer to the 1974–75 pre-draft of the EEC Commission because the draft proposal itself has not been officially distributed. More detailed discussion can be expected when the final proposal of the EEC Commission is available [101].

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The draft proposal is modelled on the German concern law and is designed to provide basic rules for group structures. The proposal's analysis focuses on the basic principles for group structures, including (1) the necessity for a legal framework for groups, (2) the concept of dependency among companies, (3) the specific reporting and auditing requirements envisioned for inter-company relations, (4) the protection of the dependent enterprise and the obligation of the dominating enterprise, and (5) the form of enterprise agreements establishing the legal basis of groups.

3.2.1. Impediments to harmonization laws

The preamble lists a number of "assumptions" which constitute the reasons for harmonized legislation on groups of companies among the Member States. As the official Explanatory Notes to the draft proposal ("Notes") state, the principal objective of legislation on groups of companies is "harmonization" of European law [102].

Whether or not the Ninth Directive agenda reflects a genuine need in the EEC market, the fate of harmonized European law on groups of companies will ultimately be decided by non-legal considerations. Political and social factors will be decisive. Within each Member State, criticism of the capitalist structure and of particular national and foreign policy preferences will frame the debate. Harmonized legislation on groups of companies must accommodate the range of political and social constraints among the Member States. National revision of company laws is often a hard-fought and divisive process. Altering co-determination legislation may be equally difficult, depending upon the influence exercised by unions in the various Member States [103].

Given its concern law, Germany is unlikely to question seriously the necessity for harmonized EEC legislation on groups of companies. Several issues may be troublesome in Germany: for instance, to what extent and by what means the rights of outside shareholders and creditors of the dependent corporation are strengthened under harmonized EEC legislation; to what extent co-determination rights are maintained or extended; and, above all, to what extent the formation of groups of companies is supported or restricted by requiring certain legal structures. The Ninth Directive thus may stir considerable debate in Germany. Moreover, other Member States are even less likely to recognize the necessity for harmonized legislation on groups of companies [104].

3.2.2. Defining company domination

The draft proposal seeks to create a legal scheme for the relation between parent companies and their dependent "EEC subsidiary companies". "Company" is defined as the legal form which a publicly held stock corporation takes in each of the Member States [105]. Upon examining the entire document, it becomes clear that the draft proposal would apply only if an

enterprise group has such a company as a "dependent corporation" in one of the Member States. The draft proposal defines a "dependent" company as "one over which the dominant undertaking" (*i.e.* the parent company) "is able, directly or indirectly, to exercise a dominant influence" [106]. By defining "dependence" as the converse of "domination", the drafters make the concept of "domination", which is fundamental to the German concern law, an essential feature of the draft proposal. Contrary to the view expressed in the Notes to the draft proposal, this concept of domination is not found in the laws of most of the other Member States. It should be noted that the absence of clear definitions of "direct domination" and of "indirect domination" will compound the problems of implementing this innovative legislation [107].

Article 3 provides for application of the draft proposal in cases of joint domination by two or more enterprises. It is unclear whether a company can be dependent on two or more enterprises under the laws of the Member States and there is no national legislation on this issue. Because possible solutions have not been discussed sufficiently, all comments made on the draft proposal recommend the deletion of this provision [108].

3.2.3. Notification and disclosure of company acquisition

The draft proposal imposes requirements of notification and disclosure upon all parent companies based upon their shareholdings in the dependent corporation. A dependent corporation must be notified of a shareholding of 10% and/or the subsequent acquisition of additional 5% blocks of its shares [109]. Until such notification is made, no shareholder rights may be exercised. The shareholding notified must be recorded in the annual records of the dependent corporation and, if specific percentage rates are reached, disclosed according to national laws.

In principle, such a notification requirement is similar to the German concern law. But the German law requires notification only for the acquisition of 25% or more and subsequent notification upon acquisition of 50% or more of the outstanding shares. Thus, a notification is required if the shares acquired give the buyer certain rights and influence in the company. If the objectives of the draft proposal are (1) to set up a legal framework for groups of companies, and (2) to protect minority shareholders, it is uncertain how a notification requirement set at increments of 10% acquisition will directly serve such purposes [110].

3.2.4. Additional obligations

Apart from the notification of acquisition discussed above, the draft proposal establishes two additional obligations, application of which would depend on whether the relation of dependence exists de facto or is based on an enterprise agreement.

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3.2.4.1. De facto domination. Section 4 of the draft proposal, which consists of Articles 7–12, outlines the extent of influence which one or more dominant enterprises may exercise on a dependent corporation without an enterprise agreement. These provisions are designed to protect minority shareholders, creditors and employees of a dependent corporation from the exercise of dominant influence. This protection of particular interest groups raises a number of questions. For instance, UNICE argues that the protection of employees' interests should not be considered as one of the objectives of legislation on groups of companies [111], because employees' interests are protected by existing labor legislation, such as the German co-determination law. Similarly, the interests of creditors are adequately protected by EEC legislation, such as the Second Company Law Directive, the proposed Bankruptcy Convention, and the Fourth Company Law Directive [112]. This leads to the question whether the protection of creditors' interests should be the subject of company group laws. In short, critics can contend that several aspects of the draft proposal are redundant [113].

Article 7 of the draft proposal is the basic rule governing liability of a dominant enterprise. It provides that a dependent corporation not subject to an enterprise agreement must be managed in a way that assures its own greatest advantage; it provides that the dominant enterprise and each of the members of its administrative body shall be liable when the dominant enterprise exercises influence over management that results in damage to the dependent corporation. In principle, Article 7, paragraph 1, is comparable to AktG section 317(1). But the language of the two provisions differs. Under the German provision, when the dominating enterprise "causes" a dependent corporation to enter into disadvantageous transactions it must reimburse the dependent corporation for any damages resulting therefrom. Article 7, paragraph 1, of the draft refers to "influence" of a dominant enterprise resulting in "damages" to the "interests of the dependent corporation". The meaning of "influence" and "damages" for which the dominating enterprise may be liable needs clarification because the lack of precise definition is likely to cause legal and economic uncertainty, making necessary decisions within the group extremely difficult.

The directors' liability established in Article 7, paragraph 2, should not be governed by laws on groups of companies. This recommendation has already been issued by the EEC Commission in Article 14 of the proposed Fifth Directive [114]. Moreover, Article 7, paragraph 2(a), does not specify what criteria must be met in order to relieve a member within the dominating enterprise's management of any liability. Article 7, paragraph 2(b), which provides for the liability of members of the management board of the dependent corporation, assumes that such members must preserve the interests of the dependent corporation and that, in order to avoid any liability, they must refuse to follow the instructions of the dominating enterprise.

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Under Article 8 of the draft proposal, the dependent corporation is required to disclose "significant measures" that were undertaken or considered and rejected by the dependent corporation on the "initiative" of the dominating enterprise; this disclosure is intended to safeguard the dependent corporation's interests and is to be made in a special annual report ("dependence report"). This article goes beyond the requirements of the German concern law, which requires that a dependence report be available for inspection by auditors and the supervisory board, but which does not stipulate that it be published or distributed to shareholders [115]. Although it is not quite clear how detailed the Article 8 dependence report must be, the information it contains could prejudice the confidential character of certain information since a broad interpretation of the draft proposal would require publication of information damaging to the competitive position of the dominating enterprise. In addition, under the German concern law, the dominating enterprise is not obliged to reveal its actions and compensatory advantages are considered in determining the injury sustained by the dependent corporation. Thus, it appears that Article 8 goes beyond both the goals of providing sufficient information regarding infringements of Article 7 and of ensuring that interested parties receive relevant information.

Article 9 provides the further safeguard that, upon request of a shareholder, a creditor or the employees' representative of the dependent corporation, a court or other competent authority may appoint special auditors for the dependence report. Under the German concern law, on the other hand, a shareholder may only apply for court appointment of a special auditor if the auditor, the supervisory board or management has averred in the dependence report that transactions with the dominant de facto enterprise are, in fact, detrimental to the dependent corporation. Because Article 9 of the draft proposal goes beyond the German provision, it has been criticized by UNICE and BDI [116].

The rights stipulated in Article 9 should not be granted to employees and creditors because these parties have other means of obtaining the required information [117]. The imprecise language of Article 9, paragraph 1, raises the questions of when facts "give rise to the presumption" and when a dominating enterprise has "instigated" measures sufficiently detrimental to a dependent corporation to merit judicial investigation. Abuse of rights under Article 9 is not unlikely, since the financial burden of investigation is automatically borne by the dependent corporation alone. Significantly, the draft proposal fails to provide standards to be applied by auditors and courts in the evaluation of special reports. This deficiency may well result in conflicting interpretations and consequent legal uncertainty among the Member States.

Article 10 grants courts (or other competent authorities) substantial remedial powers where influence of the de facto dominating enterprise upon management of the dependent corporation has damaged the dependent corpo-

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ration. These measures may include suspension of board members of the dependent corporation, prohibition of further performance of damaging contracts, revocation of damaging measures, and a judicial decree that the dominating enterprise must offer to purchase the shares of the minority shareholders. In contrast, compensation under German concern law is subject to stricter judicial scrutiny and less potent remedies. For this reason, UNICE and BDI demanded that Article 10 remedies, other than compensation for damages by the dominating enterprise, be stricken [118].

Article 11 provides that proceedings under Article 7 may be brought by the dependent corporation, by any shareholder acting on its behalf, or by creditors unable to obtain satisfaction from the company. As outlined above, rights according to Article 7 should only be granted to shareholders but not to creditors, since they are already protected by various remedies. Furthermore, the claims referred to in Article 11 only concern claims for damages. National laws provide that actions for damages to the dependent corporation may only be brought by the dependent corporation itself or that, under certain circumstances, a derivative right of action be granted to shareholders [119].

3.2.4.2. Enterprise agreements. Articles 13–32 of the draft proposal, on dependent corporations as parties to enterprise agreements, impose a different set of obligations. They regulate instances in which management of a dependent corporation defers to management of another enterprise under a written agreement. As outlined above, the group structure of enterprise agreements is familiar in Germany [120]. Related enterprises in other EEC Member States, however, should not be compelled to adopt the particular forms of this group structure since these forms are unlikely to be compatible with the manner of operation of most groups.

When an enterprise agreement is initiated according to these provisions, the minority shareholders of the dependent corporation must be offered the choice of a cash repurchase of their shares, stock of the parent company, debentures, or "annual equalization payments" based upon the estimated average earnings per share. When the dominating enterprise is a non-EEC company, it may only offer a cash option. According to the Notes, the offer of securities is not permitted in such cases in order to avoid the legal and practical difficulties of monitoring the terms of exchange [121].

Articles 17 and 22 provide for preparation of an independent report on the appropriateness of the compensation offered to shareholders who apply for an examination of such findings. These provisions, which have no equivalent in the German concern law, could, in certain circumstances, lead to a three-level indemnification procedure which would include examination by courts with new experts reviewing the situation on each level. German experience indicates that examination of compensation offers by the courts often takes five years or longer. This would impose an extended period of uncertainty for which the dominating enterprise would invariably bear the costs [122].

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Once concluded, an enterprise agreement requires that the dominating enterprise exercise its managerial powers with the "care of a conscientious director and in the group interest" [123]. Negligent failure to adhere to this standard results in liability, but only for the dominating enterprise and not for its individual directors [124]. In addition, the dominating enterprise is liable for obligations of the dependent corporation arising prior to or during the contractual period, unless it can prove that the dependent company's failure to fulfill its obligations is attributable to circumstances which are not the result of any "influence" that it has exercised or failed to exercise [125]. If the enterprise agreement expires, the dominating enterprise must compensate the dependent corporation for any "diminution in...value" which it has sustained during the lifetime of the contract, unless it can prove that the diminution was not the result of its influence [126].

According to Article 24, paragraph 2, any direction may be blocked if the directed measure is subject to the approval of a supervisory board on which employees of the dependent corporation are represented, provided that their interests are not safeguarded in an equivalent manner by the dominating enterprise.

Article 24, paragraph 2, and other articles of the draft proposal presuppose that the two-tier board system is introduced in all Member States. Since several Member States oppose the compulsory introduction of this system, it appears to be inappropriate to base provisions on such an assumption [127]. Moreover, the application of Article 24, paragraph 2, would cause difficulties since it would require assessment of whether one form of employee involvement is equivalent to another. This sort of assessment is difficult to make because of the profound differences that exist in this area in both Member States and in non-EEC countries. If the forms of employee involvement are not equivalent, measures of the dominating enterprise could be blocked by the supervisory board of the dependent corporation, even though the measures are beneficial to the group [128].

Article 26, which provides for the liability of a dominating enterprise that has negligently failed to exercise management powers appropriately, is comparable to the provision contained in the German law. In order to prevent any abuse of rights to which the outside shareholders are entitled, however, the German concern law also imposes the risk of costs upon the claiming shareholder if his or her claim for payments to the dependent corporation is not successful. Article 26, paragraph 2, provides that, in any case, the dependent corporation will have to bear all costs. This would permit an abuse of rights.

Article 28, which requires approved annual accounts, reports, and audit reports, only governs dominating enterprises within the EEC. As the Notes point out, the EEC has no jurisdiction to impose Article 28 on enterprises formed in non-Member countries.

Articles 29 and 30 are obviously intended to protect the interests of

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creditors of dependent corporations, as well as those of the dependent corporations themselves. In AktG section 302, the German concern law provides that the dominating enterprise must assure that the worth of the dependent corporation is maintained if the enterprise agreement is terminated. Article 30 goes far beyond this German compensation provision. Apparently, the creditors' interests which are to be protected cannot exceed the worth of the dependent corporation. Since, according to Article 30, any losses of the dependent corporation are compensated, any additional protection of the creditors' interests appears unnecessary [129].

4. Summary

The draft proposal is inspired by the German concern law, with its stress upon the concept of "domination". As demonstrated, the German concern law distinguishes between situations in which such domination is exercised on the basis of an enterprise agreement and that which exists by de facto arrangement. Depending upon which instrument of domination is used, German concern law imposes different requirements on the related enterprises in order to achieve its central objectives: the protection of the dependent corporation's outside shareholders and of creditors. The draft proposal has generally adopted this concept of domination on either a factual or a contractual basis, but it imposes requirements on the related enterprises which, in essential parts, extend far beyond the German concern law. Apart from Germany, the Member States have rejected the implementation of laws on groups of companies. In view of this and the fact that the draft proposal substantially exceeds the requirements imposed on related enterprises by the German concern law, one may draw several conclusions.

First, the necessity of harmonized EEC legislation on groups of companies will not be recognized unanimously. In particular, political and social constraints will remain an intractable obstacle toward Ninth Directive adoption.

Second, the draft proposal adopts the German concept of domination based upon either enterprise agreements or a de facto influence. This concept may reflect particular circumstances in Germany, but it does not appear to account for the different situations of other Member States in which enterprise agreements are rarely used and in which the number and structure of corporations differ significantly from the situation in Germany. As indicated by the UNICE comment, the other Member States are expected to oppose the introduction of the German concern law as European law since the draft proposal exceeds the German concern law; therefore, the implications of the draft proposal will be much more restrictive for international business activities.

Third, the percentage rates underlying the general notification requirements according to Section 3 of the draft proposal are too low. Generally, a holding

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of 5–10% in a corporation does not result in a dominating position for the holding company.

Fourth, the provisions governing the dependence report in Article 8 of the draft proposal subject the dominating enterprise to stringent publication and disclosure requirements which do not appear to be justified by the objectives of the draft proposal and which are more likely to restrict business activities than to protect the interests of outside shareholders.

Fifth, the sanctions in Article 10 of the draft proposal go far beyond the corresponding provisions of the German concern law. Article 10 will generally provide for the basis of official intervention in the internal structure of related enterprises and thus needlessly violate the principles of a free economy. Moreover, the rights of employees are not and should not be subject to laws on groups of companies.

Sixth, the compensation claim of the dependent corporation under Article 30 of the draft proposal does not fit into the concept of domination by enterprise agreement and exceeds the provisions in the German concern law.

Seventh, the draft proposal is not clear as to the implications for non-EEC dominating enterprises. As does the German concern law, the draft proposal leaves unanswered, for example, questions of which laws govern the validity of an enterprise agreement, which courts are competent to enforce rights under the draft proposal, and how certain rights, such as the obligation to assume losses of the dependent corporation, can be enforced against the non-EEC dominating enterprises.

As the draft proposal is considered merely a working paper, it is expected that the final proposal by the full EEC Commission may already reflect some of the objections raised here. The reactions to the final proposal will demonstrate whether and to what extent a directive on company groups will be accepted by the Member States.

Appendix

The pertinent provisions of the draft proposal read:

Article 2

1. For the purpose of this Directive, a dependent undertaking is one over which another undertaking, referred to as the dominant undertaking, is able, directly or indirectly, to exercise a dominant influence.
2. An undertaking shall be presumed to be dependent on another undertaking where the other undertaking directly or indirectly:
   (a) holds the major part of the undertaking's subscribed capital, or
   (b) controls a majority of the voting rights attaching to the shares in the undertaking, or

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(c) is in a position to appoint at least half of the members of the administrative, management or supervisory body of the undertaking, provided that these members have the majority of the voting rights.

3. Holdings of an undertaking dependent on the dominant undertaking and holdings of other persons acting in their own names but on behalf of the dominant undertaking or of an undertaking dependent on it shall be regarded as forming part of the holding of the dominant undertaking within the meaning of paragraphs 2(a) and (b).

Article 3

1. Where, by virtue of an agreement or otherwise, two or more undertakings are in a position to jointly exercise directly or indirectly a dominant influence over another undertaking, each of the first mentioned undertakings shall be considered to be a dominant undertaking and the latter undertaking to be a dependent undertaking.
2. It shall be presumed that two or more undertakings are in a position to jointly exercise a dominant influence over another undertaking where they jointly satisfy one of the conditions laid down in Article 2(2)(a)–(c) and where either the majority of their shares are held by the same person or more than half of their administrative, management or supervisory bodies are made up of the same persons.
3. Article 2(3) shall apply.

Article 4

1. Where a natural or legal person acquires directly or indirectly more than 10% of the subscribed capital of a company, it shall notify the total amount of the holding and the voting rights attaching thereto to the company in writing within two weeks from the date of acquisition of those shares which increased the holding to more than 10%. Each further acquisition of shares of the company which raises the holding beyond successive steps of 5% shall be notified in the same way. Like notification shall be made each time the holding falls below the percentage of 10% or below each step of 5%.
2. Shares held by persons in their own names but on behalf of another person shall be regarded as shares belonging to the latter. Where such latter person is an undertaking, shares held by a person dependent on such undertaking or held by other persons in their own names but on behalf of a dependent undertaking shall also be regarded as shares belonging to the former undertaking.

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Article 5

1. A shareholder may not exercise the rights attaching to shares which are to be notified in accordance with Article 4(1) until such notification is made.
2. Where, contrary to the provisions of paragraph 1, voting rights have been exercised at the general meeting and the result of the vote has been influenced thereby, the resolution adopted as a result shall be void or may be declared void. The rights of third parties acquired in good faith shall not be affected thereby. An action to have the resolution found or declared void may be brought by any shareholder who contests the entitlement of another shareholder to take part in the vote.
3. Such action shall be brought within a time limit which shall be fixed by Member States at not less than three months and not more than one year from the date on which the applicant became aware or ought to have become aware of the notifiable holding. Article 46 of Directive ●●● of ●●● [1] shall apply.
4. The company may require the repayment of dividends to which, by virtue of paragraph 1, a shareholder was not entitled.
5. Member States shall also provide for appropriate penalties where notification is not made in accordance with Article 4(1).

Article 6

1. Holdings notified pursuant to Article 4(1) shall be mentioned by the company receiving such notification in the notes to its annual accounts. Notifications made for the first time, and the notification of subsequent modifications bringing the amount of a holding above or below the threshold levels of 10%, 25%, 50%, 75% or 90% of the company's capital, shall moreover be disclosed forthwith by the company in the manner prescribed by the law of each Member State in accordance with Article 3 of Directive 68/151/EEC. The name of the shareholder making such notification, the notified amount of the holding and voting rights attaching thereto shall be indicated in the notes on the annual accounts and in the publication.
2. Member States may waive mention of the notification in the notes on the annual accounts and, where appropriate, its publication, where such mention or publication would place the shareholder concerned or the company at a significant disadvantage. The management body or person who took such decision shall record it in the notes to the annual accounts.

[1] Proposal for a fifth Directive on the structure of sociétés anonymes: Supplement 10/72 to the Bulletin of the European Communities.

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Article 7

1. An undertaking which dominates a company within the meaning of Article 2 or 3 of this Directive, and which influences directly or indirectly the management of the company, shall be liable to the company for any damage resulting from that influence and attributable to:
   (a) a fault of management, under the same conditions as if the dominant undertaking were a member of the management body of the dependent company, or
   (b) transactions effected or measures taken which are not in conformity with the interests of the dependent company or failure to effect such transactions or take such measures as would have been in conformity with such interests.
2. (a) Each member of the administrative or management body of the dominant undertaking shall, together with it, bear joint and several unlimited liability. A member may however be relieved of liability if he proves that the influence giving rise to the damage is not attributable to him.
   (b) Where members of the management body of the dependent company are also liable, they shall bear joint and several liability with the undertaking and the persons liable pursuant to paragraphs 1 and 2(a).

Article 8

1. Where a company is dominated within the meaning of Article 2 or 3 of this Directive, its management body shall prepare each year a special report indicating exclusively whether:
   (a) the company has in the preceding financial year concluded any agreement on a scale significant to it with
      - the dominant undertaking,
      - a third party dominated by the dominant undertaking,
      - a third party on the initiative or in the interest of the dominant undertaking,
      - a third party on the initiative or in the interests of another person dominated by the dominant undertaking.
   (b) the company has in the preceding financial year taken or failed to take significant measures
      - on the initiative of the dominant undertaking,
      - on the initiative of a third party dominated by the dominant undertaking,
      - in the interests of the dominant undertaking,
      - in the interests of a third party dominated by the dominant undertaking,
   (c) any such agreements or measures or any failures to conclude such agreements or take such measures are wholly or partly detrimental to

the company. Detriment may in particular result from agreement on or imposition of conditions which differ from those which independet undertakings would have agreed between themselves. Where a number of business transactions are consolidated in a single agreement which is not customary in business relations between independent undertakings, those transactions shall be dealt with separately for the purposes of the information required to be given under subparagraphs (a) and (b). Account shall not be taken of any benefits which might compensate for the detriment suffered.

2. The person responsible for auditing the accounts of the company shall examine the accuracy of the particulars contained in the report. The result of the examination shall be recorded in a separate note in the report. Where the auditor has established in carrying out the examination that the particulars given are incomplete, he shall state this fact in the note.
3. The report, together with the note, shall be made available to shareholders from the date of publication or dispatch of the notice – convening the general meeting at which the annual accounts and the appropriation of the annual results are to be considered. It shall be published at the same time as the annual accounts and in like manner.

Article 9

1. On application by a shareholder, or by a creditor of the company who is unable to obtain satisfaction therefrom, or by the duly appointed employees' representatives within the company, the court or authority competent under national law may appoint one or more special auditors where the special report provided for in Article 8 contains particulars as specified in paragraph 1(c) of that article or where facts are alleged which give rise to the presumption that the company has, at the instigation of the dominant undertaking or another person dominated by that undertaking, concluded agreements or has taken or failed to take measures and that the interests of the company have thereby suffered detriment.
2. Before appointing the special auditors, the court or authority shall invite the management or supervisory body and the person responsible for auditing the accounts of the company to appear and to express their observations.
3. The special auditor shall ascertain whether the company has suffered detriment as a result of such agreements or measures or its failure to take such measures and whether it appears that these may result from the influence of the dominant undertaking or another person dominated by it. He shall take account of benefits granted to the company that offset any detriment and shall assess the latter in relation to them.
4. The special auditor shall be entitled to obtain all information and documents necessary to carry out his task both from the company and from the

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undertaking which dominates it and from other persons dominated by the undertaking, and to carry out all necessary investigations.

5. The special auditor shall prepare a written report on the results of his investigation. The management body of the company shall disclose a summary of this report together with the conclusions contained therein in the manner prescribed by the law of each Member State in accordance with Article 3 of Directive 68/151/EEC.
6. The costs of the examination and any advance payments in respect of those costs shall be borne by the company.
7. These provisions shall be without prejudice to national provisions governing procedures for a special audit of the company prescribed for other purposes.

Article 10

1. On application by the persons referred to in Article 9(1), the court or authority competent under national law may, after having ascertained that the dominant undertaking has either directly or through another person dominated by it influenced the management of the company, and has thereby damaged the company, order one or more of the following measures, if it considers this necessary to protect the company, its shareholders or employees:
   (a) suspension from office of one or more members of the management or supervisory body of the company or any other measure under national law having the same effect;
   (b) prohibition of further performance of damaging contracts and revocation of damaging measures without prejudice to the rights of third parties acquired in good faith;
   (c) imposition of a requirement that the dominant undertaking shall offer to purchase the shares of shareholders of the company in the manner and under the conditions laid down in Articles 15 and 17. The management body of the company shall disclose the offer in the manner prescribed by the law of each Member State in accordance with Article 3 of Directive 68/151/EEC within one month from the date of receipt of the report referred to in Article 17. It shall also state that the experts' report referred to in Article 17 shall be sent free of charge to shareholders on request. Shareholders shall be entitled within one month from the date of publication of the offer to request the court to examine whether the offer is appropriate. Article 22(2) shall apply. Shareholders shall be entitled within three months from the date of publication of the offer to require acquisition of their shares. Article 23(2) shall apply.
3. Before ordering the measures provided for in paragraph 1, the court or authority shall invite the members of the management or supervisory body

of the company, the dominant undertaking and, where appropriate, the special auditor to appear and to express their observations.

Article 11

1. Proceedings under Article 7(1) and (2) may be brought by the company or by any shareholder acting on its behalf.
2. Proceedings may also be brought by any creditor of the company who is unable to obtain satisfaction therefrom, without prejudice to the provisions governing arrangements, compositions, bankruptcy, winding-up and similar proceedings.
3. The period within which proceedings may be brought shall be not less than three years from the date of the act causing the damage or, where this has been concealed, from the date of its discovery.

Article 12

Articles 7 to 11 shall not apply where the dominant undertaking is entitled to manage the company pursuant to Articles 24 or 35. The same shall apply in the context of a set of rules introduced under Article 38.

Article 13

A company may, by written contract, submit to management by another undertaking. This undertaking is hereafter called the other party to the contract.

Article 14

1. The contract shall offer every outside shareholder of the company the choice between
   (a) the acquisition of his shares as provided for in Article 15, or
   (b) the annual equalization payment as provided for in Article 16.
2. Outside shareholder means any shareholder of the company with the exception of the other party to the contract and the following undertakings:
   (a) any undertaking dominating the other party to the contract;
   (b) any third undertaking linked with the other party to the contract by reason of a control contract or unilateral declaration within the meaning of Article 33;
   (c) any undertaking belonging to the same group as the other party to the contract within the meaning of Article 38;
   (d) any third undertaking which is wholly owned by the other party to the contract;

   where such undertakings hold shares in the company.

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Article 15

1. The other party to the contract shall offer to acquire for cash the shares of every outside shareholder of the company.
2. However, where the other party to the contract is also a company and is not dependent on another undertaking, it may offer, instead of cash, either to acquire the shares of outside shareholders in exchange for shares or convertible or ordinary debentures of that company, or the choice between cash and such an exchange.
3. Where the other party to the contract is a public limited liability company which has not been formed under the law of a Member State or of the European Economic Community and is not dependent on another undertaking, it may offer the outside shareholders the choice between cash and an exchange of their shares for shares or convertible or ordinary debentures of that company.
4. Where the other party to the contract is a dependent undertaking, it may likewise make an offer to outside shareholders in accordance with paragraph 2 relating to shares or convertible or ordinary debentures of its dominant company, provided that such company is not dependent on another undertaking.
5. Where the other party to the contract is an undertaking dominated by a public limited liability company which has not been formed under the law of a Member State or of the European Economic Community, it may likewise make an offer to outside shareholders in accordance with paragraph 3 relating to shares or convertible or ordinary debentures of the company dominating it, provided that the company is not dependent on another undertaking.

Article 16

1. The other party to the contract shall also offer the outside shareholders of the company an appropriate annual equalization payment. To this end it shall undertake to make them an annual payment of an a[Amount equal at least to that which, having regard to the previous earnings and the future prospects of the company, could probably be distributed as the average earnings per share.
2. Where the other party to the contract is also a company and is not dependent on another undertaking, it may offer the outside shareholders, instead of the annual payment referred to in paragraph 1, either an annual payment of an amount corresponding to the earnings of its own shares or the choice between the two payments.
3. Where the other party to the contract is an independent limited liability company not formed under the law of a Member State or of the European

Economic Community, it may also offer the outside shareholders the choice between the annual payment referred to in paragraph 1 and that referred to in paragraph 2.

4. Where the other party to the contract is a dependent undertaking it may offer the outside shareholders, instead of the annual payment referred to in paragraph 1, an annual amount calculated by reference to the earnings per share of the company dominating it, provided that such company is not dependent on another undertaking.
5. Where the other party to the contract is dominated by an independent public limited liability companyof a merger not formed under the law of a Member State or of the European Economic Community, it may offer to the outside shareholders the choice between the annual payment referred to in paragraph 1 and that referred to in paragraph 4.
6. The ratio between the shares of the companies concerned shall, in the cases referred to in paragraphs 2 to 5, be calculated in the same way as for a share exchange in the event of a merger.
7. In calculating the earnings pursuant to paragraphs 1 to 5, appropriations of the annual profits to optional reserves shall be taken into consideration only in so far as this is justified in accordance with sound business practice.

Article 17

1. The management body of the company shall appoint one or more independent experts and instruct them to prepare a report on the appropriateness of the offers. The experts may be the persons responsible for auditing the accounts of the company.

   Articles 52 to 54, 57 and 62 of Directive ●●● of ●●● [2] shall apply in respect of these experts.
2. In their report, the experts shall in particular state whether the offers of the other party to the contract are in accordance with Articles 15 and 16 and whether or not, in their opinion, they are appropriate. Such statement shall at least:
   (a) indicate the method or methods used to arrive at the payment offered for acquisition of shares, share exchange ratio and equalization payment;
   (b) state whether such method or methods are adequate in the case in question, indicate the values arrived at using each such method and give an opinion on the relative importance attributed to such methods in arriving at the values decided on.
3. The report shall also describe any special valuation difficulties which have arisen.

[2] Proposal for a fifth Directive on the structure of sociétés anonymes. Supplement 10/72 to the Bulletin of the European Communities.

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4. Each expert shall be entitled to obtain from the companies concerned any relevant information and documents, and to carry out all necessary investigations.

Article 22

1. Any outside shareholder may within one month of the publication of the contract pursuant to Article 20 apply to the court for an examination of whether the consideration offered for acquisition of the shares and the annual equalization payment are appropriate. Where the other party to the contract is also obliged to effect disclosure pursuant to Article 21, this period shall commence on the date on which the second publication is made.
2. The Member States shall determine the judicial procedure in accordance with the following principles:
   (a) the court may appoint independent experts at the expense of the company; such experts shall be under the same obligations and enjoy the same rights as experts appointed pursuant to Article 17;
   (b) where the consideration for acquisition or the annual equalization payment are held to be clearly inappropriate, they may be increased by the court;
   (c) the decision of the court shall be res judicata in respect of all shares of the same class as those in respect of which a decision by the court was applied for;
   (d) in cases provided for the subparagraph (b), the decision of the court shall be disclosed by the management body of the company in the manner prescribed by the law of each Member State in accordance with Article 3 of Directive 68/151/EEC after it has acquired the force of a final judgment;
   (e) the costs of proceedings must not be borne by the applicant except in so far as is reasonable.
3. If an increased consideration for acquisition or annual equalization payment is ordered by the court, the other party to the contract may terminate the contract without notice within one month from the date on which the decision of the court has acquired the force of a final judgment.

Article 24

1. (a) From the time of publication pursuant to Article 20, the company shall be subject to management by the other party to the contract. The latter may issue instructions to the management body of the company and such instructions shall be complied with by that body. Where the other party to the contract is also subject to a requirement of disclosure pursuant to Article 21, it may exercise management powers or issue instructions only when the second publication has been effected.

(b) Articles 15 to 17 of the second Directive[3] shall not apply to transactions of the company that must be effected by virtue of an instruction pursuant to subparagraph (a).

2. If an instruction relates to a measure which requires the approval of the supervisory body of the company and if the latter withholds its approval, the requirement of approval shall cease upon repetition of the instruction. This provision shall not apply when account has been taken of employees in the composition of the supervisory board except if their interests are safeguarded in an equivalent manner at the level of the other party to the contract. If the other party to the contract is also a company and if account has been taken in the composition of its supervisory board of the employees of the company receiving the instructions, the instructions may be repeated only with the approval of that supervisory board.

Article 25

The other party to the contract shall exercise its management powers and its right to issue instructions pursuant to Article 24 with the care of a conscientious director and in the group interest.

Article 27

The members of the management body of the company shall not be liable for damage that the company may sustain arising from acts or omissions by them consequent on the exercise by the other party to the contract of its management powers and its right to issue instructions. They shall bear the burden of proof thereof.

Article 29

1. The other party to the contract shall be liable for any obligations of the company arising prior to the conclusion of the contract or during the contractual period. Nevertheless, proceedings may be brought against it only after the creditor has addressed a written demand to the company.
2. The other party to the contract may, however, be relieved of such liability if it proves that failure by the company to fulfill the obligation is attributable to reasons which are not the result of any influence it has or has failed to exercise.
3. The guarantee arising from the liability provided for in paragraph 1 may be invoked from the date of publication pursuant to Article 20 or, where the other party to the contract is also required to effect disclosure pursuant to Article 21, from the date of the second publication.

[3] Directive 77/91/EEC of 13 December 1976, OJ No. L 26 of 31.1.1977, p. 1.

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Article 30

1. The company shall upon expiry of the contract be entitled to require the other party thereto to make good any diminution in the value that the company has sustained during the contractual period. When determining the diminution, the company's capital together with reserves, the profit or loss and the profit or loss carried forward at the date of publication pursuant to Article 20 and such amounts at the end of contractual period shall be taken into consideration.
2. The other party to the contract may, however, be relieved of this obligation if it proves that the diminution in the company's value during the contractual period was not the result of any influence it has or has failed to exercise.

Notes

[1] EEC Treaty, Article 54(3)(g) reads:

3. The Council and the Commission shall carry out the duties devolving upon them under the preceding provisions, in particular: ...
(g) by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 58 with a view to making such safeguards equivalent throughout the Community.

The second paragraph of Article 58 provides:

"Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

[2] The EEC Council generally accepts such proposals by unanimous vote, although only a qualified majority is required.

[3] The text of the draft proposal has not been officially distributed, though the 1974–75 pre-draft was made public. The authors, like several organizations which have published comments, have had access to the unofficially released version which is reproduced in the appendix. *See infra* notes 96, 99 and 101.

[4] *See* R. Goerdeler, Überlegungen zum europäischen Konzernrecht, 1973 Zeitschrift für Unternehmens- und Gesellschaftsrecht at 389 [hereinafter cited as ZGR]; U. Immenga, Konzernverfassung ipso facto oder durch Vertrag?, 1978 *Europarechts* at 242; P.M. Wiesner, Zum Stand des Europäischen Gesellschaftsrechts, 1978 Recht der Internationalen Wirtschaft, Aussenwirtschaftsdienst des Betriebs-Beraters at 1, 5.

[5] *See, e.g.*, Fourth Council Directive of July 25, 1978, based on Article 54(3)(g) of the EEC Treaty on the Annual Accounts of Certain Types of Companies (78/660/EEC), O.J. Eur. Com. (No. L.222) 11 (1978); Proposed Fifth Council Directive to Coordinate the Safeguards Which, for the Protection of the Interests of Members and Others, Are Required by Member States of Companies within the Meaning of Article 58(2) of the Treaty, as Regards the Structure of Sociétés

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Anonymes and the Power and Obligations of Their Organs, O.J. Eur. Com. (No. C 131) 49 (1972) [currently being amended]; Proposal for a Regulation on a Statute for a European Stock Corporation based on Article 235 of the EEC Treaty, Bull. Eur. Com. Supp. 4/75 (1975); Proposed Seventh Council Directive Concerning Group Accounts, 1978 Eur. Com. Documents at 703; Proposed Eighth Council Directive Concerning the Approval of Persons Responsible for Carrying Out Statutory Audits of the Annual Accounts of Certain Types of Companies, O.J. Eur. Com. (No. C 112) 6 (1978) [amended, December 5, 1979].

[6] The English term "concern", a cognate of the German "Konzern", refers to "an establishment or firm for the transaction of business; a manufacturing or commercial establishment". Webster's *New Universal Unabridged Dictionary* 376 (2nd ed. 1983).

[7] *Cf.* Immenga, *supra* note 4, at 242 (with further references to the French view); UNICE 1981 Comment, *infra* note 99, item A1.

[8] *See* M. Lutter, Europäisches Gesellschaftsrecht, Sonderheft 1 der Zeitschrift für Unternehmens- und Gesellschaftsrecht 1979, at 6 *et seq.*

[9] Goerdeler, *supra* note 4, at 389, 392; Immenga, *supra* note 4, at 242.

[10] *See* discussion *infra* at note 92.

[11] *See* section 2.1.2.2 *infra*.

[12] E. Gessler, Das neue Aktienrecht, 1965 Der Betriebs-Berater at 677, 681.

[13] *Cf.* H. Würdinger, in Grosskommentar zum Aktiengesez, introduction to AktG sections 15–19 (1973).

[14] *See, e.g.*, EEC Enterprises Compared with Their Competitors, Survey by UNICE [1965–1969 Transfer Binder] *COMMON MARKET REPORTER* (CCH) ¶9029 (February, 1965).

[15] Government draft of the 1965 Act, document no. IV/171, at 94 [hereinafter referred to as "Government draft"]; *see also* V. Eckardt, in E. Gessler and W. Hefermehl et al., Aktiengesetz, introduction n. 29 (1973).

[16] The term "enterprise", which is used but not defined in German statutes, is a generic term which encompasses both incorporated and unincorporated business and includes foreign as well as domestic entities.

[17] AktG section 20(1).

[18] *Id.* at section 20(4).

[19] *Id.* at section 20(5).

[20] *Id.* at section 20(6).

[21] *Id.* at section 20(7).

[22] *See* Government draft, *supra* note 15.

[23] This procedure was inspired by foreign, in particular American, models. The official explanation of the Government draft refers to U.S. securities laws as well as to English, Canadian, and Swedish legislation. *See* Government draft, *supra* note 15.

[24] AktG section 329(2). Specific rules apply if the enterprise heading the group is not a corporation, *cf.* AktG section 330, or if German corporations are controlled by a foreign entity, *cf.* AktG section 330(2).

[25] AktG sections 15–19, 291, and 292.

[26] *Id.* at section 17.

[27] AktG section 18 (1).

[28] *Id.*

[29] *Id.* at section 18(2).

[30] *Id.* at section 291.

[31] *Id.* at section 292.

[32] *Id.* at section 293(3).

[33] *Id.* at section 293(1).

[34] *Id.* at section 294. *Cf.* AktG sections 293–298 as to amendment and termination of enterprise agreements.

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[35] *Id.* at section 293(2).

[36] *Id.* at section 293(4).

[37] K.H. Biedenkopf and H.G. Koppensteiner, in Kölner Kommentar zum Aktiengesez, section 15, annot. 7 (1970); V. Emmerich and J. Sonnenschein, Konzernrecht (2nd ed. 1977), 23 *et seq.*

[38] AktG section 308.

[39] *Id.* at section 309.

[40] *Id.* at section 310.

[41] *Id.* at sections 302, 303.

[42] *Id.* at section 304.

[43] *Id.* at section 305.

[44] *Id.* at sections 302–305.

[45] *See* text at note 31, *supra.*

[46] Sections 304 and 305 of the AktG are not applicable to such agreements. The varying consequences of the several types of agreements in this second category are provided in AktG sections 300–303.

[47] AktG section 311.

[48] *Id.* at section 317.

[49] *Id.* at section 317(2).

[50] *Id.* at section 312.

[51] *Id.* at section 318.

[52] *Id.* at section 315.

[53] *Id.* at sections 319–328.

[54] *Id.* at section 320.

[55] *Id.* at section 319.

[56] *Id.* at section 322(1).

[57] *See* Wiedemann, *The German Experience with the Law of Affiliated Enterprises*, in II Groups of Companies in European Law: Legal and Economic Analyses on Multinational Enterprises 22, 32 (K. Hopt ed. 1982).

[58] *Id.* (citing 62 BGHZ 193, 197).

[59] *Id.* at 23.

[60] *Id.* at 33; *see also* Immenga, *supra* note 4, at 242, 247; Emmerich and Sonnenschein, *supra* note 37, at 152.

[61] Wiedemann, in K. Hopt, *supra* note 57, at 34.

[62] *See* Provincial High Court Düsseldorf (OLG Düsseldorf), 1977 Wertpapiermitteilung ("WM") 797, 798 and 1978 Die Aktiengesellschaft ("AG") 238, 239; Provincial High Court Celle (OLG Celle) 1979 AG 230, 233; Provincial Court Hanover (LG Hanover) 1979 AG 234, 235.

[63] Wiedemann, *supra* note 57, at 35.

[64] *Id.*

[65] Emmerich and Sonnenschein, *supra* note 37, at 194, 195; Wiedemann, *supra* note 57, at 36.

[66] H. Wiedemann, Gesellschaftsrecht 799 *et seq.* (1980); *but see* Würdinger, *supra* note 13, introduction at 35.

[67] *See, e.g.*, sections 305 II and III (indemnity), 330 II (preparation of partially consolidated financial statements), 334 I sentence 3 (report of the management for the combine) AktG.

[68] *See* H.G. Koppensteiner, "Faktischer Konzern" und Konzentration, 1973 ZGR 1, 12.

[69] Emmerich and Sonnenschein, *supra* note 37, at 221.

[70] *See* Federal Ministry of Justice (Bundesminister der Justiz), Report of the Enterprise Law Commission (Bericht der Unternehmensrechtskommission), Bonn, No. 1418 *et seq.* (1980).

[71] *See* Bundesminister der Justiz, *supra* note 70, no. 1449 *et seq.* (with respect to the negative position of the Enterprise Law Commission towards the 1974–75 pre-draft proposal of a Ninth EEC Directive).

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[72] *See* R. Houin, *Les groupes des sociétés en droit français*, in II Groups of Companies in European Law: Legal and Economic Analyses on Multinational Enterprises 45 *et seq.*, 58 (K. Hopt ed. 1982).

[73] *Id.*

[74] *Id.*

[75] *Id.* at 58.

[76] *Id.*

[77] *Id.*

[78] D.D. Prentice, *Groups of Companies: The English Experience*, in II Groups of Companies in European Law: Legal and Economic Analyses on Multinational Enterprises 99 (K. Hopt ed. 1982).

[79] *Id.* at 100.

[80] *Id.* at 102.

[81] *Id.* at 112.

[82] *Id.* at 123–125.

[83] *Id.* at 110.

[84] *Id.* at 111.

[85] P. Van Ommeslaghe, *Les groupes des sociétés et l'expérience du droit belge*, in II Groups of Companies in European Law: Legal and Economic Analyses on Multinational Enterprises 59 *et seq.*, 98 (K. Hopt ed. 1982).

[86] *Id.*

[87] *Id.*

[88] *Id.* at 93.

[89] *See* W.F. Bayer, *Horizontal Groups and Joint Ventures in Europe: Concepts and Reality*, in II Groups of Companies in European Law: Legal and Economic Analyses on Multinational Enterprises 5 (K. Hopt ed. 1982). Examples of such horizontal groups include AgfaGevaert (German/Belgian); Dunlop Pirelli (French/Italian); Hoesch–Hoogoven–Estel (German/Dutch); Fokker–VFW (German/Dutch); and the bi-national management structure of the Enka group within the Akzo group of companies.

[90] *Id.* at 3 *et seq.*

[91] *See, e.g.*, R. Houin, *supra* note 72, at 45, 58. ("Even though the phenomenon of enterprise groups is quite important in France, the pertinent French law is poor. This is especially true for the statutory law, while there is a certain body of relevant case law. There is no general legal definition of what constitutes an enterprise group....") *Cf.* German Konzernrecht, see text *supra* at notes 9–71 (more highly developed body of law governing related enterprises).

[92] EC DOK No. 15.524/XIV/70-D.

[93] EC DOK No. XI/328/74-D.

[94] EC DOK No. XI/593/75-D.

[95] *Cf.* M. Lutter, *supra* note 8, at 29.

[96] See letter of the working Committee "Enterprise Law" of the working group "European Company Law" within the Federal Association of German Industries ("BDI"), dated December 11, 1980, p. 2 ("BDI Letter"). With respect to the French point of view, *see* R. Houin, *supra* note 72, at 58; Yves Guyon, *Examen critique de projets européens en matière des groupes de sociétés*, in II Groups of Companies in European Law: Legal and Economic Analyses on Multinational Enterprises 155 *et seq.* 174 (K. Hopt ed. 1982).

[97] Official BDI Comment, dated March 30, 1976, on parts I and II of the 1974–75 pre-draft for a proposal of a Ninth Directive; BDI letter, *supra* note 96, at 2.

[98] *Cf.* M. Lutter, *supra* note 8, at 30 (compares English, French and German literature on the subject).

[99] The response of UNICE to the draft proposal is set forth in the UNICE 1981 Comment, dated April 23, 1981.

[100] *See supra* notes 96 and 99.

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[101] The Commission indicated that further revisions of the draft proposal will not be published or made available to third parties until the full Commission has adopted a revised version as the official proposal.

[102] The Notes state on page 37:

...the provisions contained in this document are not concerned solely with the elimination of legal obstacles; they are intended above all to provide a framework in which groups can be managed on a sound legal basis whilst ensuring that interests affected by group operations are adequately protected. Such a legal framework adapted to the social circumstances of groups is lacking in the legal system of most Member States.

[103] *See* R. Goerdeler, *supra* note 4, at 389, 390.

[104] *See* the UNICE 1981 Comment, *supra* note 99, items A 1 and 2, stating:

that the Commission has not adduced any evidence that the development of groups has been hampered by existing company laws, and that indeed the contrary would seem to be demonstrated by the fact that nine out of ten Member States have not considered it necessary to introduce a system of group law. UNICE considers that company law in the various Member States has hindered neither the formation of groups of companies nor their proper functioning;

U. Immenga, *supra* note 4, at 242. On the French point of view, *see* R. Houin, *supra* note 72, at 58; Y. Guyon, *supra* note 96, at 174.

[105] The types of companies affected by the draft proposal would include: the Société Anonyme (S.A.) in Belgium, Luxembourg and France, the Società per Azioni (S.p.A.) in Italy, the Aktiengesellschaft (AG) in Germany, the Namenloze Vennootschap (N.V). in The Netherlands and Belgium, The Aktieselskabet in Denmark, and, in Ireland and the United Kingdom the public company limited by shares and the public company limited by guarantee and having a share capital. (Greece was not a Member State when the most recent draft proposal was released.)

[106] Article 2.1 of the draft proposal. The definitions of dependence contained in Article 2 of the draft proposal are equivalent to sections 16(4) and 17 of the AktG.

[107] *See* UNICE 1981 Comment, *supra* note 99, items B 5 through 9.

[108] *See* UNICE 1981 Comment, *supra* note 99, item B 10; BDI Comment, *supra* note 97, to Article 7 of Part II of the 1974–75 pre-draft proposal.

[109] *Cf.* Articles 4 through 6 of the draft proposal.

[110] *See* UNICE 1981 Comment, *supra* note 99, item B 29; for an increase of the percentage quotas for notifications *see* BDI letter, *supra* note 96, and BDI Comment, *supra* note 97, at Article 18 of part I.

[111] UNICE 1981 Comment, *supra* note 99, item B 11.

[112] *See* Second Council Directive on Coordination of Safeguards, O.J. Eur. Com. (No. L. 26 a(1977); Fourth Council Directive, *supra* note. 5.

[113] *See* UNICE 1981 Comment, *supra* note 99, item A 4 (regarding section 4 as unacceptable).

[114] *See* UNICE 1981 Comment, *supra* note 99, item B 19; BDI Comment, *supra* note 97, Article 1 of part II; on the proposed Fifth Council Directive, *see* note 5 *supra*.

[115] B. Kropff, in E. Gessler and W. Hefermehl et al., *supra* note 15; AktG, section 315, annot. 1 (1976).

[116] See UNICE 1981 Comment, *supra* note 99, item B 24; BDI Comment, *supra* note 97, Article 3 of part II.

[117] *See supra* notes 111 and 112 and accompanying text.

[118] UNICE 1981 Comment, *supra* note 99, item B 25; BDI Comment, *supra* note 97, Article 5 of part II; BDI letter, *supra* note 96.

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[119] *See* UNICE 1981 Comment, *supra* note 99, item B 26.

[120] *See supra* text accompanying notes 11–71.

[121] *See* Notes to Article 15 of the draft proposal, at 68.

[122] *See* UNICE 1981 Comment, *supra* note 99, item B 33; BDI Comment, *supra* note 97, Article 12 of part II.

[123] *See* appendix, Article 25.

[124] *Id.*, Article 27.

[125] *Id.*, Article 29.

[126] *Id.*, Article 30.

[127] Every German stock corporation is required to have a two-tier board system consisting of a board of managers and a supervisory board. *See generally* AktG, Sections 95–116; UNICE 1981 Comment, *supra* note 99, item B 34. If an enterprise is not structured as a stock corporation, a two-tier board system may still be required by the German co-determination laws.

[128] *See* BDI Comment, *supra* note 97, Article 23 of part II.

[129] *See* UNICE 1981 Comment, *supra* note 99, item B 35; BDI Comment, *supra* note 97, Articles 21 and 22 of part II; BDI letter, *supra* note 96.

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