Best Company Practice

A Duty of Loyalty for the Purpose of Preventing Abuse of Powers Under Company Law

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The primary aim of this article is to investigate whether a concept of abuse may be defined within company law with such clarity as to establish with reasonably certainty when the exercise of powers ordinarily permitted under company law must be denied, because it has been found that their exercise would constitute "abuse" of the powers in question. In accordance with the rules of "*best practice*" in a number of other areas, the article then proceeds to argue for the introduction of a concept of "sound company practice" as a dynamic legal standard for the measures which a limited liability company may or may not apply in relation to minority shareholders, company creditors, basic social interests, etc.

A *best practice* rule could prevent the worst cases of abuse of company legal powers. A *best practice* rule has the advantage of blurring the otherwise sharp edges between ordinary ethics and razor-sharp legal argumentation, as it raises some of the ethical requirements "up" to the legal level. If *best practice* rules had applied in company law, this might have prevented the cases of anti-social company raiding which have been so rampant in Denmark and which were tried by the Supreme Court through the judgment handed down in the *Satair* Case analysed later in this article.

1 Abuse of Powers in the Context of Company Law

In the context of company law, "abuse of powers" may be tentatively defined as any kind of use other than that for which the powers in question were intended by their very nature. Any such definition is, however, far too broad to constitute an adequate basis for establishing a case of "abuse of powers".

Especially in areas where the concept of abuse is new to us, i.e. where the law is virgin territory with regard to acceptance of the concept, we must demand something more in order to establish abuse, and this "more" is a certain subjective element which focuses on what the decision maker must have realised. Gradually, however, as the concept gains ground as a well-established legal institution within the relevant law, the subjective condition gains

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objectivity or may be omitted entirely, as we begin to draw our conclusions on the basis of existing objective props to the essential subjective element.

The construction of law in the area thus reaches its peak at the point where the subjective element can simply be abandoned with the establishment of standards for what we will tolerate and - especially - what we will not tolerate. With the final building block, we discard our need for the term "abuse". This vague concept acted merely as the pile driver used to force a general acceptance among legal players of the fact that something which is otherwise formally permitted should nevertheless be materially banned.[1] At this point in our deliberations, the concept of "sound company practice" enters the picture.

The concept of abuse evolves gradually as a reaction to something which the law-makers could not - or at any rate did not - guard against. A thing which may be abused is by definition a thing which is "used". Fundamentally, therefore, abuse arises out of the exercise of some active outwardly directed powers, in contrast to more passive inwardly directed powers.

The concept of abuse of powers is closely related to the concept of evasion. Although the border between the two concepts can be somewhat hazy, the distinction can be defined by saying that one abuses a *right*, for the purpose of evading a *duty*.

Abuse may often be prevented through suitable initiatives by the authorities which make the law and/or those which apply it. Such initiatives are either corrective or - often better - preventive in nature. If they are preventive, they should in principle be exercised with due observance of proportionality, to produce an adequate reaction to the abuse. We may ban weapons in private homes to avoid their being abused, but we cannot, for example, place a blanket ban on corporations simply because they may be abused. The issue at stake here is whether some of the initiatives taken to prevent abuse of companies may be said to be disproportionate, and in my view this cannot entirely be denied.[2]

Our experience with abuse (including court judgments etc.) within company law derives primarily from the category of corporations (public and private share companies and limited liability cooperatives), and to a much lesser extent from the categories of partnerships and limited partnerships. The reason is quite simply that a share company provides access to two central powers which are capable of abuse, namely (1) the limitation of liability to the outside world, i.e. an abuse of the legal person *per se*, and (2) the majority principle (in internal

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1 The development of the concept of abuse of power shows certain parallels to the development in administrative law of *détournement des pouvoirs* (*misbrug*, *Ermessensmissbrauch*), which also assumed a more subjective form before gradually becoming more and more standardised. For my work in my doctoral thesis "*Selskabsmasken*" (1991), I sought a considerable amount of inspiration in administrative law, as administrative authorities, like e.g. company organs, have the power to make decisions which carry (legal) implications for others.

2 Following a recent change in law, it is the case, for example, that a private or public company cannot be issued with the company registration number so vital for its existence if a person closely associated with the company as defined by the terms of the law has, within the last five years, been involved in a company which inflicted losses on the State: cf. in detail the Danish Taxation at Source Act Art. 56A, Item 2, cf. Art. 85.

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relations, where 51% of the voting power decides on all essential issues, unless the statutes and/or an agreement parries this principle).

2 Abuse of Limitation of Liability (Abuse of External Relations)

Limitation of liability (the ownership of a share company, a legal person) can be abused in a number of phases: in the establishment phase (2.1), in the operating phase (2.2), and finally in the dissolution phase (2.3).

2.1 The Establishment Phase

Under current company law, the most pressing risk is the abuse of share companies in dealings with the *company's* creditors, but the classic fear was actually the risk of abuse of the *founder's* creditors. The question thus posed is who is the object of interest: whom should a concept of abuse aim to protect? In the British companies of the 1400s, generally seen as the forerunners of the modern share companies (which in turn arose out of the trading companies of the 1600s), the fear of abuse of the legal person was concentrated on the scope for using it as protection against the *founder's* creditors.[3] This fear of abuse (and the question of whether one can react to an anticipated abuse) is as current as ever: cf. thus decision by the European Court of Justice in the *Marleasing* case, decision of 13 November 1990.[4] Irrespective of any risk of abuse, the fear of abuse did not constitute grounds for deeming the company in the Marleasing case to be invalidly founded; in other words, it would be a disproportionate measure to annul an entire company merely because its foundation was an expression of "abuse".

The next question in relation to the establishment of companies is whether we can entirely ban a person from founding a company because we fear abuse of the limited liability. Such a ban is possible in connection with a criminal sentence (cf. the quarantine rule of the Criminal Code's Art. 79, Item 2, 2nd clause). A demand for application of this provision was, for example, made in a widely reported criminal case in Denmark, the so-called *Jydebrødre* case. (The case was, however, dismissed, thus rendering the question of application of the rule irrelevant).[5] According to the rule, a person may be deprived (for 1-5 years) of the right to be the "founder, manager or board member of a company with limited liability, a company, or an association ... or a trust". The original draft bill also included "... or having a dominant influence in ...", but this was found to go too far -- one might say: disproportionate, incalculable -- and was cut from the final text.

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3 See Erik Werlauff: *Generalforsamling og beslutning* (1983) pp. 24ff.

4 A question on the direct enforceability in Spanish law of Article 11 of the First Company Directive, giving an exhaustive list of the cases in which a company can be declared to have been unlawfully founded. The suspicion that the purpose of establishment was to erect a shelter against the founder's creditors through the founder's investment of his non-liquid assets in the company did not constitute adequate grounds for nullifying the company.

5 Decision by Herning Court of 19 June 1990. Further on this case, see Erik Werlauff in *FSRs Årsskrift* 1991 Skatteret-Erhvervsret pp. 323ff.

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By virtue of its link to an actual criminal case, Art. 79 of the Criminal Code is directly controlled by the courts (and also by the proportionality principle), but a couple of years ago, a different and more dubious attempt was made to prevent abuse of companies. Under the new rules, a company registration number for tax purposes may be denied to a company if, within the last five years, its actual owner or a member of its board or management has been the owner or a board member or a manager of a company which has inflicted losses on the government (cf. the Danish Tax at Source Act Art. 56A, 2 cf. Art. 85). A bank guarantee is then demanded for the amount of three months' estimated tax at source, and if the security is not made available within eight days, the undertaking/company is denied registration with the companies register. It is of course a very serious matter for a company to encounter such a reaction, which in reality prevents it from functioning as a company: no wages can be paid, no bank account established, etc. The rule raises a number of doubts, although it is governed by a proportionality principle (if lesser measures are adequate -- abbreviated accounting periods for tax payments -- the authorities cannot apply the rule).

There are other possibilities for abusing a company during the establishment phase than the sheer risk of using the company for inflicting further losses on the state. It is conceivable, for example, that an attempt might be made to evade the capital requirements (in Denmark now DKK 500,000 for a public company and DKK 125,000 for a private company). Such an attempt might involve application of a company form which is inappropriate to the content, e.g. a cooperative. In this case the situation may be described as an attempt to abuse a *right* (the right to exercise a free choice of the legal form which one's business is to have) in order to evade a *duty* (the duty to provide a certain minimum capital as a precondition for the registration of certain company forms). The founders may call the undertaking a cooperative with limited liability (in order to avoid the minimum capital required for an Ltd. or plc), but it is genuinely a company with the distinguishing features of a private or public company. In such cases, the absence of a genuine link to the cooperative form prevents the company from being deemed to be a limited liability cooperative; rather, it must be considered a failed attempt at establishing a private or public company which floundered on the inability to raise the required minimum capital, and therefore cannot be appropriately registered.

> In decision of 7 January 1993,[6] the Danish Commerce and Companies Appeal Board upheld the decision of the local companies register in accordance with a statement by the Danish Commerce and Companies Agency that a company could not be filed with the register under the name requested because the official abbreviation for a limited liability cooperative entered into the name, although the company did not possess the distinguishing features of such a cooperative as described in the Danish Companies Act's Art. 1 Item 4 and the Danish Private Companies Act's Art. 1 Item 4. The company possessed all the features of a public or private company, but lacked the statutory minimum capital.

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6 In case 91-69.320, *Årsberetningen 1993* p. 254.

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> The mere fact that the company called itself a cooperative without being one was adequate reason in the opinion of the Appeal Board to support the decision to reject registration with the companies register.
> The company argued, however, that it was eligible for registration "pursuant to the freedom available under company law to enter into contracts as a company with limited liability, although neither a public nor a private company nor a cooperative". The Danish Commerce and Companies Appeal Board's response to this was: "The presumptions on which a company with limited liability which falls outside the statutory company types and which is legally founded in compliance with the basic principle of freedom to enter into contracts under company law may be recognised are the existence of circumstances which have conditioned the formation and structure of the company in such manner as to set the company apart in essential ways from the statutory company types. The Appeal Board is in accord with the police commissioner and the Danish Commerce and Companies Agency, that with regard to its construction, disclosed ownership, liability, dividend entitlements and dissolution, the company in question is not significantly different from a public or private company. The fact that the company was formed with no contributed capital and thus does not fulfil the capital requirements of the Companies Act and the Private Companies Act is not in itself adequate reason for the company to fall outside the scope of these acts".

The Appeal board then upheld the rejection.

In view of this decision, one could imagine the founder making an attempt to use an entirely different form of company (i.e. with no cooperative associations), e.g. a "home-made" company form, and the area of freedom of type under company law can hardly be considered entirely clear, but to some extent such attempts must also be rejected as attempts at abuse.

> Cf. e.g. *TfS 1993.606 Ø*, where a businessman owed money to the tax authorities. A petition was made for distress to be levied on his undertaking. He argued that the firm was not his, but a separate legal person by the name of "Venus Kiosk & Pizza S.m.b.a." [an abbreviation used for a company with limited liability], and the bailiff's court cancelled the bailiff's levy on the grounds that the execution was levied in a shop which the court was informed was not the property of the owner (the person). The High Court, however, based its grounds on the fact that the term "S.m.b.a." did not refer to an independent legal object, and the execution could therefore proceed.[7] In my view, the decision shows that the High Court was aware of the possibility of abuse.

The founder's reaction to this might be to choose a company which would be undeniably a share company - only it would not be a Danish company. The choice might, for example, fall on a cheap foreign company which would then establish a Danish branch before applying for recognition as a legal person on an equal footing with Danish companies. This possibility raises the following

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[7] The decision did not provide any detailed arguments, thus making it impossible to see whether the High Court rejected the legal personality because (a) the formalities of formation and separation were not complete (which cannot be seen from the case), or (b) because a loosely named "cooperative" with no foundation in the requisite company form cannot be recognised as a legal person.

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interesting question under company law: Can a company domiciled abroad be so "weak" that we refuse to accept its branch in this country? *If* we answer yes to this question, two possible reactions arise. One is a subsequent reaction, whereby we refuse to recognise the company as a company, and instead sanction the lifting of the veil (reject the limitation of liability) protecting the company's actual creditors. The second possibility is a pre-emptive reaction whereby we refuse to register the branch as a branch because we do not recognise the company (thereby protecting future creditors).

The European Treaty's Art. 43 plus Art. 48 (former Art. 52 plus Art. 58) *appear* to give us the direct answer that we *must* accept the company. A foreign company is just as good as a Danish company, and any one among us wanting to conduct his business in the form of a company must be able to choose freely whether to use a national or a foreign company: cf. the criterion in the judgments *The Commission versus France, Segers versus Bedrijfsvereiniging and Commerzbank*.[8]

In *the Commission versus France*, decision of 28 January 1986, Case no. 270/83, E.C.R. 1986, p. 273, France had enforced tax regulations which allowed a certain tax rebate for shareholders of French companies (in partial compensation for double taxation of company income). A distinction was, however, made between a foreign company as shareholder and a French company, as a foreign company with a French branch was not entitled to the rebate. This was in contravention of the establishment rules of Art. 52 (cf. Art. 58), and the Court did not accept France's argument that all a foreign company needed do was to establish a French subsidiary, as Article 52 specifically provides freedom of choice for companies with respect to how they want to establish themselves transnationally (via branches, subsidiaries, agencies, etc.).

In the case of *Segers*, decision of 10 July 1986, Case no. 79/85, E.C.R. 1986, p. 2375, the Dutchman Mr Segers had elected to conduct his business in Holland in the form of a British private limited company, Ltd.) instead of using a Dutch public or private company. When he was taken ill and applied for sickness benefits as manager of his company, the application was refused as his company was not Dutch. The Court decided that this contravened the establishment rules.

In the case of *Commerzbank*, decision of 13 July 1993, case no. C-330/91, the German Commerzbank AG had made a tax payment on account on behalf of its branch in Great Britain, but as the branch's income (interest from the USA) was tax free in Great Britain, the payment on account was to be refunded to the branch. When refunding such tax payments, companies domiciled in Great Britain were paid accrued interest, while similar interest payments were denied companies domiciled in other States. The Court decided that this explicitly contravened the Treaty's Articles 52 and 58, and the fact that if the foreign companies had been domiciled in Great Britain, they would not have been exempt from payment of the tax involved in the case was irrelevant for the case. Following the decision, the British tax authorities were forced to make refunds going back a number of years to thousands of foreign companies which had thus suffered discrimination under the tax rules.

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[8] Cf. Erik Werlauff: *EC Company Law - the Common Denominator for Business Undertakings in 12 States* (1993) pp. 17ff. and the second Danish edition of the same work: EF-selskabsret; 12 staters fælles virksomhedsret (1994) pp. 88ff.

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Similarly, the criterion by which we recognise or refuse to recognise a foreign company as a legally established person indicates strongly that we cannot censor companies according to those we like and those we don't. As is known, the Scandinavian countries apply the registration or incorporation criterion (in contrast to the main seat criterion dominant in the other EU States except Great Britain, Ireland and Holland).[9]

But should these noble principles also apply if the company has absolutely no business links to its home State? If it has been established solely in order to evade our national requirements respecting its minimum capital? (in Denmark, as already noted, DKK 500,000 for a public company and DKK 125,000 for a private company). In such cases one could presume that we can refuse to register the branch on the just grounds - and without coming into conflict with Community law - that the use of a company domiciled in another State with which the company lacks any genuine link constitutes such abuse of the relevant legal form as to entitle us to take such pre-emptive action - and not just to react by sanctioning the loss of limited liability - as to refuse to register the establishment of a branch of the company in this country.

An example of this is found in recent Danish court practice, although the decision has been appealed, and was referred to the ECJ by the Danish Supreme Court. See High Court Judgment from Østre Landsret reported in the Danish journal *Skat Udland* (*S.U.*) 1995.324 Ø *Centros Limited* (UK).[10]

> In judgment of 8 September 1995 (7. Afd. no. B-3114-93, reported in *S.U.1995.324 Ø, Centros Limited*, England), the High Court established that an empty British private company cannot be used to evade the Danish rules on minimum capital requirements when the company is not engaged in any kind of activity in its home country, and now wants to establish a Danish branch.
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> The company was established in 1992, but had been dormant until it was bought by a Danish couple who entered into managerial and board positions. According to the statutes, the company capital was £100, but only two shares each of £1 had been paid up.
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> When the company wanted to establish - and register - a Danish branch, the Danish Commerce and Companies Agency demanded an explanation of where the company had its main activity and administrative seat. Unless documentation was provided proving that Centros Limited was engaged in a genuine business activity and was thus a commercial enterprise, the Agency would not register the branch.[11]

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9 Cf. Geir Woxholth in *Lov & Rett* 1993.579ff.

10 The decision and the genuine link criteron are reviewed and analysed by Erik Werlauff: *Koncernretten* (1996) pp. 80ff.

11 The refusal to register the company was taken to the high court and in line with this, the Minister for Industry gave the following answer to a question to the minister: "Any foreign undertaking, including a British limited company (Ltd.), can undertake commercial activity in Denmark through a branch (secondary establishment) or through the establishment of a public or private company (primary establishment). The establishment of a branch in Denmark in accordance with the law on establishment requires that the foreign company has a basis in reality. It must have been lawfully established in its home country and operate a proper commercial business there. Thus the foreign company may not be an empty shell, a major purpose of which is to avoid the Danish requirements concerning company capital. If

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> Counsel for the Danish Government argued in court that the branch covered by the application must be deemed to be the company's main establishment. Counsel referred *inter alia* to the fact that according to evidence given in court, the capital in England had not been paid up. Counsel pleaded further that "according to European Court of Justice precedent, the refusal to effect registration was in agreement with the European Treaty's Art. 58, cf. Art. 56 [presumably a typing error in the case record for "Art. 58, cf. Art. 52"], as registration of a branch in Denmark must be deemed to be evasion of the minimum capital requirement of the Danish Private Companies Act's Art. 2, while the establishment in England had likewise been effected with a view to conducting the company's full and entire activity in Denmark."
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> Counsel finally pleaded that "registration had been refused for the purpose of protecting certain public law interests, such as prevention of the phoenix syndrome and protection of creditors and joint contractors, and this purpose cannot be pursued by less radical measures."

In the grounds for its decision, the Court stated: "Based on the information before it, the Court finds that [the couple] acquired Centros Limited for an amount corresponding to approx. DKK 1,000 with the sole purpose of establishing a branch of this company in Denmark in order to evade the Danish statutory minimum capital requirements. The Court also finds that Centros Limited does not conduct any kind of activity. In decision of *6 October 1976 in case no. 14/1976*, the European Court of Justice established that it is a significant feature of a branch that it is subject to the management and control of the parent company. In addition, in decision of *5 October 1994 in case no. C-23/1993 [TV 10]* concerning the freedom to supply services, the Court has said that a Member State cannot be denied the right to introduce measures to prevent exploitation of the freedoms guaranteed under the Treaty by a service provider whose business is aimed fully or mainly at the territory of the state but such as to evade the rules which would apply to him if he had been established in the territory of the State".

The Court then concluded as follows: "As the High Court finds that *the evasion of preceptive Danish law which was Claimant's intention* is not, according to European Court of Justice case law, protected by Community rules on the freedom of establishment, the Court dismisses the case" [emphasis added].[12]

In its decision of 9 March 1999 in C-212/97, *Centros Ltd.*, the European Court upheld the case of the Danish couple Marianne and Tonny Bryde against

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the above requirements are not satisfied, the prospective company cannot be registered as a branch of a foreign company. This follows from Art. 157, Item 1 of the Danish Companies Act and Art. 127, Item 1 of the Danish Private Companies Act. The prospective "Ltd.", having in a legal sense associations only with Denmark, must instead be deemed to be a Danish public or private company which must fulfil the ordinary legal requirements concerning the formation of a Danish company, including a minimum capital of DKK 500,000/200,000".

12 The High Court decision in the Centros case is discussed by the editor in *S.U. 1995.322*. The editorial comment presumes "that it will no longer be possible for Danish people to operate a business in Denmark and avoid the Danish capital requirements in company law by using a company in England".

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the Danish Companies and Commerce Agency. The Court found that the Agency could not refuse to register a branch of Centros, on the grounds that Centros does not trade in the United Kingdom but conducts all its business in Denmark, and that a British company was chosen in order to avoid the Danish capital requirements for registered private companies, cf. *Erik Werlauff* in ZIP 1999.867 ff.

The judgment does not even allow for mitigating circumstances such as the possibility of imposing the Danish capital requirements applying to private companies. The only reservation mentioned in the judgment is ”fraud”, allowing Member States to adopt ”the necessary guarantees” to protect public creditors against fraudulent conduct and to penalise any fraud committed by the company or its members ”where it has been established that they are in fact attempting, by means of the formation of a company, to evade their obligations to private or public creditors established in the territory of the Member State concerned,” in this case Denmark.

In order to prevent circumvention of capital requirements through the choice of a non-regulated company type, for which of course no capital requirement can be made, Danish case law has been exceedingly restrictive in its recognition of alternative company types – so restrictive, in fact, that the situation in law approximates a state of compulsion with regard to type, *Typengesetzlichkeit, cf. TfS* 1993:606 Ø, *TfS* 1997:287 Ø and *TfS* 1997:288 Ø. Companies have also been refused recognition in cases where liability limits etc. have not been transparent to the public: cf. *UfR* 1998.1088 Ø and *TfS* 1998.644 V.

There is a straight line of logic from this practice to the practice which the Agency attempted to apply in the case of Centros, but which was rejected by the Court. This does not necessarily imply, however, that all attempts at protecting capital are wasted, but as the situation applying to any person about to chose a company form for his business can be compared to that of communicating vessels in which water will seek its own level, the possibility of using a foreign company for national activities has now become a realistic alternative.

The question must then finally be asked whether the state is powerless in the face of de facto circumvention of requirements which it considers essential. Although the Court apparently only opens the door to protection against ”fraud” *per se*, i.e. a very limited area, the answer must be that the state is not powerless. To understand this, we need to make a fundamental distinction between establishment and operations. Establishment is sacrosanct; operations can well be fenced in by precautionary measures aimed at protecting some of the interests involved here, as long as such measures are applied in a manner which does not discriminate on the basis of nationality.

Some such precautions can be applied via case law, while others will require legislative change.

The question of the circumstances under which company members may become *liable for the company's debts* is one of the case law issues. Precisely those member states which allow their companies to operate on a very slender capital base have developed fundamental principles for *lifting the veil* or *piercing the veil.* In my book ”Selskabsmasken” (1991) I attempted to analyse the state of law on this issue, and found it to be developing on highly uncertain and casuistic grounds. However, Danish courts have now also accepted lifting of

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the veil as a legal reality: cf. *TfS* 1997:780 H, Midtfyns Festivalen. The financial affairs of two companies had become so intermingled that the scope for profit-making was concentrated in one while the risks were isolated in the other, and on this basis the favoured company was found liable for the other company's debts ”at least in relation to the Danish Customs and Tax Authorities, which were involuntary creditors of the company”. The main shareholder's personal affairs had, however, been kept separate from the companies, and there was nothing to indicate that operations should have stopped earlier, so the person, now his widow, was cleared of both liability and responsibility. The judgment does *not* restrict itself merely to the issue of the merging of capital, but is a genuine statement on liability.

As the question of initial capital protection and subsequent liability and responsibility are communicating vessels, the need to develop basic principles on lifting the veil will become more urgent as *Centros* and its consequences begin to be felt. Legislation may well be considered (cf. Swedish law).

With respect to any preventive measures to *protect public creditors*, it would be possible (cf. the Court's comments) to introduce a requirement for bank guarantees to be provided by companies and other legal persons whose capital is below a set limit, provided that the requirement is applied so as not to discriminate on the basis of nationality. Danish law already contains provisions under which a company can be required to make security available for tax-at-source etc. with regard to any person associated with the company if the person has been involved in the collapse of a company resulting in a loss to the state within the last five years: cf. Section 56A, paragraph 2 compared with Section 85 of the Danish tax-at-source act (*Kildeskatteloven*). Provisions of this kind could be given broader scope as required.

With respect to *loans to shareholders*, one might take this opportunity to consider whether the Danish rules have become too restrictive. If the decision is made to retain them, and it is found that they can be undermined by the employment of a foreign company, the problem must be solved via taxation, e.g. by taxing all dividend payments for which no counter service has been rendered in the form of work performed, sales etc.

In summary, it will be seen that all Centros requires from us is another mode of thinking in the formulation of national law. Such law may not be directed against the *establishment phase*, where it contravenes *freedom of establishment,* but it may be directed against the *operations phase*.

In German law, the *genuine link* principle has also sparked interest: cf. my introductory comments that even a State which uses the main seat criterion may need to use the *genuine link* principle in special cases, especially if the host country has entered into a treaty with the home country concerning mutual recognition of a registration criterion. In this context the question has been raised in the professional literature - and rightly so in my view - of how "little" is enough before a genuine link is deemed to exist anyway, and it has been argued that even a slender link to the State of domicile in the form e.g. of contracts entered into on financial instruments or similar would form an adequate basis on which the *genuine link* principle could *not* be applied by the host country.

While I doubt the correctness of this view, it nevertheless points out that once the genuine link principle has been recognised by the courts, the next bastion

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appears in the form of an established link, for example in the manner mentioned (which will undoubtedly be available by the metre on the market, together with the brass plate of a shell company), and it is uncertain whether the authorities would be able to prove their *pro forma* argumentation on this point.

In *ZIP 1995.1009 (OLG Düsseldorf)* it was established that under German law, the existence of a corporation founded and registered in *Delaware* could not be recognised when the company - which had activities in Germany involving a resident of Germany - had no real connection to the American state of registration (*genuine link*) and when all the company's activities took place in Germany. The use of this company was therefore deemed to be an evasive measure for the purpose of exploiting the extremely liberal company legislation of Delaware; the corporation was thus a *pseudo-foreign company.*

It followed that the person acting on behalf of the "company" was liable for all of the company's obligations (analogous to the liability of the person who represents the company in unregistered companies).

The decision in *ZIP 1995.1009* was heavily criticised by Carsten Thomas Ebenroth, Matthew J. Kemner and Andreas Willburger in *ZIP 1995.972ff.* They stress that there *was* a genuine link to the USA, namely the security investment agreement which the Delaware company had entered into with a public company in New York; the agreement included a choice of law, the legislation of New York.

The authors note that although, in German international company law, the main seat criterion is the dominant principle, Germany has entered into treaties with the USA and Spain introducing a registration criterion in dealings with these two countries. The registration criterion may, however, be broken if there is absolutely *no* real connection to the state of registration, in other words if there is no genuine link whatsoever. But it is the view of the authors that such a genuine link did exist in this case.

2.2 The Operating Phase

We now come to the question of abuse of company law in the operating phase. In this phase, there are two statutory powers (or benefits if you prefer) which lend themselves in particular to abuse: (1) the limitation of liability (i.e. the right to allow the company to go bankrupt without having to pay its debt personally) and (2) the majority rule (which I refer to separately below). We touch here on the very roots of the concept of operating one's business in the form of a share company, namely partly (1) the external relationship to the company's creditors, who basically have only the company capital to fall back on, and partly (2) the internal relationship to joint owners in the company, the basic principle of which is that the person dominant in the majority of the company makes most company decisions. Naturally, it takes a matter of a very serious nature to touch these basic principles which make up the very core of the legal nature of limited liability companies: the external limitation of liability (or rather: the encapsulation of liability) and the internal majority principle. Its counterpart is the personally owned company (partnership, company with unlimited liability) characterised by its external personal liability and the more internal unanimity of decision, at least in important matters capable of incurring liability. Strong interests and feelings surround these two principles and any restriction in them

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must have strong objective reasons - it will often be necessary to demonstrate abuse in order to legitimise restrictions.

If we turn first to the principle of limited liability, we again find two options available to us: we may react either to prevent abuse or to correct it. All Member States of the European Union and the European Economic Area have instituted preventive provisions requiring reaction in the case of significant capital losses (the law demands reaction not later than on the loss of 50% of the company capital): cf. in the case of Denmark Art. 69a of the Companies Act (governed by the Second Company Law Directive, the Capital Directive). It is left to the individual states to decide what measures should apply to companies of the "cheap" type, the private share companies, as the Capital Directive does not mention them in this connection. Since 1 June 1996 under Danish law, when a new private company act came into force, the company must react if 40% or more of the share capital is lost. It has now been specified that the Danish Commerce and Companies Agency (which in Denmark is the registrar of *inter alia* public and private companies) can give the company a period in which to reestablish its capital via the company's own earnings, provided that documentation in the form of consolidation plans etc. is submitted to the Agency for use in the assessment of the possibility of reestablishment (cf. the new Private Companies Act's Art. 52, Item 2).

Most countries, including Denmark and the other Scandinavian countries, do, however, lack one thing (which may also be very difficult to regulate in any precise manner): we have no *relative* capital requirements, i.e. statutory capital requirements of a certain size relative to the company's sphere of activity etc. Such activity-related capital requirements exist within specially regulated sectors, e.g. banks, savings banks, stockbrokers, insurance companies etc. Cf., for example, the Danish Banks and Savings Banks Act's Art. 21 ff (the 8% requirement with respect to own funds relative to total risk-weighted assets); these provisions regarding qualified types of companies are to at large extent governed by EU directives, the banking directives.

We do not, for example, demand a plan of operations to be deposited at the formation of a company, as do Belgium and other countries. If the company goes bankrupt within a certain period after formation, any person with a legal interest in the matter can demand a copy of the operating plan, and if the company has expanded more than its operating plan and hence its capital could sustain, this is a clear indication of liability.

Consequently, our reaction to abuse is often corrective - i.e., some kind of legal consequence after the damage has been done, after a loss has been incurred. This can involve liability for damages. Despite special provisions on this point (the Danish Companies Act's Art. 140 ff), it is the ordinary rule of *culpa* that applies. The central question is, however, whether areas may be found where the rule of *culpa* is inadequate. In my view the answer must be yes, and this is in line with a more general tendency in law in recent decades, where traditional ways of considering guilt do not always appear adequate. A number of legal disciplines show a tendency to increased objectivity. In this context this must mean that if a person consistently operates a share company with a capital which is two low relative to its sphere of activity, such that the operating risk is consistently shifted from own capital on to that of the company's creditors, an

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urgent need exists for instituting legal consequences, irrespective of traditional conditions of liability for compensations.

Taught by bitter lessons with parent companies (and also a few natural persons in their capacity main shareholders) attempting to run away from the debts of an insolvent subsidiary, many industrial countries among those with which we generally compare ourselves have developed a case law (but not yet any legislation) on the liability of insolvent companies in exceptional cases. Germany has its doctrine of *Haftungsdurchgriff*, corresponding to the British and American doctrine of *lifting the veil* or *piercing the veil*, i.e. of lifting/piercing the veil protecting the face of the real company owner. The other Scandinavian countries (Sweden, Norway and Finland) have occasionally - although only in a perfunctory and inconsistent manner, yet still better than in Denmark - recognised that in a limited area, the basis may exist for rejecting limited liability, *ansvarsgenombrott*. In the USA, some of the first cases of this kind concerned the *Yellow Cabs*. The Court did not find it reasonable that a joint parent company or administrative company should be able to diversify or to atomise its liability by dividing the company into a large number of companies, each with only two cabs (two-cab companies), such that a tortious act caused by one cab in one of these companies could cost no more than the net capital of the tortfeasor company. The court sanctioned lifting of the veil with regard to the joint parent or administrative company, whereas, understandably enough, the courts exercised greater reticence with regard to any ultimate *natural* owner; at this point we confront the consequences of rejecting the limitation of liability in earnest.

It is common practice in current legal research to apply a viewpoint from the discipline *law and economics* to legal problems, and thus to argue that lifting of the veil should not be seen as a problem of company law, but as a problem of compensation law. Seen from this angle, the loss of limited liability is merely an extension to compensation law, and the message from law and economics is that a court should only sanction lifting of the veil in favour of persons injured under compensation law, not in favour of creditors under contract law: cf. discussion in Carl Martin Roos in *TfR 1993.227ff* of recent views of American legal and economic schools of thought on theories of lifting the veil and other issues. The thesis by Henry Hansmann & Renier Kraakmann (Yale) cited by Roos attacks the very roots of limited liability in company law, arguing that in cases where the risk of company ownership is neutral for the shareholder, the company's limited liability acts as an incentive on the shareholder to engage in reckless investments. He need no longer make rational decisions as he will not have to carry the consequences himself, and the rule of limited liability therefore enables him to externalise risks and costs by leaving the company to make the investments. Roos appears to share this view but he points out that it breaks with the more traditional viewpoint, according to which the limitation of liability under company law encourages profitable but high-risk investments. Hansmann and Kraakmann show that American compensation law forces the establishment of small companies, the only genuine purpose of which is to act as buffers against compensation claims, and to counter this abuse Hansmann and Kraakmann propose a general rule of lifting of the veil. The two authors do not

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consider this to be an issue concerning company law but rather compensation law.

Parts of this argument may readily be conceded. Naturally, the core application of a doctrine prescribing the lifting of the veil would be in relation to involuntary creditors (and this does focus the issue on claimants under compensation law). Such creditors have not asked to become creditors of the company, and it would not seem reasonable if they can be neatly discarded through a clever company structure. This would enable the company with many taxies, the company with a fleet of tankers, the company with a portfolio of polluting environmentally damaging firms, the company with a number of building projects etc. to atomise its liability in an unacceptable manner.

I do not, however, find that this argument presents the whole truth. In reality there are other types of involuntary creditors than those who have suffered losses under compensation law, namely those who had no genuine choice. This group includes the State as creditor of company taxes, value added tax, PAYE taxes, etc. If we accept the State as an involuntary creditor with a special need of protection, this would, however, involve some acceptance of the assumption that claims under public law should be more worthy of protection than claims under private law, and this would be wrong in principle, both in the context of compensation law and the doctrine of lifting the veil. The argument must therefore not stop here. In everyday business life, the situation in which small contractual creditors - typically small businesses, small tradesmen etc. - would find themselves would be equally as involuntary as that of claimants under compensation law. When receiving an order, these many small businesses often have no choice: either they decide to deal with the principal irrespective of its company structure, or the order will pass to another equally hungry business.

In practice, only the large lending creditors are left to ensure their own protection. Among these would typically be banks, finance companies etc.

In my view there is therefore a deep truth in the - never implemented - bill proposed in the Swedish report *SOU 1987:59* on *ansvarsgenombrott* (lifting the veil), the main principle of which was that the liability of the ultimate decision-maker with the dominant influence on a company which was clearly undercapitalised for its purpose should be voidable in cases where a creditor (most often a lender) had clearly been apprised of the company's financial situation prior to the signing of the contract. *In this case* - but also only in this case - no special consideration was to be given to the creditor.

In my 1991 doctoral thesis, "*Selskabsmasken; loyalitetspligt og generalklausul i selskabsretten*" (The company mask: duty of loyalty and omnibus clauses in company law), I attempted more or less successfully to establish some basic principles in Danish law for lifting the veil, seeking inspiration from the perfunctory practice and literature in American, British, German, Norwegian, Swedish and Finnish law. The result may not have been the best possible solution, but I still hold the view that the doctrine put forward in the thesis was sound, and will gradually make its influence felt in coming years.

To summarise the thesis's main arguments etc. would exceed the scope of this work, but I can quote its final paragraph, which contains a summary of its main points in a slightly philosophical formulation. The thesis attempts to unite two major points of view: (A). A company's majority owners may not unreasonably

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favour themselves or people close to them at the cost of the company or the minority. (B). Neither may they structure or operate the company in such a manner that the risk which they and the other company owners should have carried by investing capital which is adequate for its purpose in the company is shifted from them on to the company's other partners, in particular the creditors, but also the employees, other joint contractors and to some extent society at large.

The first concern, (A), is predominantly a private law issue. Previous legislation had been satisfied with regulating this concern and the principles of equality springing from it, the purpose of which was to ensure that on-going contractual collaboration of a kind where some of the contracting parties hold the actual or legal power to enter into transactions on behalf of their joint contractors could not be unreasonably exploited for own profit by those wielding the power.

The second concern, (B), is to some extent a public law issue because it demands due regard from the persons responsible for the company's transactions with respect to a number of interests which are or may become involved in the company, but which may not be clearly identifiable at the time when the transaction is concluded. This concern demands, under the influence of public law, that company members must take a number of supplementary interests into account, even if the members have explicitly or tacitly accepted among themselves that some of them will gain advantages at the cost of the company.

A *persona* in Greek drama was the mask which the actor held in front of his face. A modern company is a legal person, a *persona ficta*. Major advantages flow from the right to operate one's business through a *persona ficta*, especially with regard to making majority decisions and limiting one's liability. These advantages require the observance of a set of game rules, some of which are written down, while others are in the main unwritten but important nevertheless. Not all of the things which have not been explicitly banned are permitted. The many written rules are expressions of a single pivotal unwritten rule superior to all of them. Its message is: "You who have the power to decide in this *persona ficta* act not only on your own behalf, but also on that of others. You must be loyal not only to your own interests, but also to those of others. If you neglect this unwritten duty of loyalty (which cannot be read in full in any written omnibus clauses), you must expect that the *persona* which you were allowed to place in front of your face will be removed again. If this is done, your legal position both internally and externally in the company will be as if the former *persona* had never existed. In the company's internal relations this means that any unusual transaction will require the approval of any joint owners, and a claim for overruling it may be made if no such approval exists; and with regard to the company's external relations, it means that the debts of the *persona* will become your debts."

So far, only very little Danish case law exists involving lifting of the veil as the legal consequence of abuse of limited liability. A number of Scandinavian cases will be reported below. With regard to Danish cases it should be noted that apart from the decisions by the Danish Industrial Court [*Arbejdsretten*] mentioned below, we still do not have any Danish cases which have been settled purely on the basis of doctrines regarding lifting of the veil. We do, however,

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have a number of cases in which personal liability has been established on the basis of contract law, and we also have a number of insolvency cases in which identification between closely connected companies has been established. Cases based on contract law will not be considered here.[13]

A number of cases heard by the Danish Industrial Court establish an identification between the main or sole shareholder and a poorly capitalised public or private company in situations where the contractual partner has suffered financial losses upon the collapse of the company. These cases can hardly be read in any other way than as an argument in favour of, and the institution of, a doctrine proper on the loss of limitation of liability.[14]

Lifting of the veil sanctioned in favour of employees in a private company. *Industrial Court Decision AR 1988.418.* Reported in the Danish law journal *Fagligt Nyt* 1990/16.168. The company held the contract for municipal rubbish collection 1980-87. The commercial carrier's permits were issued to the sole shareholder/director. 1987 - claim from workers' union for back payment due to breach of agreement. Practically no equity. Considerable wage payments to sole shareholder. "Under these circumstances, the Court has no hesitation in establishing that [the director] is personally liable for the back payment owed and the fine incurred".

See also *Industrial Court Decision AR 1989.372* reported in *AB Fagligt Nyt 1990/16.168ff*: 'A' was sole shareholder. He owned an inn. In 1988 he leased it to a public company. In mid-1989, the public company bound itself in mediation meetings to make back payment of wages amounting to DKK 230,000. Considerable operating losses in the public company. A few months later the public company closed, and 'A' took over the running of the inn on a personal basis. The Industrial Court: "The court bases its decision on the fact that as sole shareholder, chairman of the board - which was composed of close family members - and manager of the public company - 'A' was in full control of the company, and, as hitherto, he continued to be responsible for the running of the hotel and restaurant business after the establishment of the lease. The Court thus finds the link between 'A' and the company to have been so close that in relation to the fulfilment of obligations under current collective agreements, 'A' must be identified with the company."

See next a shareholder's personal liability for wages, lifting of the veil. *Industrial Court Decision of 19/2/1992,* case no. 91.030, *AB Fagligt Nyt 1992/5.84*. No separation had been made between the activities of the private company and the shareholder's personal activities; this was clear from annual accounts, pay slips, statements and correspondence. Neither had the employees received any information regarding the extent to which they were employed by the company, and the Court therefore found that the shareholder must accept personal liability for the claims of the employees, and that the agreement with them was also binding on the personal business. In determining the fine for unlawful dismissal, the Court stressed the fact that the private companies controlled by the person had received previous judgments against them for similar offences.

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13 For a more detailed discussion, see Erik Werlauff: *Selskabsret* (2nd ed. 1994) pp. 33ff.

14 For a more detailed discussion, see Erik Werlauff: *Selskabsret* (2nd ed. 1994) pp. 34ff.

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In the other Scandinavian countries, the issue of loss of limited liability is also attracting growing attention, and the courts occasionally prove willing to sanction such loss (but they can of course only do so if such a claim and plea is brought and supported by relevant evidence).

> The fact that a plea for lifting of the veil is brought almost routinely in other Scandinavian countries does not mean to say that it is also sanctioned every time. In a highly controversial Swedish case involving "playland" *Lekland AB* in *ND 1993.460 HD* (= *NJA 1992.375 HD*), the mayor and town clerk had issued a letter of intent, according to which the city had a "policy" to continue the company in question, which was owned by a municipal trust. When the company went bankrupt and owed the bank SEK 12.5 million, the bank sued the city for payment principally under the law of guarantees, but alternatively arguing for the rejection of limitation of liability. Högsta Domstolen established, however, that the bank must have known that no council decision had been made accepting liability, and that the bank which was in possession of quite detailed knowledge of the company's affairs could not claim loss of limitation of liability. The latter viewpoint corresponds quite well with the views on the distinction between different types of creditors given above.

A case of joint employer's liability between a Norwegian subsidiary and its foreign parent company has received sanction in a Norwegian supreme court case in *Rt. 1990.1126 H (= ND 1991.546 H).*

> The daily manager of the Norwegian subsidiary was terminated when the parent company restructured the Norwegian undertaking. The activities of the subsidiary were gradually transferred to another Norwegian company. The parent company and subsidiary were deemed to have a joint employer's liability, as the employer's functions were divided between the two companies: cf. on this *Rt. 1989.231 (= ND 1989.96).*

In Denmark a high court decision was recently handed down, sanctioning liability of one company for another company of the same "group". However, this decision is currently before the supreme court, apart from which it can hardly be considered a pure decision on loss of limited liability, but rather as the consequence of the fact that the assets and liabilities of the two companies had been allowed to mix. Irrespective of the latter objection, it must, however, be stressed that the decision did not touch on compensation law. It was based on identification, which makes it by its very nature a decision on the limits of one form of objective liability.[15]

> In *TfS 1997.780 H*, loss of limited liability/identification was sanctioned between two companies in a case where a music festival held each summer (*Midtfyns Festivalen*) was arranged by a private company (the festival company) which had leased the right of catering etc. to another private company (the restaurant company). One natural person owned 100% of the restaurant company and 35% of the festival company, but as the restaurant company owned another 20% of the festival company, they were in reality both dominated by the same person.

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[15] Cf. Erik Werlauff: *Koncernretten* (1996) pp. 132ff.

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At the festival in 1990, things went wrong for the festival company, which became insolvent during that summer. The festival company was dissolved with no assets by the bankruptcy court. The Danish Tax and Customs department, which had suffered a loss in excess of DKK 3.1 million, now claimed sanctioning of the identification between the insolvent company on the one hand, and on the other hand the two defendants, the restaurant company and the natural owner (now his surviving spouse in undivided possession of the estate).

It was argued that the division of the festival activities had been purely formal, and had had the purpose of erecting a shelter against creditors, including the Tax and Customs Department. It was argued that the companies' activities had been intermixed, and that the books had been in a muddle. Alternatively, it was argued that the physical owner had incurred liability in damages (*culpa*) by not having terminated the operations of the festival company at an earlier date.

The Court commented that the separation of the festival activities into a festival company and a restaurant company, both in reality controlled by the same physical person, did not automatically imply identification, either between the two companies or between the festival company and the person. The grounds for this were that a similar separation could have been made between the festival company and an independent third person.

In the present circumstances, the basic activity - the annual holding of a music festival on Funen - was, however, so closely linked to the person that a transfer of the activity could not in actual fact proceed without his personal approval. On this basis, the division between the two companies, both controlled by him, could not have legal effect on him unless a clear and unambiguous financial separation of the activities had been made. This applied in particular in relation to the unique structure, whereby the restaurant company had acted as a kind of bank for the festival company (as the latter did not have its own accounts). The daily administration of the two companies had been done as one. It had not been possible for the surroundings readily to ascertain which company was responsible for the individual activities. It had been common for agreements to be signed and invoices issued merely under the designation *Midtfyns Festival* or similar without indication of the company's name.

A detailed scrutiny of the company's daily books and subsequent accounts performed by the Tax and Customs Department had established that to some extent, entries in the books of one company should have been in the books of the other. Balancing of accounts had been neglected. Cash differences had not been resolved. To this should be added that the restaurant company had paid the creditors which it was necessary to pay for the festival to be held the following year, 1991.

In this way the restaurant company had acquired goodwill for the festival rights, including know-how to arrange the festival without payment to the festival company.

Following an assessment of the two companies' mutual financial affairs, it was found that the finances of the two companies had been so intermixed as to make the restaurant company directly liable for the festival company's debt to the Tax and Customs Department, and the primary charge based on a claim of loss of limited liability was upheld. The court did not, however, find that the physical owner's personal finances had been so closely connected with the finances of either company that he too was directly liable for the debts of the festival company. The surviving spouse residing in undivided possession of the estate was therefore acquitted of the primary charge based on loss of limited liability.

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> The next question was that of the person's personal liability in damages. The court based its decision on the fact that at the planning stage of the festival for 1990, he had expected a profit. On this basis he was found not to have exercised his controlling influence in the festival company in such a way as to render him personally liable in damages for the operations of this company. The alternative claim based in compensation law was also dismissed.
>
> A minor charge was based in a claim that the deceased should have been aware at some stage that the festival was running at a considerable loss. It could not, however, be determined with any certainty at what date he had or should have acquired this knowledge, or what transactions he may have entered into after that date which would render him liable in damages. Consequently, he had not incurred any personal liability in this regard either.
>
> The total result was therefore that no liability in damages was sanctioned with regard to either the sister company or the physical owner, but lifting of the veil was sanctioned with regard to the sister company, but not with regard to the natural owner.

As long as we have neither statutory provisions (*ad modum* those in *SOU 1987:59* proposed Swedish ABL Art. 1) or a firm case law or doctrine, our sole protection against abuse amounts to (a) the preventive aspect, i.e. adequate capital requirements (which so far have unfortunately only been formulated in absolute terms, not in relation to activities), and (b) the corrective aspect, i.e. the traditional *culpa* and damages concepts, however inadequate they will often prove to be, because it is so difficult for outsiders to bring firm evidence of what takes place within the group's internal spheres.

In my view, therefore, we stand rather poorly protected against company abuse once the legal person has been established. During the establishment phase, we enjoy quite extensive protection, but in the operating phase, our protection is much weaker.

2.3 Abuse in the Dissolution Phase

We now come to the dissolution phase, and the question of what can be abused in this stage. The answer is that the object of abuse is the manner in which company members secure possession of the company's assets during the dissolution phase.

When a share company is wound up, it would be nice to shed hypothetical contingent claims in the form of possible warranty or repair claims etc. - and this *is* actually possible to some extent. The land developer with many building projects, the production company with many potential warranty claims etc., can to some extent actually dissolve itself out of latent obligations. The situation is that we must, on the one hand, demand clarification and settling of known claims (accepted as well as disputed ones) at the time of dissolution, while on the other hand we have not, at least not in any legislation current, so far made any demands for allocations (in the form of contingent liabilities, purchase of warranty insurance or similar) to cover claims not (yet) known. To do so would presumably complicate the dissolution process unnecessarily, but that is not to say that we have yet found the right balance between, on the one hand, the

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legitimate interests of creditors, and on the other hand the concerns for a reasonably smooth dissolution process.

Our rules on how to tackle contingent claims are sparse, and we have no legislation on unexpected claims. Allocations must be made for all possible claims, and if a claim is in dispute, the company cannot be finally wound up until the claim is settled, if necessary by court proceedings through several instances. But when it comes to claims which were not and could not have been known, e.g. the warranty claims of a building firm, which only emerge after the company is wound up, the view prevails in Danish law that the shareholder who has received his surplus remaining on winding up is not liable for such later claims: cf. *UfR 1992.640 V.*

> *UfR 1992.640 V:* A private building company sold a property in 1975, which was sold again by the buyer in 1983. The company went into (solvent) liquidation in 1986 with a distribution in 1987 of a net capital of almost DKK 800,000.
>
> In 1987, the property's new owner complained of a foundation problem in the house, but when the legal person had gone, the owner took action for damages against the sole owner who had received the payment. Irrespective of the factual circumstances surrounding the sole owner's business and relationship with the company, the law provided no basis for ruling that the person who had received the payment in good faith from the dissolved company was liable for an uncovered claim for damages against the company.

In other words, *animo lucrandi* does not apply (where should the limit be drawn?), and in the absence of positive legislation on this, the court was forced to fall back on ordinary compensation law, i.e. that a shareholder (or the liquidator on his part) should have *known* or *ought to have known* that a claim existed which would involve losses for the creditor at winding up unless allocations were made to cover it.

On the other hand, the recurrent "use" of limited liability as a tool to wind up one's company and "harvest the profits" (to shut the door on contingent claims, so to speak) is not abuse *per se*. Under current law, abuse can only be sanctioned if specific presumptions existed regarding some claims against the company at the time of winding up.

Another consideration is that allocations should not be made for any conceivable hypothetical claim which could arise after winding up. Neither the shareholders nor the liquidator have a duty to imagine the worst case, which would imply that all goods sold by the company were defective and/or incurred product liability, or that all construction work etc. performed by the company would give rise to warranty claims etc. Some specific fact and probability must be present.[16]

The assessment required by the liquidator is undeniably very difficult, and it should be noted that the rules on this issue - or the lack of same - are not remedied through European directives, for the prospects of implemention of the draft liquidation directive lie in the far future, apart from which these questions have not been satisfactorily resolved in the present draft proposal.

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16 Thus e.g. in *UfR 1974.371 H* (case in insolvency) in consequence of a specific major guarantee deposit.

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See on this *UfR 1992.674 V:* At the winding up of a solvent public company in 1987-88, 17 buyers of properties from 1986/87 demanded that an allocation of DKK 100,000 per buyer should be made to cover unsecured claims against the estate in case any defects should emerge in the properties within 20 years from the signing of the deeds. The high court noted that during the time which had passed since the sale to the buyers of the then newly built houses, no defects had been noted of a kind to involve payment of compensation or reductions in price, or which had involved legal action for claims of this kind. Neither had any information been placed before the court to indicate that any defects of a kind to entitle the buyers to compensation or reductions in price would emerge later.

"Admittedly, under these circumstances" the claims registered with the liquidator by the buyers had been so remote and uncertain in nature that - although this was a voluntary dissolution of a solvent public company - the company had been entitled to refuse to recognise the claims as registered.

In the formulation of the Court's premises as quoted, one can almost hear a note of regret in the judge's voice, that he was unable to assist the claimants. Although both the quoted 1992 decisions are presumably a correct indication of the legal position on the issues of liquidations for the sake of gain and allocations, it must be said that if the question is whether it will pay a businessman, e.g. a builder, to wind up his business at "natural" intervals and harvest the profit, the answer must be a clear yes under current law. No outsiders are likely to note that the company's registration number on its letterhead changes every few years; the name remains the same, for his new company bought it from the liquidated estate.

Some will argue that such procedures are inherent in the legal nature of the limited liability company; others would be more likely to say that the procedure approximates abuse of the company as legal form. I lean towards the latter view.

Another specific avenue of abuse during the winding up phase - or rather: a more lucrative alternative to winding up - has emerged in Denmark in recent years. It is company raiding, known here as *selskabstømning*. As no fewer than 1,600 cases on the so-called net list of stripped companies are awaiting the outcome of a few trial cases intended to show who should be made responsible, the issue has enormous practical importance. The situation in asset stripping cases can be summarised briefly as follows:[17]

If the major or sole shareholder M has scaled down his activities in so far as his company C (private or public) has sold its business, C may be the owner of a bank account of DKK 10 million, which is C's only asset, while, for example, liabilities might show a (current) tax debt of DKK 4 million and an equity amounting to 6 million. M and his adviser, solicitor S's starting point, is now that unless M wishes to start new activities in C, he must let C go into liquidation, resulting in a final tax assessment for C and payment to M of the surplus left on winding up. With the figures given in this example, the surplus will be the equity of DKK 6 million less winding up costs.

If, having seen the liquidation notice in the Official Gazette, some person should now approach C and S offering to buy the share capital of C for an amount exceeding the equity of DKK 6 million, both C and S are likely to show

[17] Cf. Erik Werlauff in *TfS 1995.23.*

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some interest, even if it may look a bit strange that somebody is offering to pay for a tax liability e.g. at 80% of the 4 million, thus resulting in a total purchase price not of DKK 6 million, but of 9.2 million.

At least as far back as spring/summer 1993, both C and S knew that there is something called "asset stripping" - meaning that the friendly potential buyer has no intention whatsoever of continuing the company's operations, but simply wants to take the cash holding of DKK 10 million and avoid paying the company's taxes, so that in this example the buyer would pocket the difference of 0.8 million kroner.

In order to avoid any more cases of asset stripping, a liability clause has been inserted in the Danish Company Taxation Act's Art. 33A (that is to say, linked to the existing Art. 33, which provides for the liquidator's and shareholders' liability for dividend payments made before payment of company taxes, whether such taxes derive from ordinary or extraordinary tax assessments, limited, however, to the amount paid in dividend, and with regard to shareholders, limited to the amount paid individually to them).

The new Art. 33A rule provides that any person who transfers shares in a company against payment of a premium price is liable up to an amount corresponding to the transfer payment for the payment of taxes and dues for which the company has a current or latent liability at the date of transfer. It is a condition that the transferor fulfils the definition of major shareholder in the Danish Personal Taxation Act's Art. 19a, Items 2-4, but in this context his investment must be only 10% or above. "Premium price" means a payment which "clearly exceeds the relative preportion of the company's net value at the time of transfer". The rules only apply if, at the time of transfer, the company was facing no significant financial risk from its commercial activities.

Against payment of a fee, an advance approval may be obtained to the effect that the clause will not be applied, but the approval may be made conditional upon security being given to cover taxes and dues.

In drawing up the bill, it must have been felt that the only effective intervention against the risk of future abuse was the introduction of a liability clause proper; in cases where the provision's objective characteristics are fulfilled, the major shareholder is liable for the government's tax losses. This change in law should not, in my view, be seen in isolation; it is part of the trend I have attempted to describe towards an increasing tendency to establish some liability provisions on an objective basis covering (major) shareholders in cases which can be defined as abuse of the company as legal form.

With regard to those cases of asset stripping which took place prior to the new act's coming into force, the following comments apply:

In ordinary circumstances, the assessment of the company buyers and their (fully collaborating) advisers does not attract much legal interest. The actions of the buyers can be characterised as fraud against creditors under the Criminal Code's Art. 283, cf. *UfR 1978.414 Ø, UfR 1981.701* and *UfR 1985.940 H* (breach of trust, with dissenting vote: fraud against creditors), and the buyers, and in some cases their advisers, will be liable in damages for any government losses, but the buyers at any rate will often have no financial means of discharging their obligation, or they will be beyond the reach of the authorities.

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The vendors (i.e. the former major or sole shareholders) can hardly be affected by any of the objective company law provisions on liability for unlawful dividend payments, as the matter does not appear as a payment to them. Liability of vendors and/or their advisers can only become an issue in cases where they fulfil the conditions of *culpa* in compensation law, and this is certainly not always the case; and one must not, for example, see 1991 events through the glasses of 1994/95. Today, every child has heard of company raiding, but a couple of years ago the concept was not known among decent major shareholders and their equally decent lawyers.

It is my view that irrespective of how critical one's personal view may be of the sales profits gained by major shareholders, the conclusion must be that under current law, the liability of the major shareholder and/or its adviser can only be sanctioned if they can be proved to have acted knowingly or negligently, whereas neither unlawful gain, nor objective types of liability in company law (in connection with dividend payments etc.), nor other *culpa*-independent forms of liability or responsibility can apply. A more detailed exposition of this view may be found in my article in *TfS 1995.23*, and it is supported by the first Danish trial case on the issue, the *Satair* decision, currently, however (December 1996), under appeal to the supreme court.[18]

> In *TfS 1995, 763 Ø* the high court sanctioned the liability in damages of Satair Holding A/S for losses suffered by a subsidiary when sold to a corporate raider, who removed the assets without paying company taxes. The operating company had sold its fleet of leasing airplanes and had a liability of DKK 13.8 million in deferred taxes. The company's accountant argued that the company could be sold at a price corresponding to its book value plus 65% on deferred taxes, but negotiations with various parties achieved a price of 80%. When the company went into bankruptcy, the receiver of the estate made a claim for compensation for both the amount paid in dividend and all costs. The claim was based partly in general rules of compensation law and partly on an objective responsibility for the repayment of unlawfully removed assets: cf. Art. 84, Item 4 of the Danish Private Companies Act current at the time. It was argued particularly with regard to liability in damages that a sole shareholder (in this case the parent company) which had managed the subsidiary was covered by the management liability rule of the current Private Companies Act's Art. 110.
>
> All three high court judges were agreed in finding that liability in damages must be sanctioned. They were also agreed that the objective duty of repayment did not apply, as the payment of the remaining purchase sum for the company did not appear in the accounts as a payment made by the company in connection with the unlawful transaction (self-financing purchase of shares).
>
> Two judges stressed in particular that the parent company as sole shareholder, through the joint management within the group, had exercised complete control of the subsidiary, thus ascribing to it a duty of control and supervision similar to the duty of management, including sound administration of capital, maintenance of assets, etc. These judges note in particular that given the price of 80% of the incumbent tax, the purchase sum must be considered conspicuously high, and that the parent company must have been aware that depreciations for tax purposes would require investments of approx. DKK 70 million by the buyer. The parent

[18] The decision and its consequences are analysed in detail by Erik Werlauff in *TfS 1995.837*.

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> company had not examined whether the requisite basis of depreciation could be acquired for the sum it knew to be available. Despite its lack of information on the affairs of the buyer, the parent company waived the requirement of documentation for the existence of the basis of the requisite depreciations. By this action, the parent company exposed the assets of its subsidiary to an entirely unnecessary risk, thus overstepping the duty of management under the current Private Companies Act's Art. 36, Item 2. The parent company had entered into its transactions on so defective a basis that the breach of the current Private Companies Act's Art. 84, Item 2 should have been foreseen." On these grounds, the two judges found that the parent company had a duty to prove that in light of the behaviour of the authorities which had been pleaded by the parent company during the case, the behaviour described was not culpable, and this was not found to have been proved.
>
> One judge did not find, however, that the transfer of company management in connection with the transfer of the share capital to a buyer had been covered by the management liability rule of Art. 110 or Art. 112 of the Private Companies Act current at the time. This judge therefore assessed the liability of the parent company solely on the basis of the ordinary compensation rules, following which the judge listed the danger signals apparent to the parent company - and there were several such. A string of circumstances should thus have given rise to well-founded doubt as to the buyer's ability and intention to undertake the requisite tax transactions. There was no documentation to indicate that by investing in two German leasing companies, the company could already gain depreciation entitlements for the current year. There was no information, for example, on whether the two German leasing companies had already acquired adequate depreciable assets. Neither was there any documentation to prove that the buyer's immediate liquidity surplus after the deal - DKK 2.6 million, corresponding to 3.7% of the necessary depreciation basis of approx. DKK 70 million - would be at all adequate to cover the costs of acquisition of the leasing partners, let alone adequate to allow the buyer to make a profit. Neither was there any documentation to prove that if the Danish/German double taxation treaty currently undergoing revision was changed, the buyer would then be able to avoid taxation of the company on recouped depreciations, thus eliminating its tax liability.

Despite this, the parent company did not make it a condition of the contract that control of the company and its cash holdings would not pass to the buyer until binding contracts had been entered into on the acquisition of depreciable assets. On the contrary, the parent company had secured itself - not only against any risk of loss, but also against the purchase being called off in case the condition concerning the presumption of lawful confirmation of the tax liability was not fulfilled.

Two out of the three high court judges thus applied legal principles which go somewhat further than the ordinary compensation law, as these judges "displace a parallel" to the duties of supervision and control resting with a company's board to cover the parent company (i.e. the parent company as a legal person) on the presumption that the parent company will keep the subsidiary under very close management and control. Just as there is a creative element of new law ("freehand drawing", one might say) in the principles proposed by me regarding the lifting of the veil of a parent company, there is a definite creative element in the decision to impose obligations on the parent company in its capacity as a legal person, obligations (maintenance of assets etc.) corresponding to those

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resting with the board of the subsidiary. German company law establishes such duties for a parent company in the presence of certain conditions, but Danish law does not, and it has not previously been claimed that the courts could create such a state of law without authority.

The Supreme Court decision in the Satair case may be summarised as follows (cf. my comments in *TfS 1997.114*):

1. The Court stressed that the sale of the company was "motivated solely by the purpose of avoiding payment of a tax of DKK 13 million", and that the sale "thus did not have the character of an ordinary business transaction".

2. Next, the Court stressed the additional profit which Satair had gained in comparison with the alternative: a solvent liquidation of the profitable company. The premises state: "Relative to the amount payable in dividend if the company had been wound up, Satair Holding gained an additional profit of 80% of the company's tax liability."

3. Now follows the Court's preliminary conclusion: "Under these circumstances, Satair Holding had special reasons to be alert to the risk of the interests of the tax authorities being ignored in the sale." In other words, the Court here states that a sale motivated purely by tax reasons and fetching a high additional price relative to the surplus left on winding up calls for the buyers to be particularly alert to the possibility of abuse by the buyer. In the construction of a standard for the actions of the *bonus pater* majority seller (one could say: sound company practice in the context of a majority sale), the premises already establish a stricter standard of alertness at this early stage. This does not seem unreasonable.

4. The next part of the premises discusses the extent to which the vendor should have realised that the tax liability could not be neutralised. On this point, the premises state that the vendor must have been able to see that a not insignificant risk existed that the investment in operating equipment would not be carried out (or that they would not be recognised under tax law). From the observation by the High Court of (1) the need for very high depreciations and (2) the risk that this need could not be met, a straight line runs to the above comments by the Supreme Court.

5. The Court further noted that the risk that the investment would not be made would be particularly high if the purchase was made with the company's own assets (self-financing), as in that case the company would not have enough money to make the requisite depreciable investments. While the logic of this step in the premises is also correct, the next two sentences are more problematic: "In the sale of a profitable company, the only asset of which is a cash holding or similar means - *a risk will always exist* that the purchase sum will be paid with the company's own assets; and in the case of Satair Holding, the fact that the contract stipulates the National Bank transfer of the purchase sum and the company's assets at same day value must have made the risk obvious that the sale would be based on self-financing" [emphasis added]. The former sentence that "a risk [of self-financing] will always exist" appears to me to contain an element of hindsight, and the latter sentence, that the simultaneous transfer should have made self-financing an obvious risk, is no less problematic. When a company is sold (an everyday occurrence for lawyers, accountants etc.), the exchange of payments is probably always simultaneous, which is also the main

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rule of the Convention on the International Sale of Goods (CISG) Art. 14. (the Act also applies to the sale of private and public shares). If the two sentences cited here were the only supporting arguments in the premises, there would be reason for concern.

6. The premises next state that Satair Holding did "nothing to prevent the risk to the tax authorities", and on this basis the way is cleared for the final conclusion that "in the sale of the profitable company, Satair Holding neglected the interests of the tax authorities in an indefensible manner, and that it is therefore liable in damages for the authorities' loss".

It is very important to note what the Supreme Court mentions and what it omits to mention regarding the standard of alertness incumbent on the vendor of a company, i.e. regarding the drawing of the line between good and bad faith. The premises cited above as numbered by me show that high but not impossibly high demands are made on the vendor, who must ensure a high degree of certainty that the tax burden is genuinely lawfully neutralised, so that the interests of the tax authorities are not neglected.

It is also clear that these demands have not been satisfied in this case, but we cannot see (and we are clearly not meant to see) the precise degree of negligence in question. As we saw, the majority of High Court Judges labelled the action gross negligence, but the Supreme Court avoids taking a stand on this, probably because the question of recourse against advisers, banks etc. must be foreseen, and because the weighing of degrees of guilt has not yet been pleaded before the Supreme Court.

The basis in law on which the Supreme Court sanctions liability in damages is *not* the special provision in company law stipulating that a shareholder (in contrast to a member of board or management) can only be held liable in cases of gross negligence (while the other can also be held liable in cases of simple negligence). This rule is found in the Danish Companies Act's Art. 142, 1st clause, cf. Art. 112, 1st clause of the Private Companies Act current at the time (which is not repeated in the Private Companies Act of 1996). On this point, the Supreme Court states that "as Satair Holding was sole owner and actual manager of the profitable company until its sale, the liability of Satair Holding should not be assessed under Art. 112 of the former Private Companies Act, but under the ordinary rule of compensation in Danish law ...". In other words, when Art. 112 is removed, gross negligence need not be proved. Simple negligence will do (which is not to say that in this particular case, "only" simple negligence has been found). This line of reasoning in the premises, that in certain circumstances it must be possible to judge a major shareholder according to entirely ordinary rules of compensation without having to prove the existence of a case under the rule of gross negligence, is one which I argued in my doctoral thesis "*Selskabsmasken*" (1991), and it is of course satisfying in principle to find it again in the premises of a supreme court decision.

At those points in its reasoning where the Supreme Court concludes that the action has been negligent and given rise to liability in damages, the Court omits - presumably for the reasons indicated above - to designate the degree of negligence found to exist in the case. Instead, the Court uses the formulation (twice in the premises, both on page four of the judgment) that Satair

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"*negligently* ignored the interests of the tax authorities" and "the negligent action shown by Satair".

The key question for the fixing of the degree of alertness to be exercised in the sale of profitable companies can hereafter be summarised in the following question: Did the vendor take any real steps to prevent the risk to the tax authorities? This question does not imply that the vendor should have demanded a bank guarantee or similar to secure the claims of the tax authorities (although some such step would of course have been pleasing). Instead, the following two-stage reasoning must be applied: How thoroughly did the vendor ensure that planned investments etc. would be carried out? If the answer to this is: not very thoroughly, the next stage is: That means that you exposed the company to the risk of being bought for its own assets, thus exposing the tax authorities to the risk of loss. That makes you responsible. What we have just done is in fact to establish the standard of "*best practice*".

I am here forced to draw the same conclusion as in the case of the High Court decision, that this is not a case of reversed onus of proof, but the requirement of alertness placed on the vendor is so strict that in a number of cases the result will tend towards it. When a sale has the features of the Satair case, it is necessary to look more closely at what the vendor did to prevent the risk of self-financing. If it can be proved that specific steps were taken, especially with regard to documentation of recent and, in tax terms, realistic investments, etc. the vendor must be acquitted.

To summarise the issue of abuse in the case of the dissolution of a company, it is my view that legislation provides much less thorough and consistent protection than is the case when a company is formed. The situation is somewhat analogous to the operating situation, where the protection against abuse is also poor. When serious loopholes are found in the protection (cf. the cases of asset stripping), our only recourse is the hurried application of band-aid solutions (in this case to protect the state as creditor), but we still do not have a thoroughly prepared list of our requirements for "sound company practice" in the case of the dissolution of a company. We may therefore expect cases of abuse to continue to occur.

3 Abuse of a Dominant Influence (Abuse in Internal Relations)

It is also possible to abuse a dominant influence in a limited liability company. (This is in contrast to a personally owned company, the typical feature of which is the application of a unanimity, and thus a veto principle, to all important decisions). Only an indication of the problems which we face here can be given within the scope of this section.

It was accepted by the courts at an early stage that a dominant influence can be abused, and that it was important to have measures to prevent it: cf. some cases from as early as the 1800s (cited in my thesis "*Selskabsmasken*", p. 631) - but the acceptance of the importance of preventive measures was long based purely in *contract law*, in the view that the object of breach was the company law principle of equality, i.e. the party requiring protection against this abuse was the contractual partners (= the other company members). There were no

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other parties to consider - neither the company itself nor society at large. The company was and has remained the sum of the private interests involved therein (more recently formulated as the *nexus of contracts*,[19] i.e. the sum of the company's own contracts).[20] There was therefore no reason to step in, except in the case of breach of equality principles or contractual interests.[21] Reasons of economy also spoke in favour of this view. It prevented dissatisfied company members from cluttering the courts with their problems. One British judge expressed it thus: "This court is not required on every occasion to take the management of every playhouse and brewhouse in the Kingdom!" (*Carlen v. Drury,* 1812, 35 ER 61 Ch).[22]

The recognition that there are other interests in need of safeguards than those of company members was presumptively instituted from 1974 (when omnibus clauses were introduced, in Denmark in the Companies Act's Arts. 63 and 80). These clauses included the company among the parties in need of safeguards against abuse of the dominant influence in the company, but in practical terms this is unlikely to have changed the intensity of the protection to any significant degree, if for no other reason than that whether a specific action was in the interest of the company cannot be contested, unless one or more offended company members takes private legal action to this effect.

To this should be added that the bigger the required majority for the endorsement of a transaction at the level of importance where it must be placed before a general meeting, the more difficult it is to establish abuse. (Amendments to the statutes ordinarily require a 2/3 majority vote: cf. the Danish Companies Act's Art. 78; a number of vital transactions require a majority of 9/10: cf. the Act's Art. 79). The strict majority requirements constitute a safeguard in their own right (a right of redemption for outvoted company members is, furthermore, linked to the Danish Art. 79 cf. Art. 81a). The material safeguards provided by the omnibus clauses have thus been replaced by a clearly defined formal protection which moves the boundaries of the material safeguards far into the background.

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19 See Clas Bergström and Per Samuelsson in *TfR 1995.325ff* on the so-called contract theory perspective, often adopted by legal and economics experts in studies of the share company as a company form. The theory defines the company as the sum of all its contracts (nexus of contracts), i.e. not as a legal person in the more traditional sense. Bergström and Samuelsson present several versions of the theory, the purest version of which is the total removal of any regulation under company law. Their conclusion does, however, offer considerable support for disposive, i.e., declaratory rules in company law as a reminder and an offer to companies, but not in preceptive legislation.

20 Clas Bergström, Peter Högfeldt and Per Samuelsson analyse the principle of equality in company law in *TfR 1994.117ff*. They find that its importance has been drastically reduced through the introduction of the omnibus clauses, as the prinicple of unwarrantability of the omnibus clauses implements both the equality principle and the profit maximisation principle, and when the demands of any specific situation require a balancing of these two principles, the profit maximisation principle must be given priority over the equality principle

21 On the equality principle in company law, see also Per Samuelsson pp. 77ff in "*Nye tendenser i skandinavisk selskabsret*" (1995), reviewed by Erik Werlauff in UfR 1995 B p. 311.

22 Cf. Erik Werlauff: *Selskabsmasken* (doctoral thesis 1991) pp. 43, 50 and 312.

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It is also clear from recent case law that the fact that the decision has been made with a special majority vote makes the courts hesitant to establish abuse. This was seen, for example, in the Danish Supreme Court decision on a drastic capital increase in Ringkjøbing Bank, where a very high capital increase, a considerable portion of which did not allow the right of preemption, was found by the Supreme Court not to contravene the omnibus clause, which a large minority shareholder had pleaded in vain: cf. *UfR 1991.180 H.*

Ringkjøbing Bank A/S, UfR 1991.180 H: A decision was made to increase the share capital from DKK 32 million to DKK 48 million. Of this, 28 million carried the right of preemption while 19 million did not, and 1 million was employee shares. The Arnth-Jensen family, which had a considerable minority holding in the bank, was not entitled to vote due to the three months registration limit imposed by the Bank's statutes current at the time. On the question of barring the decision under the omnibus clause, the High Court had stated: "Given the fact that the Defendant is involved in banking and has a special need for local support and thus for the spreading of its shares, the Court does not find that ... the decision to authorise the share increase, which decision was not in contravention of the current statutes with regard to the proportion of shares with and without right of preemption for existing shareholders, was made under the influence of interests aimed at procuring undue advantages for others at the cost of the Claimant." The Supreme Court stated bluntly: "*There are no grounds for overruling the decision, which was made by a qualified majority, on the plea that it contravenes the Act's Art. 80*." Note the reference to "qualified majority", which is presumably meant to imply that the wider the support which the decision has won, the harder it is to overrule it under the omnibus clause. This may have several important implications after the introduction of the double 9/10 criterion of Art. 79, Item 2.

To this should be added the viewpoint - heavily coloured in contract law - that the more willing a minority would have been to accept a decision which is very similar to what was actually done, the less inclined the courts will be to sanction "abuse". In other words, in relation to the dominant influence in the company, abuse is a relative, contract-dominated concept.

See on this the high court decision in *UfR 1966.739 V* on the widow and the manager's terms: Two partners, P1 and P2, each owned half the share capital in a company. They had entered into a shareholders' agreement. According to the agreement, the surviving partner was entitled to buy a single 500 kroner share from the deceased partner's widow in order to gain the dominant influence. The widow's shares were then to be redeemed after a number of years. It was clear from the evidence given by the family lawyer that it had probably been understood that the surviving partner would have to allow himself a "decent managerial salary" in order to redeem the other partner's widow. P1 then died. P2 redeemed the fateful 500 kroner share, thus gaining control of the company. P2's employment terms as manager were then negotiated. He wanted an emolument of 20-25% of the annual financial result and a five year fixed-term appointment. The widow was able to accept a 15% emolument and no fixed term. When the matter was taken to the board, P2 was given an emolument of 20% and the desired fixed-term appointment. The widow protested. She asked for the matter to be submitted to the general meeting. This was done. The decision was ratified by the

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meeting. The widow then took legal action, but lost. No detailed grounds are given.
The widow pleaded abuse by the majority with the purpose of gaining undue advantages at the cost of the minority: cf. now the Danish Companies Act's Art. 80. *If* abuse of controlling influence was established, this would overrule the fact that conflict of interest had not been an issue at the general meeting. (The reason why this plea was also rejected may be that the terms which the manager "allowed" himself were not too far above what the widow was prepared to accept. Furthermore, the terms were part of a mutually binding agreement, although the details of the terms had not been drawn up in advance. The courts will only step in in cases of obvious abuse of minorities).

As seen, for example, in the bank decision cited above, it is very difficult for the courts to establish abuse, especially in cases where the powers implicated are "merely" administrative rather than financial. One is tempted to repeat: "This court is not required on every occasion to take the management of every playhouse and brewhouse in the Kingdom!" One may well ask why this should be so, and a bold answer would be that we froze the law, so to speak, when we introduced the omnibus clauses. These are not true omnibus clauses, i.e. they do not refer to a certain dynamic standard, e.g. a standard *ad modum sound company practice* or similar. The clauses also contain some very strict rules (clearly intended ..., undue advantage ...), and it could be said a little provokingly that the state of law was set back with the introduction of the clauses. Their negative formulation of what constitutes abuse may be an impediment for the protection against abuse. I have often experienced this myself in my advice to minority members who felt themselves abused. The burden of proof to be lifted in a case weighs a ton. Might it not be better to define the interests to be protected in *positive* terms, and then to allow the view of what constitutes abuse of a dominant influence to develop dynamically under application of the yardstick of sound company practice or a similar concept? See, for example, the draft of the EU's fifth company directive (the Structure Directive), Article 10a, which will establish the positive principle that the members of the board and management must safeguard the interests of the company.

In contrast, as soon as we turn to a "qualified" type of company (bank, insurance, stockbroker etc.), we are far better at safeguarding against abuse. The reason is that the interests of investors or insurance holders are at stake here, i.e., a much stronger element of public law is entering the picture as a supplement to the still contract law-dominated company law element. Based on the EU bank directives, the Danish Bank and Savings Bank's Arts. 7b-c thus provide (as do the banking laws of other EU and EEA countries) that application must be made to the supervisory authority before a qualified holding can be aquired in a bank etc., and that the supervisory authority must intervene through suspension of voting rights etc. if qualified owners impede the responsible operation of the bank.

To summarise the situation of *unqualified* company types, it is fair to say that the law provides only sporadic protection against abuse. Apart from a few

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special rules, we have only the *culpa* and compensation provisions to fall back upon.

As a postscript I ask this question: All the above comments relate to abuse of the *dominant influence*. May it be possible also to abuse a *minority influence*, in other words, is it possible to abuse the right to say no?

The absolute right to say No may certainly be abused if one holds the controlling influence (or is the company's board). This can occur if interested motives are behind the decision in cases e.g. where a statutory approval is required for the transfer of shares (Danish Companies Act's Art. 20). But as soon as the decision is fairly bound by rules (i.e. specified in the statutes), the refusal cannot effectively be contested as an indication of abuse.

Another more interesting question is: Can a minority abuse its rights? Briefly, the presumption must be that abuse of the right to say No cannot be established (e.g. to proposals of amendments to statutes, mergers, divisions etc.). There have been cases in German law where the minority has demanded a premium price for its shares as a conditon of approving a merger, and where the courts, at the request of the company, subsequently overruled the premium price on the grounds of breach of *Treu und Glauben*, more or less similarly to 5-1-1 of Christian V's Danish Law on agreements in breach of law and honour, "*lov og ærbarhed*". In essence, however, these cases do not revolve around the rejection by the minority. The issue being contested is rather the transaction by the majority (i.e. the company) which involves differential treatment of the shareholders in order to push through a merger wanted by the majority. These cases do not, therefore, provide any documentation of the possible existence of abuse by a minority as a concept.

It must, on the other hand, be presumed that abuse of active minority rights is a distinct possibility, and that it is possible to react to such abuse as called for by the circumstances. Scrutiny as a minority right (25% of capital) can, for example, be abused, but to guard against exactly this problem, the Danish Companies Act's Art. 95 has inserted provisions on control by the bankruptcy court and the rejection of baseless requests for scrutiny.

Apart from such special rules, minority requests must generally be accepted as they are. This applies, for example, to requests for 10% of the capital to hold extraordinary general meetings etc.; such requests must be satisfied, regardless of whether the company may find its purpose to be petty spite. If the statutes establish minority representation on the board, such represenation is in principle liable to abuse, e.g. by a competitor to the company, and it has been argued in the literature, cf. Gunnar Gersted in *UfR* 1965 B, p. 51, in favour of legislating to allow a board member to be removed from his seat by court judgment in case of gross disloyalty to the company (German law contains such provisions, but they have been "abused" in attempts to remove anti-nuclear activists from the boards of energy companies). There have likewise been cases in German law where employee representatives on the board have been removed because they reported the company to the anti-trust authorities, using information obtained from the board. A rule along the lines proposed for the removal of a disloyal board member is thus undeniably a two-edged sword in company law.

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In summary, it must be said that only active minority rights, not the passive rights (the right of veto), are liable to abuse, and that the scope for interfering in the abuse is limited.

4 Conclusion

It must be clear from the above comments that in spite of all good intensions, a number of possibilities exist for abusing the rights enshrined in company law. It must also be clear that it is far better to take preventive action (to prevent the founder from using this particular company form etc.) than to take corrective action; but preventive action gives rise to a number of problems involving proportionality, and partly also to practical problems, as we should avoid cluttering company law with formalities merely in order to prevent any kind of abuse.

In areas where we have a long standing or fixed practice (abuse of dominant influence, choice of adequate company form), we have freed ourselves of the subjective element otherwise found in compensation law, so that we no longer think in terms of "abuse", but rather in terms of the limits to what a given right in company law may be used for, or not used for. It appears to me that such a process of objectivisation would be useful with regard to (a) the choice of the right company form, (b) the choice of domicile with genuine links, (c) choice of the right capital requirements, (d) inclusion of the requisite responsibility to creditors on dissolution, and (e) protection of company and minority against abuse of power in connection with majority decisions in company law.

Just as we have "*best practice*" rules in a number of areas - sound banking practice, sound stockbroking practice, sound securities trading practice, sound markeing practice, etc., a number of factors speak in favour of introducing a concept of "sound company practice" as a dynamic legal standard with regard to what a company may or may not be used for. A *best practice* rule would be able to put a stop to the worst cases of abuse of rights in company law with regard to minority members, company creditors, basic social interests etc.

A *best practice* standard could put a stop to the worst cases of abuse of rights in company law. A *best practice* standard has the advantage that it blurs the otherwise sharp edge between ordinary ethics and hair-splitting law, as it lifts some of the ethical requierements "up" to the level of law. If *best practice* rules had applied in the area of company law, we might have avoided the cases of anti-social asset stripping which have flourished in Denmark and which were sanctioned by the Supreme Court in its decision in the Satair case analysed in this article.

I am not blind to the fact that a *best practice* standard itself can give rise to uncertainty in and unpredictability of the law. The *best practice* standard cannot, therefore, stand alone - by which I mean that one cannot deduce from it the particular legal outcome of an action in conflict with the *best practice* standard. But as a dynamic legal standard by which limited liability in conflict with sound company practice can be applied, or transactions by the controlling influence which are in conflict with sound company practice, such a standard would demonstrate its value. If, with the introduction of such a standard, the powers

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were invested in one central expert body, in Denmark the Commerce and Companies Agency for example, to pronounce specifically on the content of sound company practice, possibly combined with the powers to issue supplementary generally progressive prescriptions on the concept (*ad modum* the powers which in Denmark are vested in the Securities and Exchange Commission [*Fondsrådet*] by the Securities Trading Act [*Værdipapirhandels-loven*]), many conflicts could be avoided or settled amicably once the content of the *best practice* concept had been established.

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