

Summary of the results of the dissertation with the title

“Protection of minority shareholders in majority decisions in partnership law”

I. Overview

This dissertation examines the necessity of minority shareholder protection in majority decision-making in the law of partnerships (“Personengesellschaftsrecht”). The BGH judgement of 21.10.2014 (Ref.: II ZR 84/13), in which a paradigm shift in matters of minority shareholder protection was apparently carried out, was the food for thought for this dissertation. While jurisprudence has so far primarily relied on the regulatory instruments of the principle of certainty (“Bestimmtheitsgrundsatz”) and the doctrine of the core areas (“Kernbereichslehre”), it seems to want to focus solely on the duty of loyalty in future. With this consideration, the judgement has triggered one of the most important discussions currently taking place in partnership law.

The study is divided into two parts, a basic part and a main part. In the first part the regulatory problem of this work is presented. First, the reasons why many founders of a partnership decide to include a general majority clause in the articles of association are discussed. Then, the risk of majority opportunism associated with majority clauses is examined. Subsequently, the fundamental significance of contractual freedom is explained. The basic part ends with considerations which justify an encroachment on contractual freedom against the background of the existing regulatory problem.

In the second part, a detailed discussion of the individual potential regulatory instruments to protect the minority takes place. At the beginning, the admissibility of general majority clauses is discussed. The following section is devoted to formal exercise control through the principle of certainty. In the following section, the indispensable rights (“unverzichtbare Rechte”) and irrevocable rights (“unentziehbare Rechte”) summarized as the doctrine of the core areas will be examined. Subsequently, the regulatory instrument of fiduciary duty will be analyzed. The paper ends with a discussion of the significance of the principle of equal treatment.

II. Essential content

1) Regulatory problem

The dispositive law prescribes a unanimous resolution for partnerships. However, in order to increase the ability to act and the functional ability of a partnership, majority clauses which have as their object the general introduction of the majority principle for all resolutions, are widespread. The lower quorum for resolutions associated with the majority principle can have positive effects, particularly in the case of corporations with a large number of shareholders and urgent resolutions. However, the majority principle is a decisive advantage with regard to the incompleteness of articles of association. Due to various causes, such as the phenomenon of bounded rationality of the contracting parties or prohibitively high transaction costs, articles of association do not contain an expressly agreed solution for all future developments and eventualities.

The majority principle not only makes it easier to adapt the foundations of a corporation, but also prevents minority shareholders from exercising their veto right for opportunistic purposes. In principle, a minority shareholder with a lower investment must fear a failure of the company less than a possible majority shareholder and could exploit this circumstance within the framework of the unanimity principle to obtain special advantages.

At the same time, however, the introduction of majority decisions is accompanied by the possibility that a majority shareholder or a coordinated group of shareholders may use his respectively their voting weight to the detriment of the other shareholders. Such a motivational situation exists above all if the possible external financial advantage is greater than the financial loss to be borne only pro rata, which one experiences due to the damage to one's own corporation.

The risk potential for majority opportunism is also increased by the fact that there is often a locking-in effect in partnerships. This means that shareholders often cannot leave a partnership without financial losses due to specific investments.

Against this background, the question how the state can intervene to existing articles of association. Therefore, the significance of contractual freedom and its limits were examined. Here it was worked out that contractual freedom on the one hand serves the realization of the principle of self-determination. On the other hand, contractual freedom is of extraordinary importance for our national economy, because it is the basis for free trade, through which resources basically reach those for whom they have the relatively most valuable use.

However, it is first and foremost up to the minority shareholders themselves to take adequate precautions against opportunism, since private autonomy takes precedence in this respect. According to the principle of self-responsibility, each shareholder must bear the risks incurred by joining the corporation. The reference to the self-responsibility of the shareholders, however, only carries as far as the individual is actually in a position to independently provide for his own protection.

However, various causes, such as bounded rationality or prohibitively high transaction costs, can lead to minority shareholders not being able to provide sufficient contractual protection against majority opportunism when setting up a corporation. This justifies corrective intervention for reasons of minority and institutional protection. Restrictions on contractual freedom are conceivable at two different levels. An intervention can take place on the one hand at clause level (content control) or at resolution level (resolution control).

2) Admissibility of general majority clauses

It was first determined that majority clauses, which refer to all matters of the company as a whole, are not immoral pursuant to § 138 para. 1 BGB. The accusation of the self-incapacitation of the shareholders, is invalidated by the fact that all shareholders are entitled to an ordinary right of termination pursuant to § 723 para. 1 sentence 1 BGB. An abstract general restriction of contractual freedom at the clause level must therefore be rejected.

3) Principle of certainty

In accordance with the principle of certainty, the resolutions covered by the majority principle had to be listed individually. In its effect such a regulation corresponds to a decision-making aid. Decision-making aids have the advantage that they are intended to improve the decision-making of the contracting parties and, in so doing, only slightly interfere with the contractual

freedom of the parties involved. With the principle of certainty, however, there is the problem that, due to the volume of information, there may not be a sufficient warning effect for minority shareholders. This phenomenon of limited information absorbency is described by the term information overload. Furthermore, the provision of information only helps to a limited extent against bounded rationality. In addition, it was found that the over-inclusion of the principle of certainty has a dysfunctional effect against the background of the sanctioning of the failure to mention a subject of a decision.

4) Regulatory instrument of indispensable rights

Representatives of the regulatory instrument of indispensable rights are of the opinion that certain subjects of resolutions, such as the right to participate in general meetings of shareholders, should be excluded from the disposability of the parties. In this regard, it was stated that such an encroachment on contractual freedom cannot be justified on the grounds of self-incapacitation, since the shareholders are in a position, on the basis of their ordinary right of termination, to evade a possible external determination by withdrawing from the company.

More revealing is generally the argumentation with the protection of institutions. However, it has been shown that institutional protection can also be achieved through dynamic barriers. This solution has the advantage that, against the background of the heterogeneity of the various forms of partnerships, reference can be made to the respective circumstances of the individual case, such as the legal form of the company, the purpose of the company and the respective motives. With regard to the requirement for minimally invasive interventions in contractual freedom, a rigid barrier such as the instrument of indispensable rights must therefore be rejected. This is also supported by a comparison with the jurisprudence on termination of membership. It would be contradictory if, on the one hand, membership as a whole could be withdrawn against the will of the shareholder concerned and, on the other hand, a subsequent restriction of individual rights should not be possible with the consent of the person concerned.

5) Regulatory instrument of irrevocable rights

According to the regulatory instrument of irrevocable rights, the effectiveness of a majority decision which directly intervenes in a legal position encompassed by the regulatory instrument depends on the consent of the shareholder concerned. This consent can either be given as ad hoc consent or before the resolution is passed as anticipated approval.

It was shown that the regulatory purpose of the instrument of irrevocable rights is to be seen in the corrective function to the tendency of minority shareholders to lack self-protection against majority opportunism. However, it was found that there are considerable concerns regarding the restriction of the contractual freedom of the participants due to the regulatory instrument of irrevocable rights.

The first reason for this is that the regulatory instrument of irrevocable rights cannot be classified as decision-making aid. On the one hand, it is not possible to introduce majority decisions by agreeing on anticipated approvals for all variants. On the other hand, the rationality-enhancing effect of anticipated approvals is doubtful. This is due to a lack of specifications regarding the design of anticipated approvals as well as deficits of the recipients with regard to the absorption and processing of information.

In addition, it was pointed out that the application of the regulatory instrument of irrevocable rights can lead to complicated delimitation problems in three different areas, leading to legal uncertainty in practice. This concerns first of all the question which rights of the shareholders are included in the scope of protection. In addition, the distinction between direct and indirect interventions can cause delimitation difficulties. Finally, the question of the existence of a consent obligation is by no means easy to answer.

It has also been shown that the regulatory instrument of irrevocable rights leads to both over-inclusion and under-inclusion. The former has the consequence that contractual freedom is unduly restricted by the requirement of anticipated approval or the granting of a veto right. The latter leads to the fact that the protection of the regulatory instrument of irrevocable rights is incomplete, since not all conceivable variants of majority opportunism within the framework of decision-making are covered.

In addition, it was shown that veto rights can impair the ability of a corporation to act and function, as various interests may have to be compromised. It is particularly problematic that the regulatory instrument of irrevocable rights favors minority opportunism, as far as minority shareholders can use their veto right to achieve special advantages.

Finally, it was found that the regulatory instrument unilaterally favors the minority, as it does not provide solutions to the problem of minority opportunism.

For the reasons set out above, a restriction of contractual freedom by the requirement of anticipated approvals or the granting of veto rights cannot be justified. The regulatory instrument of irrevocable rights must therefore be rejected.

6) Duty of loyalty

The deficits of the regulatory instrument of irrevocable rights have shown that it makes more sense to limit the risk of majority opportunism by a dynamic barrier, such as the duty of loyalty between shareholders. With its manifestations as a duty of consideration and promotion, the duty of loyalty represents a standard of conduct which determines *ex ante* how the shareholders must behave in future. Two different standards can be derived from the duty of loyalty. The first is abuse control, which must be taken into account with regard to management measures. On the other hand, the stricter standard of review of the regulatory instrument of objective justification, which is applied in fundamental resolutions.

The regulatory instrument of objective justification consists of the review steps of objective reason, necessity and appropriateness. The focus of the audit is on appropriateness. The conflicting interests of the parties involved must be carefully balanced. As a rule, the intensity of the interests concerned, the contractual distribution of risk, the real structure of the corporation, circumstances in the person of the shareholders as well as their voting behaviour are decisive for the assessment.

In addition, it was found that an abstract-general waiver of the regulatory instrument of objective justification is inadmissible, since such a blanket waiver is accompanied to a high degree by systematic decision-making errors.

The analysis of the regulatory instrument of objective justification has shown that its functioning is capable of minimizing the regulatory problem.

It was noted that the openness of the regulatory instrument helps to take account of the complexity of the issues to be resolved. This ensures a high degree of individual justice and at the same time prevents the risk of over-inclusion. The high degree of individual justice also has the advantage that the regulatory instrument of objective justification reduces transaction costs, since the articles of association can dispense with regulations regarding future eventualities that may never occur. Instead, the shareholders can engage in subsequent gap filling, since the openness of the regulatory instrument of objective justification ensures that a conflict resolution mechanism exists for all potential disputes in connection with the exercise of voting rights. By avoiding under-inclusion, an efficient protection of minority shareholder is guaranteed.

In addition, the accusation of an increase in legal uncertainty was refuted against the regulatory instrument of irrevocable rights. This is because the regulatory instrument of objective justification essentially corresponds to the audit of a possible consent obligation in the system of irrevocable rights. However, the with legal uncertainty associated audit whether an irrevocable right is affected and whether there is a direct interference with it are excluded.

Furthermore, it was worked out that on the basis of the given review steps as well as the existing weighing criteria a reasonable framework is set for the judicial freedom, which encloses the danger of arbitrary decisions. The argument put forward in this context of a judge's lack of economic competence is invalidated by the fact that, under the conditions of the business judgment rule, the shareholders have a margin of discretion with regard to business decisions and, if necessary, experts can contribute to the assessment of the economic issues.

Moreover, the steering effect emanating from the regulatory instrument of objective justification contributes to a containment of majority opportunism and thus at the same time to the ability of self-regulation of a corporation without state intervention.

However, critics must be allowed to admit that the fundamental potential for minority opportunism cannot be eliminated by the regulatory instrument of objective justification. For minority shareholders, there may well be a motivation to exploit the state of uncertainty caused by court proceedings against a resolution in order to obtain special advantages. However, a comparison with the regulatory instrument of irrevocable rights has shown that the hurdles for minority opportunism are significantly lower there. In addition, it can be argued that minority opportunism can be prevented elsewhere with the duty of loyalty. If a shareholder has a blocking minority, the loyalty duty can contribute to the reduction of minority opportunism with its expression in the form of the instrument of the obligation to consent.

7) Principle of equal treatment

Finally, the coexistence of the independent regulatory instrument of the principle of equal treatment with the objective justification must be waived. This is supported, on the one hand, by the fact that the scope of application of the principle of equal treatment is completely within the scope of the duty of loyalty and, on the other hand, by the difficulty of being able to determine material unequal treatment. The existence of an objectively ascertainable formal unequal treatment must instead be taken into account in the weighing of conflicting interests within the framework of the regulatory instrument of objective justification.