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Volume 22 | Number 2 | Article 1

12-1-1999

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Bernd Singhof, *Equity Holders' Liability for Limited Liabilities Companies' Unrecoverable Debts—Reflections on Piercing the Corporate Veil under German Law*, 22 Loy. L.A. Int'l & Comp. L. Rev. 143 (1999).
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LOYOLA OF LOS ANGELES
INTERNATIONAL AND COMPARATIVE
LAW REVIEW

VOLUME 22 DECEMBER 1999 NUMBER 2

Equity Holders' Liability for Limited Liability Companies' Unrecoverable Debts—Reflections on Piercing the Corporate Veil Under German Law

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I. INTRODUCTION

In many countries, the notion of "piercing the corporate veil"[1] (*Durchgriffshaftung*) is a recognized concept of corporate law. Yet, from a doctrinal point of view, the concept is underdeveloped and "exceedingly murky."[2] The notion of piercing varies considerably among foreign jurisdictions.[3] The

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The *Loyola of Los Angeles International & Comparative Law Review* was unable to obtain English translations for certain German source material cited in this Article. Accordingly, the *Review* relies on the author's representations as to the accuracy of these sources.

1. DANIEL ZIMMER, INTERNATIONALES GESELLSCHAFTSRECHT 332–333 (1996).

2. WILLIAM A. KLEIN & JOHN C. COFFEE JR., BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 140 (6th ed. 1996).

3. In the United States, veil-piercing jurisprudence is among the most frequently litigated issues; by comparison, the volume of litigation is considerably lower in Germany

sweeping language of a few vague court decisions causes confusion in this area of law and is the subject of numerous contradicting articles. Notwithstanding some striking similarities, the respective national jurisdiction preoccupies the ongoing discussions. Given the increasing number of cross-border business transactions and corporations doing business in foreign jurisdictions, it seems helpful to acknowledge legal solutions other legal systems offer. This approach may help lawyers recognize foreign corporate alternatives and induce lawyers to think about how to shape or amend their (national) concept.[4]

Generally, "piercing the corporate veil" refers to the direct, personal liability of one or more of a company's shareholders.[5] These shareholders may be held liable beyond their initial investments in the company.[6] Such liability arises when deference to the company's legal personality is deemed to contravene the principles of good faith and justice.[7] Some examples of situations giving rise to shareholders' personal liability involve commingling of private and company funds and gross undercapitalization of the company.[8] However self-explanatory this preliminary description sounds, it is rather insufficient and contains shortcomings. First, "piercing," if overly applied, disregards the corporate form and might undermine the concept of the legal corporate entity. Second, the determinative test for personal shareholder liability is somewhat unclear. Third, there is a dispute over the legal consequences of piercing the corporate veil, i.e., whether it triggers liability to the direct benefit of the corporation's creditors or installs internal liability to the corporation's benefit.

As indicated, piercing the corporate veil is a general corporate problem. Yet, a closer look at German case material indicates that the problem mainly arises in close member-managed companies where shareholders are not separated from control, but rather, exert undue influence on the corporation. Not surprisingly,

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and U.K. *See* Sandra K. Miller, *Piercing the Corporate Veil Among Affiliated Companies in the European Community and in the U.S.: A Comparative Analysis of U.S., German, and U.K. Veil-piercing Approaches*, 36 AM. BUS. L.J. 73, 77 (1998).

4. In Europe, there is remarkable initiative to create a supranational "European Private Company." *See* Peter Hommelhoff & Dietmar Helms, *Weiter auf dem Weg zur Europäischen Privatgesellschaft*, 90 GMBH-RUNDSCHAU [GMBHR] 53, 53 (1999).

5. *See* KLEIN & COFFEE JR., *supra* note 2, at 140.

6. *See id.* at 140–142.

7. *See infra* Part IV.A.

8. *See* KLEIN & COFFEE JR., *supra* note 2, at 140.

piercing the corporate veil was initially introduced in the context of limited liability companies that have only one equity holder.[9] In those wholly owned companies, there is almost no separation between management, equity holders, and those bearing the risk.[10] Consequently, the doctrine of piercing the corporate veil in Germany focuses on the limited liability company (*Gesellschaft mit beschränkter Haftung*), as governed by the Limited Liability Company Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung* (GmbHG)).[11] Accordingly, this Article exclusively analyzes German law pertaining to limited liability companies.

II. THE UNDERLYING CORPORATE PRINCIPLES

A. Legal Entity and Separation of Funds

Generally, a corporation is considered a legal entity distinct from its members, to which rights and duties attach.[12] With respect to limited liability, the concept of a separate legal personality (*Juristische Person*) is set forth in GmbHG section 13,

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9. *See* HEINZ ROWEDDER, GMBHG § 13 cmt. 24 (Heinz Rowedder ed., 3d ed. 1997).

10. A striking feature in this respect warrants highlighting: the equity holders' meeting is a company's supreme decision-making body. GmbHG section 45 provides that the equity holders' rights, in relation to the company's affairs and especially with regard to management of the business, and how these rights are exercised, are set forth in the articles of association (*Gesellschaftsvertrag*), unless statutory provisions provide otherwise. Generally, this leaves remarkable leeway to the equity holders' meeting (e.g., it may give directions to the managing directors and may lead to full managing competence through the equity holders' meeting). In a nutshell, the law permits the members of a limited liability corporation to enter into any agreement they desire to govern internal relations limited only by certain broad public policy restrictions.

11. *See* Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG), v. 20.4.1892 (RGBl. S. 477), *amended by* GmbHG, v. 22.6.1998 (BGBl. I S. 1474) (F.R.G.). The vast majority of companies in Germany are organized in the form of limited liability companies. *See* Heribert Hirte, *The European Private Company, A German Perspective*, *in* THE EUROPEAN PRIVATE COMPANY 95, 96 (Harm-Jan De Kluiver & Walter Van Gerven eds., 1995). In 1991, there were about 465,650 limited liability companies as opposed to 3,500 stock corporations (*Aktiengesellschaften*), of which only about 650 were listed on the stock exchange by 1995. *See id.* at 95. Since the introduction of the Small Stock Corporation Act (Gesetz für kleine Aktiengesellschaften und zur Deregulierung des Aktienrechts, v. 2.8.1994 (BGBl. I S. 1961) (F.R.G.)), however, taking the form of a stock corporation with equity financing at capital markets, in this author's opinion, seems to have become more and more attractive to small and medium-sized German businesses.

12. *See* SCHOLZ, KOMMENTAR ZUM GMBHG-GESETZ § 13 cmt. 2 (Volker Emmerich ed., 9th ed. 2000) [hereinafter SCHOLZ, KOMMENTAR ZUM GMBHG].

which states: "The company with limited liability as such has its independent rights and duties; it may acquire title and other real property rights and may sue and be sued before the courts."[13] Thus, it is *the company* that both incurs debts and acquires rights. The company essentially acts through its statutorily authorized agents[14] ("members" in a member-managed limited liability company and "managers" in a manager-managed limited liability company[15]).

In addition, the company itself is the *only* party liable to creditors. Once a limited liability company legally registers in the commercial register, no equity holder, simply by virtue of being a member, is personally liable for the company's debts and obligations. This is not, as it may seem, a natural "'corollary' . . . of the concept of the corporation as an entity."[16] Rather, it is based on a self-standing decision of the corporate legislation's drafters.[17] GmbHG section 13[18] provides that "only the company's assets are available to satisfy the claims of the company's creditors. . ."[19] and thus circumscribes the fundamental principle of corporate separateness (*Trennungsprinzip*)—separation of the company's and the equity holders' assets.[20]

B. Parallel Concepts of Corporate Finance

In general, limited liability offers the advantage of allowing members to participate in the control of the business without risking their personal assets beyond their initial investments in the company. This would be legally unacceptable in absence of at least some creditor protection laws. Limited liability shifts some of the risks of business failure to creditors and company employees. Thus, these individuals have vital interests in the legal protection of the company and in its capital.

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13. § 13 Abs. 1 GmbHG (F.R.G).
14. *See* § 35 Abs. 1 GmbHG (F.R.G.).
15. *See* KARSTEN SCHMIDT, GESELLSCHAFTSRECHT § 36.II.2 (3d ed. 1997).
16. KLEIN & COFFEE JR., *supra* note 2, at 139.
17. *See* SCHOLZ, KOMMENTAR ZUM GMBHG, *supra* note 12, § 13 cmt. 55 (Volker Emmerich ed.). *See also* Karlheinz Boujong, *Das Trennungsprinzip des § 13, Abs. 2 GmbHG und seine Grenzen in der neuen Judikatur des Bundesgerichtshofes*, *in* FESTSCHRIFT ODERSKY 739, 739 (1996).
18. § 13 Abs. 2 GmbHG (F.R.G.).
19. *Id.*
20. *See* Marcus Lutter, *Haftungsfragen in der Holding*, *in* HOLDING-HANDBUCH 248, 252, cmt. F 10 (Marcus Lutter ed., 3d ed. 1998).

The Limited Liability Company Act provides statutory rules governing the protection of stated corporate capital (*Haftungskapital*).[21] Compliance with these rules is the indispensable price equity holders pay in exchange for the shelter corporate limited liability provides.[22] As the rules become more elaborate, some last resort protections, which hold equity holders personally liable, become narrower in scope. Accordingly, prior to commencing discussion of piercing the corporate veil, one must address the concept of corporate finance.

In Germany, strict mandatory rules securing the legal entity's capitalization support the corporate principles described above. In general, corporate law requires that corporations remain furnished with an amount of contributed legal capital (*Stammkapital*)[23] to protect creditors.[24] Equity holders only "deserve" limited liability if they contribute cash or any form of tangible or intangible property or benefit in a verifiable manner, and do not extract those contributions at a later time.[25] No equity holder is exempt from these obligations.[26]

Based hereon, German corporate law provides a complicated set of special preventive rules to secure legal capital, not only at the time of formation,[27] but also throughout the duration of the

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21. *See* §§ 5, 7 Abs. 2–3, 9, 9c, 19–25, 30, 31 GmbHG (F.R.G.).

22. *See* § 13 Abs. 2 GmbHG (F.R.G.). *See also* Karsten Schmidt, *Zur Durchgriffsfestigkeit der GmbH*, 15 ZEITSCHRIFT FÜR WIRSTSCHAFTSRECHT [ZIP] 837, 838 (1994).

23. *See* § 30 Abs. 1 GmbHG (F.R.G.).

24. *See* § 5 GmbHG (F.R.G.). The concept of legal capital does *not* require that the company post a bond equal to the stated amount or hold sufficient funds in the corporate treasury and invest them in risk-free assets—legal capital is nothing more than an item on the liabilities side of the balance sheet. *See* § 42 Abs. 1 GmbHG (F.R.G.); § 266 Abs. 3.A.I. HGB (F.R.G.). *But see* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 60 (1991) (proffering that, in order for capitalization "requirements to be effective, the corporation must post a bond equal to its highest expected liability or hold sufficient funds in the corporate treasury and invest them in risk-free assets."). For a critical analysis of the legal capital concept, from an Italian perspective, see Marco Saverio Spolidoro, *The Legal Capital and the Raising of Funds Through Issuance of Securities in Italy*, 43 AKTIENGESELLSCHAFT [AG] 363 (1998).

25. *See* SCHMIDT, *supra*, note 15, § 13.I.2.

26. *See* § 19 Abs. 2 GmbHG (F.R.G.). *See also* SCHOLZ, KOMMENTAR ZUM GMBHG, *supra* note 12, § 19 (Uwe H. Schneider ed.).

27. *See, e.g.*, §§ 5, 7, Abs. 2–3, 9–9c, 19–25 GmbHG (F.R.G.) (the accumulation of capital (*Grundsatz der Kapitalaufbringung*)).

corporation's existence.[28] The following sections describe some of these significant rules.

1. Risk of Liability for Members: Creditor Protection and Orderly Financing of the Company

a. *Equity holders' liability for a capital shortfall after the formation* (Unterbilanzhaftung nach Gründung)

A limited liability company must register with the commercial register to be deemed full-fledged.[29] Due to the strain on the Registration Courts, a significant period of time, usually between three and six months, passes between the closing of the notarized corporate contract, the concurrent filing with the commercial register, and the company's entry in the commercial register.[30] Today, it is well recognized that the company "to be formed," i.e., the pre-incorporated company (*Vor-Gesellschaft*), is a business organization *sui generis* (*Organisation sui generis*)[31] that may enter into transactions and assume liabilities.[32] Thus, many companies enter into contracts prior to formation. Given these commercial activities during the pre-incorporation period, at the time of the company's formation (i.e., its registration), its assets and liabilities may result in a negative balance that no longer equals the stated capital. In this case, all equity holders are personally liable to the corporation for the difference on the balance sheet (*Unterbilanzhaftung*).[33] Each equity holder's individual share depends on his or her capital participation. If one equity holder is unable to pay, the others assume his or her liability.[34]

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28. *See* §§ 30–31 GmbHG (F.R.G.) (the maintenance of capital (*Grundsatz der Kapitalerhaltung*)).

29. *See* § 11 Abs. 1 GmbHG (F.R.G.).

30. *See* Marcus Lutter, *Haftungsrisiken bei der Gründung einer GmbH*, 38 JURISTISCHE SCHULUNG [JUS] 1073, 1073 (1998).

31. *See* MARCUS LUTTER & PETER HOMMELHOFF, GMBHG § 11 cmt. 2 (15th ed. 2000). "*Sui generis*" means "of its own kind or class; peculiar." BLACK'S LAW DICTIONARY 1436 (6th ed. 1990).

32. *See* LUTTER & HOMMELHOFF, *supra* note 31, § 11 cmt. 2.

33. *See* Lutter, *supra* note 30, at 1075.

34. *See* § 24 GmbHG (F.R.G.).

b. Equity holder's liability for the unincorporated company's loss (Verlustdeckungspflicht)

If, however, the registration is rejected, the unincorporated company will be liquidated.[35] In this case, a duty arises to cover any remaining debts after liquidation of the corporate assets (*Verlustdeckungspflicht*),[36] which supplements the obligations described above. This liability is the subject of long-standing debate over whether liability is limited, unlimited, internal, or external.[37] Only recently, the German Supreme Court concluded that equity holders' liability, in general, is unlimited but strictly internal.[38] Consequently, the corresponding claims belong to the unincorporated company,[39] which must use incoming payments to satisfy third party liabilities.[40] This concept seems convincing for a number of reasons. First, only unlimited liability protection prevents members facing "high losses" from taking actions that could lead to the incorporation's failure. Second, internal liability stands for harmonization of the corporate assets and the balance sheet.[41]

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35. *See* SCHOLZ, KOMMENTAR ZUM GMBHG, *supra* note 12, § 11 cmt. 55 (Karsten Schmidt ed.).

36. *See* Walter Stimpel, *Unbeschränkte oder beschränkte, Außen—oder Innenhaftung der Gesellschafter der Vor-GmbH, in* FESTSCHRIFT FLECK 345, 363 (1988).

37. *See* Lutter, *supra* note 30, at 1077.

38. *See* BGH [Supreme Court], Neue Juristische Wochenschrift [NJW], 50 (1997), 1507 (1507) (F.R.G.); Detlef Kleindiek, *Zur Gründerhaftung in der Vor-GmbH—Besprechung der Entscheidung BGH ZIP 1997, 679,* 26 ZEITSCHRIFT FÜR UNTERNEHMENS—UND GESELLSCHAFTSRECHT [ZGR] 427 (1997). *But see* Holger Altmeppen, *Das unvermeidliche Scheitern des Innenhaftungskonzeptes in der Vor-GmbH,* 50 NEUE JURISTISCHE WOCHENSCHRIFT 3272 (1997); SCHMIDT, *supra* note 15, § 34.III.3.c.

39. *See* BGH, Neue Juristische Wochenschrift [NJW], 50 (1997), at 1508. *But see* LG Heidelberg [trial court], Zeitschrift für Wirtschaftsrecht [ZIP], 18 (1997), 2045 (2048) (considering the merits of a piercing-like liability for equity holders at this stage, the court noted that external liability seems reasonable in cases where the corporation has virtually no assets, no manager, and insolvency proceedings most likely will not commence).

40. *See* BGH, Neue Juristische Wochenschrift [NJW], 50 (1997), at 1509.

41. *See* Lutter, *supra* note 30, at 1077.

c. *The de facto manager's liability prior to formation* (Handelndenhaftung im Gründungsstadium)

At the pre-incorporation stage, creditors need additional protection because there is no limited liability company in effect when contracts with third parties are signed.[42] The company has not yet taken the final step in the incorporation process, and the court has not yet audited the company to determine whether it is duly established with adequate stated capital.[43] Therefore, anybody (with or without an equity stake in the company) who acts as a "de facto manager" and enters into contracts on the future company's behalf is arguably liable thereunder.[44] A counter-party can look to these individuals, acting as a group, and hold each individual jointly and severally liable (*Handelndenhaftung*).[45] Joint and several liability is triggered, not only when the corporation fails to pay or perform a contract or when it slides into insolvency prior to formation, but it also exists simultaneously with the future company's liability.[46] The liability of these individuals so acting ceases to exist upon the company's registration.[47]

d. *Contributions in kind* (Sacheinlagen)

Yet another problem is what lawyers in the United States pictorially describe as "watering the stock."[48] "Water" is "present in a corporation when it issues shares for overvalued assets and uses the inflated value for its book entries."[49] Consequently, one

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42. *See* § 11 Abs. 1 GmbHG (F.R.G.).

43. *See* §9(c) GmbHG (F.R.G.).

44. *See* BGHZ 66, 359 (360) (F.R.G.). The external liability of de facto managers must be clearly distinguished from the general internal liability of promoters. To wit, the courts have narrowed the scope of external liability to managers and de facto managers of the to-be-formed company who were involved in the business transaction at hand, or who knew of and consented to the transaction (*enger Handelndenbegriff*). *See id.*

45. *See* § 11 Abs. 2 GmbHG (F.R.G.). *See also* Council Directive 68/151, art. 7, 1968 O.J. (L 65) 8–12.

46. *See* GÜNTER H. ROTH & HOLGER ALTMEPPEN, GmbHG, § 11 cmt. 26 (3d ed. 1997).

47. *See* BGHZ 69, 95 (103) (F.R.G.); BGHZ 70, 132 (139) (F.R.G.); BGHZ 80, 129 (145) (F.R.G.); BGHZ 80, 182 (185) (F.R.G.).

48. KLEIN & COFFEE JR., *supra* note 2, at 211.

49. *Id.* *See* SCHOLTZ, KOMMENTAR ZUM GMBHG, *supra* note 12, § 5 cmt. 37 (Heinz Winter ed.) (defining "contributions in kind" as any non-cash assets shareholders contribute to the company's legal capital).

of corporate law's primary objectives is verifying that the value of the contributions in kind (*Sacheinlagen*) equals the par value of the shares.[50] Any shortfalls must be compensated for in cash.[51] In order to circumvent these strict rules, contributions in cash are often combined with seemingly unrelated business transactions between the corporation and the equity holders in a complicated manner.[52] Only after diligent investigation is the whole transaction unmasked as a "disguised contribution in kind" (*verdeckte oder verschleierte Sacheinlage*).[53] In this case, the equity holder is not discharged of his or her obligation, but must make another contribution in cash in return for his or her contribution in kind.[54]

e. *Repayments to equity holders* (Rückzahlungen)

The GmbHG contains a number of provisions aimed at maintaining the legal equity capital.[55] For purposes of this Article, it suffices to indicate that the company is barred from making any repayment of equity contributions to the equity holders that reduces the company's net assets to below the legal capital requirements.[56] This also applies to benefits the company provides for inadequate consideration of the equity holder (*verdeckte Einlagenrückgewähr*).[57] It is important to note that these restrictions are designed to protect the company's *stated* capital only.[58] Therefore, repayment to equity holders of capital surplus exceeding the stated amount of equity capital seems fully permissible from a corporate perspective. This is evident despite the fact that, as discussed in detail below, such payment might

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50. *See* § 5 Abs. 4 GmbHG (F.R.G.); § 8 Abs. 1 Nr. 5 GmbHG (F.R.G.); § 9 Abs. 1 GmbHG (F.R.G.); *see also* § 7 Abs. 3 GmbHG (F.R.G.).

51. *See* § 9 Abs. 1 GmbHG (F.R.G.).

52. *See* LUTTER & HOMMELHOFF, *supra* note 31, § 5 cmt. 35.

53. For a full discussion of critical remarks with respect to European Law, see *id.* *See also* Lutter, *supra* note 30, at 1078 (examining Council Directive 77/91, 1977 O.J. (L26) 1–13).

54. *See* SCHMIDT, *supra* note 15, § 37.II.4.b (criticizing the legal consequences).

55. *See, e.g.*, § 30 Abs. 1, § 33 Abs. 2, § 34 Abs. 3 GmbHG (F.R.G.).

56. *See* § 30 Abs. 1 GmbHG (F.R.G.). Payments contrary to GmbHG section 30 must be reimbursed to the company. *See id.* Equity holders, other than the recipient, must assume this liability only if the recipient is unable to pay. *See* § 31 Abs. 3 GmbHG (F.R.G.). *See* BGH, Zeitschrift für Wirtschaftsrecht [ZIP], 20 (1999), 1352 (1353–1354).

57. *See* ROTH & ALTMEPPEN, *supra* note 46, § 30 cmt. 43.

58. *See* § 30 Abs. 1 GmbHG (F.R.G.).

impair the company's financial situation (i.e., its liquidity) and subject company managers to criminal prosecution.[59]

f. "Capital-replacing" loans (kapitalersetzende Darlehen)

"[W]hen a small business finds itself in financial difficulty, the equity owners very often will feel compelled to add additional funds to keep it going."[60] Under certain circumstances, however, equity owners are not free to shift from equity to debt financing.[61] A fairly complicated body of statutory and case law governs equity holders' responsibility when they equity-finance the company. If an equity holder extends loans to the company, rather than investing in the firm in the form of equity when a "prudent" equity holder would have done so to increase the company's capital, the loans will be considered a contribution to the company's equity capital.[62] Consequently, in insolvency proceedings, the equity holder is *not* entitled, along with other creditors, to a pro rata share of the assets available to satisfy all creditors' claims.[63]

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59. *See* Franz Schnauder & Bernd Müller-Christmann, *Durchblick: Der zivilrechtliche Schutz des GmbH-Vermögens vor dem Zugriff der Gesellschafter*, 38 JURISTISCHE SCHULUNG [JUS] 980, 980 (1998) (explaining how the evaluation of repayment to equity holders differs under corporate and criminal law).

60. KLEIN & COFFEE JR., *supra* note 2, at 140.

61. *See* Pepper v. Litton, 308 U.S. 295, 308–309 (1939) (discussing circumstances wherein the claims of a corporate officer, director, or shareholder may be subordinated to equity, including, for example, where there is a history of mismanagement; where an interested shareholder or director's vote brought the claim into being; and where the dominant shareholder disregarded the substance or form of corporate management, treating the corporation's affairs as his or her own). *See also* KLEIN & COFFEE JR., *supra* note 2, at 218 (noting that a court "will sometimes subordinate the shareholder/creditor to other creditors if it finds that the corporation was too 'thinly capitalized' . . . .").

62. The determinative test is as follows: would a third party, (e.g., a bank), have extended a loan with normal credit terms to the company under the circumstances? In other words, the relevant standard is the company's creditworthiness or credit rating. *See* BGHZ 76, 326 (329) (F.R.G.); BGHZ 81, 252 (263) (F.R.G.); BGHZ 90, 381 (390) (F.R.G.).

63. After some striking criticism of those rules, two important amendments to GmbHG section 32(a) were enacted in 1998: First, according to GmbHG section 32(a), paragraph 3, as amended by Kapitalaufnahmeerleichterungsgesetz (KapAEG), v. 20.4.1998 (BGB. I S. 70) (F.R.G.), small non-managing investors holding an amount of equity in the firm of 10% or less are exempt from the rules pertaining to equity holders' loans substituting equity capital. Second, GmbHG section 32(a) is not applicable to a lender who acquires equity in a firm in distress in order to overcome such crisis. *See* § 32(a) Abs. 3 GmbHG (Sanierungsprivileg; Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG), v. 27.4.1998 (BGBl. I S. 786) (F.R.G.)); BGHZ 81, 311 (311) (F.R.G.) (*Sonnenring* is the landmark case on the former law). It is foreseeable that these rules will not smooth out all the existing problems. *See also* Robin Dörrie, *Das*

Rather, the equity holder's claim is subordinated to the other creditors' claims.[64] The equity holder's credit is only repaid if there are assets left over after other creditors' claims are satisfied and discharged.[65] By the same token, loans equity holders extend at an earlier stage are deemed equity if they are not reclaimed, despite the corporation's subsequent financial crisis.[66] To prevent equity holders from circumventing this statutory approach, GmbHG section 32[67] extends the scope of the provision to include the collateral equity holders provide to secure third party loans and other legal acts, which, in economic terms, equal a loan extension.[68] In recent years, transfer of the right to use a fixed asset (*Nutzungsüberlassung*) from an equity holder to a company has increasingly been considered equivalent to the extension of a loan.[69]

The subordination of debt is not sufficient if the loan has been repaid. A supporting protection renders two sets of rules. First,

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Sanierungsprivileg des § 32a Abs. 3 GmbHG, 20 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [ZIP] 20, 33 (1999); Rudolf Neuhof, *Sanierungsrisken der Banken: Die Vor-Sanierungsphase*, 51 NEUE JURISTISCHE WOCHENSCHRIFT 3225, 3232 (1998). It is doubtful that the rules will resolve the existing problems, although the jungle of law governing "capital-replacing" loans (*Eigenkapitalersatzrecht*) has been cleared remarkably to give priority to reorganization instead of dissolution; *see* Heribert Hirte, *Aktuelle Schwerpunkte im Kapitalersatzrecht*, *in* GESELLSCHAFTSRECHT 145, 155 (Peter Hommelhoff & Volker Röhricht eds., 1997).

64. *See* § 39 Abs. 1 Nr. 5 InsO (F.R.G.) (Insolvency Act (Insolvenzordnung), v. 5.10.1994, (BGBl. I S. 2866) (effective Jan. 1, 1999) (F.R.G.)). According to the former law, an equity holder *could not* claim repayment of his or her loan during bankruptcy or composition proceedings. *See* § 39 Abs. 1 Nr. 5 InsO (F.R.G.). The inclusion of equity holders in insolvency proceedings neither improves their economic position (usually, there are no assets left after the satisfaction of prior-ranking creditors) nor tackles the pillars of the law governing capital-replacing loans. Rather, the amendment is a technical one. *See* Ulrich Noack, *Neues Insolvenzrecht—neues Kapitalersatzrecht*, *in* FESTSCHRIFT CLAUSSEN 307, 309, 318 (1997). *See also* ULRICH NOACK, GESELLSCHAFTSRECHT 85 (1999).

65. *See* § 32(a) Abs.1 GmbHG (F.R.G.).

66. *See, e.g.*, BGH, Neue Juristische Wochenschrift-Rechtsprechungs-Report [NJW-RR], 2 (1987), 806 (F.R.G.). The applicable test, however, is the subject of dispute. *See* SCHMIDT, *supra* note 15, § 37.IV.2.b.

67. *See* § 32(a) Abs. 2-3 GmbHG (F.R.G.).

68. *See id.* As a legal consequence, in insolvency proceedings, a third party creditor may only claim repayment of the amount of money he or she could not collect from the equity holder who provided the collateral.

69. *See* BGHZ 127, 1 (7) (F.R.G.); OLG Karlsruhe [trial court for selected criminal matters and court of appeals], Zeitschrift für Wirtschaftsrecht [ZIP], 17 (1996), 918 (921) (F.R.G.). *See also* Holger Altmeppen, *Zur "finanzplanmäßigen Nutzungsüberlassung" als Kapitalersatz*, 17 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [ZIP] 909 (1996).

the receiver can rescind any repayment or release of collateral granted by an equity holder for a third party loan, provided that the loan is repaid to the equity holder during the year preceding the date of an insolvency petition filing.[70] Second, strict protection is achieved through the body of case law analogizing to the rules dealing with maintenance of the company's capital.[71] Under these rules, the company shall make no payments to an equity holder if the assets covering the legal capital are thereby decreased.[72] Because under the above-described circumstances equity holders' loans are deemed equity capital, they shall not be repaid until after the financial crisis is overcome. Note that this restriction is applicable at all times—not only when insolvency proceedings are initiated.[73]

2. Outlook

The above described situation may give rise to a first-impression assessment of how narrow the scope of piercing the corporate veil, in fact, need be. Because there is an entire body of law protecting the orderly financing of limited liability companies, piercing should remain a last resort option in cases wherein the statutory protection of legal capital is rendered defunct.

Conversely, the concept of "abstract" legal capital does not demand a specific amount of guaranteed capital tailored to the individual course of the company's business. The traditional approach, therefore, secures a stated amount of capital that may be insufficient to meet creditors' needs as generated by the actual size of the firm's business.[74] As long as the value of the company's assets exceed its legal capital, the equity holders appear free to extract any capital surplus from the company.[75] Neither statutory nor case law provide efficient protection against selfish equity holders' removal of capital above the surplus, even though such removal may contribute to, or even trigger, a financial crisis for the

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70. *See* § 135 Nr. 2 InsO (F.R.G.). *See also* § 6 AnfG (F.R.G.) (*Anfechtungsgesetz* (Avoidance Act), v. 5.10.1994 (BGBl. I S. 2911) (F.R.G.)).

71. *See* §§ 30–31 GmbHG (F.R.G.). This analogy remains valid even after the introduction of GmbHG section 32(a). *Cf.* BGHZ 90, 370 (376) (F.R.G.). *See* HARTWIN V. GERKAN & PETER HOMMELHOFF, KAPITALERSATZ IM GESELLSCHAFTS—UND INSOLVENZRECHT 46 (3d ed. 1994).

72. *See* §§ 30–31 GmbHG (F.R.G.).

73. *See* SCHMIDT, *supra* note 15, § 37.IV.4.

74. *See supra* Part II.B (discussing the traditional approach).

75. *See* § 30 Abs. 1 GmbHG (F.R.G.).

company.[76] The increasing number of insolvency proceedings raises the question of whether additional protection is achievable.

III. PERMISSIBILITY OF PIERCING THE CORPORATE VEIL BY WAY OF AN EXCEPTION

Against this background, the underlying corporate principles of "legal entity"[77] and "separation of funds,"[78] if taken seriously, are not easily overruled. In several landmark cases, the German Supreme Court reiterated that "the concept of the company as a separate legal entity should not be disregarded thoughtlessly or unrestrainedly."[79] The Court, however, relied on a case-by-case analysis, based on the notion of "misuse of the corporate form" and carved out doctrinal grounds for piercing the corporate veil. It is therefore necessary to evaluate possible explanations legal authors offer and sort out fact patterns that, although seemingly related, are not covered by this notion.

A. The Modern Doctrinal Concept

As stated above, German courts have not developed a specific test for piercing the corporate veil. Because of definitional problems, the German Supreme Court accords a measure of deference to the corporate entity, which is apparently relaxed only in "extreme" instances.[80] The Court resorts to a somewhat fluid analysis that endeavors to take into account the totality of the circumstances.[81]

Doctrinal concepts referring to misuse of the corporate form, either from a subjective[82] or from an objective[83] perspective (*subjektive und objektive Mißbrauchstheorien*), have proven overinclusive. It suffices to note that the current common

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76. *See* Schnauder & Müller-Christmann, *supra* note 59, at 982.

77. *See supra* Part II.A (discussing the "legal entity" principle).

78. *See id.* (discussing the "separation of funds" principle).

79. BGHZ 20, 4 (11) (F.R.G.). *Accord* BGHZ 31, 258 (271) (F.R.G.); BGHZ 45, 204 (207) (F.R.G.); BGHZ 54, 222 (224) (F.R.G.); BGHZ 61, 380 (383) (F.R.G.).

80. *See* BGHZ 20, 4 (11) (F.R.G.).

81. *See* ROWEDDER, *supra* note 9, § 13 cmt. 22. *See also* HACHENBURG, GMBHG, app. § 13 cmt. 42 (Peter Ulmer ed., 8th ed. 1994) [hereinafter HACHENBURG, GMBHG]; SCHOLZ, KOMMENTAR ZUM GMBHG, *supra* note 12, § 13 cmt. 77 (Volker Emmerich ed.).

82. *See generally* ROLF SERICK, RECHTSFORM UND REALITÄT JURISTISCHER PERSONEN (1955) (discussing misuse of the corporate form from a subjective perspective).

83. *See* Rudolf Reinhardt, *Gedanken zum Identitätsproblem bei der Einmanngesellschaft*, *in* II FESTSCHRIFT LEHMANN 576 (1956).

underpinnings of the piercing doctrine approach the problem differently. They deem piercing a problem of proper construction and application of statutes, and thus focus on the applicable statute's legislative purpose (*Normanwendungskonzept*) to determine whether the separation between the equity holders and the corporation prevails.[84] Although the idea of misusing the corporate form is not completely dispensable, at least in the sense of voiding mandatory financing principles, the modern approach makes an important difference. In particular, the notion of disregarding the corporate form is a misnomer. At all times, the corporation remains a legal entity with all its rights and duties, some of which may also attach to equity holders at the same time.

B. Related Piercing Problems

In addition to this somewhat gloomy impression, there is also remarkable uncertainty over the factual situations governing when piercing of the corporate entity should apply. A number of court decisions refer to the piercing doctrine, but there are almost always other, albeit related, solutions to the legal problems at hand. As a doctrinal matter, this changes the situation. Deference to the concept of legal entity is of paramount importance and it may be achieved only if lawyers diligently seek solutions that do not "disregard" the corporate form in critical cases.

1. Separate Grounds of Obligation

At the outset, there is clearly no piercing of the corporate veil when equity holders are liable on separate grounds. For example, in certain circumstances, an equity holder may be liable based on a contract of guaranty (*Bürgschaft*),[85] indemnity (*Vertrag über Schadloshaltung*), a collateral promise (*Schuldbeitritt*), or a letter of support (*Patronatserklärung*). As for debts, equity holders' limited liability "must often be sacrificed."[86] Almost without fail, a bank or other lender will not extend credit to a limited liability

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84. *See* HACHENBURG, GMBHG, *supra* note 81, app. § 13 cmts. 28, 36. *See also* Wolfram Müller-Freienfels, *Zur Lehre vom sogenannten "Durchgriff" bei juristischen Personen im Privatrecht*, 156 ARCHIV FUR DIE CIVILISTISCHE PRAXIS [ACP] 522 (1957); Eckard Rehbinder, *Zehn Jahre Rechtsprechung zum Durchgriff im Gesellschaftsrecht*, *in* FESTSCHRIFT FÜR ROBERT FISCHER 579, 579 (1979).

85. "*Bürgschaft*" is a "surety" or "bond." BARNES & NOBLE, GERMAN DICTIONARY 236 (1982).

86. KLEIN & COFFEE JR., *supra* note 2, at 139.

company unless the company's principal equity holders "add their personal guarantees to the obligation . . . ."[87] "Suppliers also frequently require personal guarantees,"[88] thus demonstrating that "the significance of limited liability [in close corporations] is often overrated."[89]

Although less evident than in the above-mentioned circumstances, piercing the corporate veil does not occur when the equity holder's liability is based on *culpa in contrahendo*.[90] Under this doctrine, a (managing) self-interested equity holder leading contract negotiations, who has a significant economic interest in closing a certain transaction, (*wirtschaftliches Eigeninteresse*),[91] or who makes express representations (i.e., draws on a special personal trust relationship) inducing the contracting party's additional firm reliance (*besonderes persönliches Vertrauen*) on the correctness of his or her statements, may subject the equity holder to personal liability.[92]

A managing equity holder who does not disclose to the contracting party that he or she acts on a limited liability company's behalf gives the impression that he or she will be a party to the contract. Thus, he or she may be personally liable for the contractual obligation—for the ostensible existence of a legal

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87. *Id.* *See* BGH, Neue Juristische Wochenschrift [NJW], 49 (1996), 2156 (F.R.G.); BGH, Betriebs-Berater [BB], 53 (1998), 1175 (1175) (F.R.G.) (holding against applicability of the Consumer Credit Act (Verbraucherkreditgesetz), v. 17.12.1990, BGB1. I S. 2840) (F.R.G.)). For a discussion of this legal issue, see Barbara Grunewald, *Bürgschaft und Schuldbeitritt von Geschäftsführern und Gesellschaftern*, *in* FESTSCHRIFT KRAFT 127 (1998).

88. KLEIN & COFFEE JR., *supra* note 2, at 140.

89. *Id.* at 139.

90. Under the *culpa in contrahendo* doctrine, contractual negotiations, even those that do not culminate in the closing of a deal, give rise to a relationship of trust between the parties similar to that arising from a contract requiring parties observe the ordinary standard of care. *See* OTHMAR JAUERNIG & MAX VOLLKOMMER, BÜRGERLICHES GESETZBUCH [BGB] § 276 cmts. 69–73 (8th ed. 1997).

91. Today, it is beyond debate that having a major equity holding in a company does not constitute a significant economic interest. Otherwise the privilege of limited liability, as provided in GmbHG section 13, paragraph 2, would be senseless. The German Supreme Court, however, has not always been that clear in this respect and now requires "additional facts." BGHZ 126, 181 (184, 186) (F.R.G.). Granting a personal guarantee to certain creditors does not meet this standard. *See id.* *See also* BGH, Wertpapiermitteilungen [WM], 51/52 (1988), 1873 (1874) (F.R.G.); BGH, Wertpapiermitteilungen [WM], 45 (1985), 1526 (1528) (F.R.G.); OLG Köln, GmbH-Rundschau [GMBHR], 87 (1996), 766 (767) (F.R.G.).

92. *See* BGH, Zeitschrift für Wirtschaftsrecht [ZIP], 11 (1990), 659 (661) (F.R.G.).

situation (*Vertrauenshaftung*)[93] because the other party dealt with the individual as if he or she was the sole proprietor, and thus expected recourse in the individual's assets. A similar fact pattern, "mixing of corporate spheres" (*Sphärenvermischung*),[94] occurs when two or more limited liability companies, whose identities and functions are easily confused, perform their businesses with exactly the same staff, business address (shared buildings), and almost the same equity holders and managers. Moreover, their fields of business often overlap or supplement each other. The close physical proximity of these companies, often combined with similar firm names, makes it nearly impossible for outsiders to determine the contracting party's identity.[95] Although at first blush this fact pattern may call for piercing, it is imperative to recognize that as long as there is no commingling of funds, reasonable solutions are achievable with the general contract and commercial law doctrines, namely the duty to disclose the identities of the principal and the agent (*Offenkundigkeitsprinzip*).[96] Separation of funds does not safeguard affiliated companies that breach this duty.[97]

Finally, it should be kept in mind that equity holders could also be personally liable in tort.[98] According to the German Civil Code (*Bürgerliches Gesetzbuch* (BGB)) section 826, a person who *willfully* causes damage to another in a manner contrary to public policy is bound to compensate the other for the damage.[99] Thus, a majority equity holder may be held liable, pursuant to this section, if he or she *intentionally* "undercapitalizes" the company to the

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93. *See* BGH, Neue Juristische Wochenschrift [NJW], 43 (1990), 2679 (2679) (F.R.G.).

94. *See* SCHMIDT, *supra* note 15, § 9.IV.2. *See also* Lutter, *supra* note 20, at 283, cmt. F 69.

95. *See* SCHMIDT, *supra* note 15, § 9.IV.2.

96. *See id.*

97. *See id.*

98. *See* §§ 31, 823, 826, 831 BGB (F.R.G.). For example, managing equity holders who postpone filing for insolvency are liable in tort. *See* § 823 Abs. 2 BGB (F.R.G.); § 64 GmbHG (F.R.G.). *See also* BGHZ 126, 181 (190) (F.R.G.). According to this new German Supreme Court precedent, (BGHZ 126, 181 (193) (F.R.G.)), creditors who entered into a contract *after* the corporation is insolvent will be fully compensated under BGB section 823, paragraph 2; while in former decisions (e.g., BGHZ 29, 100 (107) (F.R.G.); BGHZ 100, 19 (32) (F.R.G.)), creditors were only compensated for damage to their dividends in insolvency (*Quotenschaden*). Thus, "piercing the corporate veil" today seems less imperative in cases of material undercapitalization. *See* ROTH & ALTMEPPEN, *supra* note 46, § 13 cmt. 23.

99. *See* § 826 BGB (F.R.G.).

detriment of creditors (*Gläubigerschädigung*).[100] Initially, finding liability under BGB section 826 was rare,[101] but now tort law has become important for equity holder liability by expanding the scope of section 826.[102] In many cases, courts have relied on torts, rather than on piercing the corporate veil, to find liability.[103] Hence, section 826 has been interpreted less subjectively than the statute's language seems to allow.[104] The German Supreme Court's reading of "intention" appears rather liberal. The Court's interpretation only requires a finding that the probability of damage was perfectly obvious to the equity holder given his or her previous knowledge.[105] Because corporate managers are required to inform equity holders when an urgent need for capital arises,[106] BGB section 826 appears to be a reliable check on the company's capitalization.

2. Construction of Contracts and Statutes

The proper handling of contractual and statutory duties and liabilities often requires consideration of the fact that the legal entity (to which rights and duties may attach) and its equity holders stand side-by-side. For example,[107] a limited liability company, as an equity holder in a limited liability partnership (*Kommanditgesellschaft*), may be subject to a restraint-of-trade clause.[108] To hold that this clause binds not only the limited liability company, but also its major equity holder, a court does not refer to the doctrine of piercing the corporate veil. Rather, the

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100. *See* BGH, Neue Juristische Wochenschrift [NJW], 32 (1979), 2104 (2105) (F.R.G.). *See also* Rudolf Nirk, *Zur Rechtsfolgenseite der Durchgriffshaftung, in* FESTSCHRIFT STIMPEL 443, 451 (1985).

101. *See* Ulrich Ehricke, *Zur Begrundbarkeit der Durchgriffshaftung in der GmbH, insbesondere aus methodischer Sicht*, 199 ARCHIV FUR DIE CIVILISTISCHE PRAXIS [ACP] 257, 278 (1999).

102. *See id.*

103. *See, e.g.*, BGH, Neue Juristische Wochenschrift [NJW], 32 (1979), at 2105.

104. *See generally* ROTH & ALTMEPPEN, *supra* note 46, § 43 cmt. 32.

105. *See* BGH, Neue Juristische Wochenschrift [NJW], 32 (1979), at 2105.

106. *See generally* SCHOLZ, KOMMENTAR ZUM GMBHG, *supra* note 12, § 43 cmt. 37a (Uwe H. Schneider ed.).

107. *See* BGHZ 89, 162 (162) (F.R.G.).

108. *See* § 112 Abs. 1 HGB (F.R.G.) (Handelsgesetzbuch (HGB) v. 10.5.1897, (RGBl. S. 219) (F.R.G.), *amended by* Handelsgesetzbuch (HGB) v. 25.6.1998, (BGB1. I. S. 1588) (F.R.G.) (providing, in pertinent part: "A partner may not, without the consent of the other partners, conduct business in the partnership's branch of business or participate as a general partner in another similar commercial partnership.")).

equity holder is restrained as a result of the corporate contract. Additionally, the clause also binds the equity holder as a matter of duty and loyalty to the company.

The context of applying statutes requires similar construction. For example, the German Supreme Court held that in insolvency proceedings,[109] close relatives of a limited liability company's equity holders are deemed close relatives of the company. Again, the Court's holding was not founded on the doctrine of piercing the corporate veil, but on general rules of statutory construction.[110]

C. Characteristic Cases of Piercing Liability

Limited liability is a fundamental principle of corporate law, under which investors in a corporation are not liable for more than the amount they invest. As a result, limited liability shifts some of the risk of a business' failure to creditors.[111] Hence, liability has never been *absolutely* limited. Courts occasionally allow creditors to "pierce the corporate veil," which means that equity holders must satisfy creditors' claims.[112] Generally, "equity holders are in danger of personal liability for the debts of a corporation if they use the corporation for fraudulent purposes or if they . . . disregard the separation of funds."[113] Under German law, three different fact patterns dominate this context, namely, commingling of funds, gross undercapitalization, and parent-subsidiary combinations.[114] Many cases involve combinations of these factual circumstances; these combinations add to the heterogeneity of the legal prerequisites and solutions.

1. Commingling of Corporate and Personal Funds

A seemingly palpable ground for the necessity of piercing the corporate veil is the commingling of corporate and personal funds or assets.[115] As a matter of law, it is unacceptable for an equity

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109. *See* BGHZ 58, 20 (20) (F.R.G.).

110. *See* SCHMIDT, *supra* note 15, § 9.III.2.

111. *See* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985).

112. *See id.* (presenting an American perspective). *See also* EASTERBROOK & FISCHEL, *supra* note 24, at 54.

113. KLEIN & COFFEE JR., *supra* note 2, at 140.

114. *See* discussion *infra* Parts III.C.1–3 (discussing the three different fact patterns).

115. *See* Walter Stimpel, *"Durchsgriffshaftung" bei der GmbH: Tatbestände,*

holder to blatantly commingle funds. The equity holder only benefits from limited liability if he or she adheres to the law.

The German Supreme Court left open the question whether the doctrine of piercing the corporate veil should apply in all commingling cases.[116] Due to the reluctance to open the floodgates to a generalized doctrine of piercing the corporate veil, two sets of cases are distinguished.

First, where the commingling of funds is reduced to certain (individual) assets, the extension of liability bears on these assets only.[117] This does not require piercing or even disregarding the corporate form for creditors' benefit. Rather, a straightforward application of civil law rules[118] and GmbHG section 13 suffices.

Conversely, within the narrow scope of piercing liability, cases lie wherein the shuffling of funds in and out of the company is so extreme that the removed assets cannot be individualized. Here, the separation of corporate and private funds is covered up or the assets are made impossible to reach by means of "opaque" bookkeeping methods or other devices. Thus, the rules governing maintenance of corporate capital described above cannot develop any protective or preventive effect.[119] Under these circumstances, equity holders may be held personally liable.[120] According to the underlying doctrinal concept described earlier,[121] such piercing liability is not a structural or an institutional liability applying to all equity holders in the same manner regardless of their individual responsibility, it is a liability for fault (*Verschuldenshaftung*).[122] Accordingly, only a principal equity holder with influence over corporate affairs may be held liable.[123]

Verlustausgleich, Ausfallhaftung, in FESTSCHRIFT GOERDELER 601, 606 (1987).

116. *See* BGH, Betriebs-Berater [BB], 40 (1985), 77(F.R.G.).

117. *See* SCHMIDT, *supra* note 15, § 9.IV.2.a.

118. *See supra* Part III.B.1 (discussing the civil law rules).

119. *See* BGHZ 125, 366 (368) (F.R.G.); BGHZ 95, 330 (333) (*Autokran*) (F.R.G.).

120. *See id. See also* Ehricke, *supra* note 101, at 292–299.

121. *See* discussion, *supra* Part III.A.

122. *See* SCHMIDT, *supra* note 15, § 9.IV.2.a.

123. *See* BGHZ 125, 366 (366) (F.R.G.) (holding that a scarecrow, "dummy," managing shareholder may not be held liable).

2. Gross Undercapitalization

Another reason for piercing the corporate veil occurs when equity holders "knowingly 'undercapitalized' the corporation at its formation [or at a later point,] so that it could not pay its foreseeable debts."[124] So far, "no decision appears yet to have clearly held [equity holders] liable based solely upon a finding of gross undercapitalization."[125] Courts refer to liability in tort, pursuant to BGB section 826,[126] in cases where the intent to damage creditors is clear from the circumstances.[127]

Because the concept of stated capital[128] is an abstract one that does not guarantee capital sufficient to the individual pursuit of business, there must be some kind of safeguard. During the course of the last major amendment of the GmbHG in 1980, however, a provision requiring capitalization sufficient for a company's intended business transactions was rejected.[129] It was deemed impossible to permanently determine, with legal accuracy, a corporation's adequate capitalization, as measured by the individual corporate undertaking and its magnitude.[130] Moreover, liability based on a rather vague ex post assessment of adequate capitalization is inconsistent with the principle of legal certainty and questions the concept of limited liability itself.[131] Hence, the doctrine of piercing the corporate veil should not reintroduce this appropriately rejected concept to serve as a catchall for cases that cannot be resolved through application of the maintenance of capital rule.

As indicated above, equity holders are personally liable only in extreme cases when they are knowingly involved in a scheme

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124. KLEIN & COFFEE JR., *supra* note 2, at 140.

125. *Id. See also* BGHZ 68, 312, (316) (F.R.G); Bundesarbeitsgericht [BAG] [supreme labor court], Zeitschrift für Wirtschaftsrecht [ZIP], 20 (1999), 878 (879) (F.R.G.) (holding against shareholder liability because of undercapitalization); Boujong, *supra* note 17, at 745; KLEIN & COFFEE JR., *supra* note 2, at 140 (noting that undercapitalization is a "more uncertain basis for 'piercing the corporate veil'").

126. § 826 BGB (F.R.G.). *See also supra* Part III.B.1 (discussing the fact that the corporate veil will not be pierced when equity holders are held liable on separate grounds).

127. *See supra* Part III.B.1.

128. *See* § 5 GmbHG (F.R.G.).

129. *See* Ehricke, *supra* note 101, at 284.

130. *See* Stimpel, *supra* note 115, at 608.

131. *See* Deutscher Bundestag [German Parliament] [BT] No. 1347, 38th Sess., at 38 (1977) (F.R.G.). *See also* Stimpel, *supra* note 115, at 608.

leaving the company exposed to business risk without sufficient capital to pay its debts.[132] In other words, equity holders are liable when they completely ignore the company's need for additional equity capital, allowing it to become grossly undercapitalized (*materielle Unterkapitalisierung*).[133] Again, piercing liability does not apply to all equity holders in the same manner regardless of their individual responsibility.[134] Only principal equity holders with influence over the management of corporate affairs are held liable.

3. Parent-Subsidiary Combinations

Under German law, one corporation's control over another (a parent-subsidiary combination) is *not* a sufficient ground for piercing the corporate veil.[135] Each corporation remains a separate entity even in a closely linked group of affiliated corporations.[136] The parent is not treated as a component of a "larger enterprise" and is not usually held liable for the debts of its subsidiaries or siblings (as with brother and sister corporations).[137] This seems to be the general view in all of the European Union member states and in the United States,[138] where the principle of

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132. *See* KLEIN & COFFEE JR., *supra* note 2, at 140. *See also* Ehricke, *supra* note 101, at 280.

133. In cases wherein equity holders extend loans to the company, rather than contributing equity capital, thus triggering nominal undercapitalization (*nominelle Unterkapitalisierung*), the loans are deemed equal with equity capital contingent on a finding of the prerequisites provided in GmbHG section 32(a).

134. *But see* LUTTER & HOMMELHOFF, *supra* note 31, § 13 cmt. 12 (explaining the minority view).

135. *See* BGHZ 81, 311 (317) (F.R.G.); Lutter, *supra* note 20, at 253, cmt. F 12. *Cf.* TIMO RAPAKKO, UNLIMITED SHAREHOLDER LIABILITY IN MULTINATIONALS (1997) (presenting an international analysis).

136. *See* Reinhard Bork, *Zurechnung im Konzern*, 23 ZEITSCHRIFT FÜR UNTERNEHMENS—UND GESELLSCHAFTSRECHT [ZGR] 237, 243 (1994).

137. *See, e.g.*, Walkovsky v. Carlton, 18 N.Y.2d 414, 420–421 (1966) (refusing to pierce the corporate veil and hold personally liable the owner of a taxi business that was fragmented into ten corporations, each of which had only two cabs registered in its name and all of which "operated as a single entity with regard to financing, supplies, repairs, employees and garaging."). *See also* KLEIN & COFFEE JR., *supra* note 2, at 141 n.29 (noting that under the enterprise liability theory, "each of the fragments of the single enterprise are held liable, but the court does not hold the ultimate shareholder liable.").

138. For discussions of U.S. and European Union law see generally KONZERNRECHT IM AUSLAND (Marcus Lutter ed., 1994). *See also* DAS GESELLSCHAFTSRECHT DER KONZERNE IM INTERNATIONALEN VERGLEICH (Ernst-Joachim Mestmäcker & Peter Behrens eds., 1991); Miller, *supra* note 3, at 84; Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036 (1991). *But see generally*

separation of funds bars general liability for an affiliated company's debts.[139]

On the other hand, a parent corporation may be involved in one of the schemes described above. Control may result in commingling of funds and material undercapitalization of the subsidiary (*konzernbedingte Vermögensaushöhlung*). Piercing the corporate veil may be allowed where a parent corporation completely strips the subsidiary of its assets thereby rendering the subsidiary insolvent to the prejudice of creditors, or where the parent company intentionally schemes to squirrel assets into a liability-free sub-corporation while heaping liabilities upon an asset-free sub-corporation.[140]

German court dockets, however, are nearly devoid of these types of piercing cases[141] because the large body of German law governing affiliated companies (*Konzernrecht*) endeavors to protect creditors and shareholders against typical dangers, such as unfair inter-corporate transactions.[142] To be sure, such unfair transactions between a corporation and its controlling equity holder are possible even when individuals control the corporation. These transactions are much more likely to occur, however, when another corporation holds control.[143] That being so, in Germany, it is imperative that specific laws provide for the taming of

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Adolf A. Berle, Jr., *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343, 343 (1947) (discussing affiliated groups of companies and the alternative theory of "enterprise entity").

139. *See* Miller, *supra* note 3, at 84.

140. Such a scheme, wherein one company bears all the risk, while its sibling (sister company) earns all the profit, is often referred to as *Institutsmißbrauch*. *See* BGH, Wertpapiermitteilungen [WM], 33 (1979), 229 (230) (F.R.G.) (finding shareholder liability pursuant to § 826 BGB (F.R.G.)). *See also* Marcus Lutter, *Die zivilrechtliche Haftung in der Unternehmensgruppe*, 11 ZEITSCHRIFT FÜR UNTERNEHMENS—UND GESELLSCHAFTSRECHT [ZGR] 244, 252 (1982).

141. *See* Ehricke, *supra* note 101, at 265.

142. *See* Maximilian Schießl, *The Liability of Corporations and Shareholders for the Capitalization and Obligations of Subsidiaries under German Law*, 7 NW. J. INT'L L. & BUS. 480, 496 (1986). Except for Germany and Portugal, the European Union (E.U.) member states do not have special provisions for corporate groups. *See Konzernrecht für Europa—Forum Europaeum Konzernrecht*, 27 ZEITSCHRIFT FÜR UNTERNEHMENS—UND GESELLSCHAFTSRECHT [ZGR] 674 (1998). They do not doubt the inherent risks, but rather, try to reach flexible solutions through modifying the general corporate and insolvency laws. *See id.* The German model served as an example for proposed E.U. Directives, but lately, seems to be of shrinking importance within the European Union. *See* Uwe Blaurock, *Steps Toward a Uniform Corporate Law in the European Union*, 31 CORNELL INT'L L.J. 377, 391 (1998); Miller, *supra* note 3, at 124.

143. *See* ROTH & ALTMEPPEN, *supra* note 46, § 13 cmt. 2.

majority shareholders—either corporations or individual entrepreneurs—who have significant business interests outside the corporation.[144] Consequently, statutory provisions[145] govern affiliated enterprises incorporated under the Stock Corporation Act (*Aktiengesetz* (AktG)).[146] The law of affiliated limited liability companies, however, has been carved out only by court decisions, many of which further developed dominating shareholders' fiduciary duties (*Treuepflichten*) or applied the AktG statutes *mutatis mutandis*.[147]

In general, a *Konzern* is created when one or more companies are subject to the uniform direction of another.[148] Majority ownership triggers a rebuttable presumption of control[149] and the existence of a *Konzern*.[150] Under the AktG, upon consent of the equity holders of both companies, the parent and subsidiary may enter into a domination agreement (*Beherrschungsvertrag*)[151] giving the parent company the right to instruct the subsidiary's management (a contractual *Konzern* (*Vertragskonzern*)).[152] The subsidiary's officers and directors are obliged to follow these instructions even if doing so is detrimental to the subsidiary.[153] Frequently, due to tax benefits, domination agreements are combined with profit transfer agreements (*Gewinnabführungsvertrag*).[154] As a result, a parent company may exploit the subsidiary. To protect the subsidiary's creditors and shareholders, the parent company must compensate for any annual loss the subsidiary incurs during the term of the agreement.[155]

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144. *See id.*

145. *See* §§ 15, 291 AktG (F.R.G.).

146. *See* Aktiengesetz (AktG), v. 6.9.1965 (BGBl. I S.1089) (F.R.G.), *amended by* Aktiengesetz (AktG), v. 16.7.1998 (BGBl I S.1842) (F.R.G.).

147. Due to the lack of specific statutory law pertaining to liability within corporate groups in the United States, scholars generally view cases involving affiliated companies as a subcategory of piercing the corporate veil. *See* Schießl, *supra* note 142, at 482. Conversely, for a proper understanding of German law pertaining to *Konzern* it is imperative to recognize that it is *not* linked to the piercing doctrine.

148. *See* § 18 Abs. 1 AktG (F.R.G.).

149. *See* § 17 Abs. 2 AktG (F.R.G.).

150. *See* § 18 Abs. 1 AktG (F.R.G.).

151. *See* § 291 Abs. 1 AktG (F.R.G.).

152. § 308 Abs. 1 AktG (F.R.G.).

153. *See* § 308 Abs. 1–2 AktG (F.R.G.) (requiring that the instructions serve the interest of the parent company or of another affiliated company).

154. "The profit transfer agreement requires one enterprise to transfer its entire profits to the other." § 291 Abs. 1 AktG (F.R.G.).

155. *See* § 302 AktG (F.R.G.).

Note that this liability is strictly *internal*,[156] is not contingent upon proof of a causal nexus between control and damage, and is not limited to the protection of the stated capital.[157]

Of course, a parent may exert influence over its subsidiary without a domination agreement, in which case uniform control[158] is based on the parent's dominant position as principal shareholder (de facto *Konzern*).[159] The parent corporation may not induce a subsidiary to enter into detrimental legal transactions unless it compensates the subsidiary for such disadvantage.[160] Should the parent company neither compensate a subsidiary until the end of the fiscal year nor grant a legal claim to its subsidiary, the parent is liable to the subsidiary for any resulting damage.[161] Again, such liability is internal, although creditors and shareholders function as "watchdogs," in that they have standing to assert the subsidiary's damage claim against the parent to the extent they are unable to receive satisfaction from the subsidiary.[162] Uniform direction in the absence of a domination agreement is often the case with affiliated limited liability companies because a parent, as an equity holder, has the right to instruct the affiliate's managing directors in all company affairs.[163] The majority view does not draw an analogy to the concepts of the AktG,[164] but rather, holds that the proper basis for the internal liability for damages is a parent corporation's violation of the duty of loyalty (*Einzelhaftung wegen Treupflichtverletzung*).[165]

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156. *See* Bork, *supra* note 136, at 259. If a domination agreement is terminated, the controlling party must provide security to the controlled company's creditors whose claims arose prior to the date on which the registration of the termination is published in the commercial register. *See* § 303 Abs. 1 AtkG (F.R.G.). In lieu of providing security, the controlling party may provide a guarantee to the creditors. *See id.*

157. *See* § 302 AktG (F.R.G.).

158. *See* § 18 Abs. 1 AktG (F.R.G.).

159. *See* ROTH & ALTMEPPEN, *supra* note 46, § 13 cmt. 91.

160. *See* § 311 Abs. 1 AktG (F.R.G.).

161. *See* § 317 Abs. 1 AktG (F.R.G.).

162. *See id.*

163. *See* § 45 GmbHG (F.R.G.).

164. *See* BGHZ 95, 330 (340) (*Autokran*) (F.R.G.); Heinz-Dieter Assmann, *Der faktische GmbH-Konzern, in* FESTSCHRIFT 100 JAHRE GMBHG 657, 665, 695 (1992).

165. *See* BGHZ 65, 15 (15) (*ITT*) (F.R.G.); Wolfgang Zöllner, BAUMBACH & HUECK, GMBHG, app. KONZERNRECHT cmt. 53 (16th ed. 1996); HACHENBURG, GMBHG, *supra* note 81, app. § 77 cmt. 56; SCHOLZ, KOMMENTAR ZUM GMBHG, *supra* note 12, app. Konzernrecht cmt. 181 (Volker Emmerich ed.). *But see* HOLGER ALTMEPPEN, DIE HAFTUNG DES MANAGERS IM KONZERN 80 (1998).

In practice, the statutory concept of controlled and balanced safeguards inside the de facto *Konzern* may not work in certain circumstances. When a parent corporation controls and operates its subsidiary, denying it any direction of its own, and refuses to allow it any opportunity to make an arm's length profit, a court may rely on the notion of "material or qualified control" to justify holding the parent company liable to the subsidiary (qualified de facto *Konzern* (*qualifiziert-faktischer Konzern*)).[166] At a certain level of domination and integration, it becomes virtually impossible to isolate the detrimental transactions (instructions) and their nexus to losses, to assess the damages, or to identify violations of the duty of loyalty. Here, under the specific circumstances described below, a parent company must compensate for any loss by the subsidiary analogous to AktG section 302.[167]

The concept of internal liability for a subsidiary's loss either based on the parent's violation of the duty of loyalty to the subsidiary, or on loss compensation (regardless of fault), was rendered "opaque" in the *Autokran* case, which was the first to deal with a "qualified de facto *Konzern*."[168] In *Autokran*, a single business was fragmented into different corporations, all of which were owned by the same shareholder.[169] The shareholder organized his enterprise as seven separate limited liability companies, each of which entered into thirty-nine leasing contracts. Upon the limited liability companies' default, the lessor obtained judgments for lease payments, but was able to collect only a relatively small sum compared to the total amounts due under the contracts.[170] The apparent objective was to ensure further fragmentation of contractual liability.[171] The German Supreme Court held the controlling shareholder directly liable to the creditors for claims exceeding the subsidiaries' assets, pursuant to an analogous application of AktG sections 303 and 322.[172] Thus, the Court shifted from *internal* to *external* liability. An

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166. *See* ROTH & ALTMEPPEN, *supra* note 46, § 13 cmt. 117. *See also* Assmann, *supra* note 164, at 657, 665, 695.

167. *See* ROTH & ALTMEPPEN, *supra* note 46, § 13 cmt. 117.

168. BGHZ 95, 330 (330) (F.R.G.).

169. *See id.*

170. *See id.*

171. *See id.* at 341–342.

172. *See id.* (applying §§ 303 Abs. 1, 322 Abs. 2–3 AktG (F.R.G.)).

analysis of the Court's reasoning also reveals that it "mixed" the concept of loss compensation *regardless of fault*, as developed for *Konzern* cases, together with the ultimate shareholder's liability, as manager of all of the companies, for *faulty* management, which is also applicable to an independent limited liability company.[173] This mixing of different concepts provided no obvious benefit. Consequently, the Court altered its position in a later decision.[174] The position of the Court today, however, appears to embrace "modified liability for conduct" (regardless of fault) rather than "liability for a certain structure of the corporate group."[175] In a consistent line of cases beginning with the *TBB* case,[176] the Court clarified that it is not, as may be concluded from earlier decisions, the density of direction that triggers liability in a qualified de facto *Konzern*, but rather, the 'objective misuse' of the parent's power of direction (*objektiver Mißbrauch der Konzernleitungsmacht*).[177] According to the Court, such "objective misuse" is evident in a situation wherein a parent company exerts its power to direct a subsidiary in a way that does not evince reasonable consideration for the subsidiary's corporate interest thereby making compensation for specific detriments virtually impossible.[178] Quite naturally, this rather sweeping language leaves the Court with remarkable leeway—the Court has since not held in a plaintiff's favor.[179] Hopefully, after necessary correction of the earlier *TBB* rulings, the Court will not demand too high a standard for liability.

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173. *See* SCHMIDT, *supra* note 15, § 39.III; Karsten Schmidt, *Konzernhaftung oder mitgliedschaftliche Haftung des privaten GmbH-Gesellschafters*, 7 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [ZIP] 146, 148 (1986); HERBERT WIEDEMANN, DIE UNTERNEHMENSGRUPPE IM PRIVATRECHT 88 (1988).

174. *See* BGHZ 107, 7 (7) (*Tiefbau*) (F.R.G.).

175. BGHZ 122, 123 (123) (*TBB*) (F.R.G.).

176. *See id.* (involving a parent and its subsidiaries engaged in the construction business; upon the parent's direction, one subsidiary collaterally promised to be liable for repaying the credit its sibling companies obtained from a bank and conveyed all its fixed assets and assigned its receivables to the bank for security purposes—upon default by the subsidiary, a creditor sued the parent company). *See also* Uwe H. Schneider, *Neues zum qualifizierten faktischen GmbH-Konzern: Das "TBB"-Urteil—Anmerkung zu BGH WM 1993, 687–*, 18 WERTPAPIERMITTEILUNGEN 782 (1993) (analyzing the *TBB* judgment).

177. BGHZ 122, 123 (130) (F.R.G.).

178. *See id.*

179. *See* Lutz Michalski & Finn Zeidler, *Die Ausgleichshaftung im qualifiziert faktischen Konzern–eine Analyse für die Praxis*, 39 NEUE JURISTISCHE WOCHENSCHRIFT 224, 224 (1996).

For purposes of this Article, it suffices to note that the liability is strictly internal.[180] Creditors have standing in a lawsuit against a controlling company only after they prove unable to obtain satisfaction from the subsidiary.[181] As discussed below, it seems equally advantageous for independent limited liability companies to remain within a conclusive concept of internal liability.

IV. ALTERNATIVE CONCEPT: VIOLATION OF THE DUTY OF LOYALTY

A. Internal Liability

The doctrine of piercing the corporate veil is a concept of last resort, the excessive application of which causes sincere doctrinal problems. The whole concept remains nebulous, particularly if taken together with the concept of the corporation as a legal entity.[182] Doubts multiply when pondering the legal consequence of equity holders' *direct* liability to third party creditors. Courts and legal scholars quite often do not discuss the doctrinal basis for the latter at all. Instead explanations range from "good faith," to analogies to the joint and several liability of partners in a general partnership (*offene Handelsgesellschaft*).[183] Most strikingly, all these explanations run directly counter to the concept of *indirect* creditor protection. Therefore, it must be commonly understood that there are very few fact patterns in which equity holders' direct external liability is attainable, if at all. In these cases, the application of BGB section 826 (liability in tort for willful damage[184] contrary to public policy) has priority.

With respect to the latent weakness of the rules governing maintenance of legal capital of independent limited liability companies, it remains a challenging task to develop a consistent system of additional creditor protection that avoids "relativity" of the legal entity, and, in particular, of the separation of funds. Against this background, in this author's opinion, such protection

180. *See* Bork, *supra* note 136, at 260 (stating that there is no need for veil-piercing tailored to *Konzern* cases).

181. *See* §§ 309 Abs. 4, 317 Abs. 1, 4, 318 Abs. 4, 323 Abs. 1 AktG (F.R.G.). *See also* SCHMIDT, *supra* note 15, § 39.III.

182. *See* Ehricke, *supra* note 101, at 262–267.

183. *See* § 128 HBG (F.R.G.).

184. *See* § 826 BGB (F.R.G.).

must be *internal*, and must safeguard a company's proper equity capitalization exceeding the stated amount. The key to a solution is twofold: first, recognizing a corporation's interests as distinct from its equity holders' private interests, and second, recognizing an equity holder's duty of loyalty, not only to fellow equity holders, but also to the company itself.

So far, in situations involving companies with only one shareholder, establishing a duty to finance properly, beyond the scope of the statutory corporate finance rules, seems to be an elusive quest because the interests of the equity holder and the company are deemed congruent.[185] A separate "corporate interest" (*Gesellschaftsinteresse*) of one-member-companies demanding legal protection has apparently not yet been recognized. It is noteworthy that "separation of corporate and private interests" and protection of the company are out of question in co-determined limited liability companies and in parent-subsidiary combinations. This should also be accepted for small limited liability companies, even when they have only one equity holder.[186] Total conformity of corporate and shareholder interests does not agree with the concept of the company as a legal entity distinct from its member(s)—such "corporate interest" does not call for absolute deference. The equity holder(s) are free to determine the corporate purposes in the by-laws[187] and may choose to dissolve the company at any time.[188] Nevertheless, as long as they decide to pursue their business in the form of a limited liability company, their freedom of financial disposition should be restricted.

There are certainly good reasons to say that such restriction—at least in the context of repaying equity contributions to equity holders—is not feasible without statutory amendment to the Limited Liability Company Act. For example, AktG section 57[189] constitutes a total ban on corporate capital payouts regardless of the coverage of the stated capital, whereas GmbHG section 30[190] does not contain such a restriction. Understandably, a stricter rule

185. *See* BGHZ 56, 97 (101) (F.R.G.); BGHZ 119, 257 (259) (F.R.G.).

186. *See* PETER HOMMELHOFF, DIE KONZERNLEITUNGSPFLICHT 256 (1982); Schnauder & Müller-Christmann, *supra* note 59, at 983.

187. *See* § 45 GmbHG (F.R.G.).

188. *See* § 60 Abs. 1 GmbHG (F.R.G.); SCHMIDT, *supra* note 15, § 37.III.7.

189. *See* § 57 Abs. 1 AktG (F.R.G.).

190. § 30 GmbHG (F.R.G.).

can only be implemented by statute. Yet this is only one side of the argument, and the problem bears on the company's sufficient capitalization in accordance with its business pursuits in general. Under statutory corporate law as it now stands, the doctrine of the duty of loyalty[191] flowing from membership (*mitgliedschaftliches Sonderrechtsverhältnis*),[192] may serve as a doctrinal basis for equity holders' internal liability for a company's insufficient capitalization. According to the aforementioned "corporate interest," an equity holder should not only owe loyalty to his fellow equity holders, but also to the company itself, even if he or she is the only equity holder.[193] This implies that managing members have a "financing responsibility."[194] Due to the normative function of the company's capital to balance possible losses and prevent a fast slide into insolvency, the company's capital should increase in accordance with the growth, nature, and risk of its business transactions. Understandably, this does not mean that equity holders must permanently adapt the legal capital to the ups and downs of the corporate business in order to escape personal liability. This would reintroduce the infeasible economic evaluation of sufficient stated capital, as described above.[195] Nonetheless, there are decisive points and turnarounds in the "life" of the company calling for change in the financial situation[196] or, if this is not obtainable, liquidation of the company. For example, equity holders may not extract assets essential for the company's liquidity to meet its foreseeable debts[197] or take

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191. *See* SCHMIDT, *supra* note 15, § 20.IV.

192. *See id.*

193. *See* BARBARA GRUNEWALD, GESELLSCHAFTSRECHT 373 (3d ed. 1999); Martin Winter, *Eigeninteresse und Treupflicht bei der Einmann-GmbH in der neueren BGH-Rechtsprechung*, 23 ZEITSCHRIFT FÜR UNTERNEHMENS—UND GESELLSCHAFTSRECHT [ZGR] 570, 584 (1994); Schnauder & Müller-Christmann, *supra* note 59, at 984; Hans-Joachim Priester, *Die eigene GmbH als fremder Dritter. Eigensphäre der Gesellschaft und Verhaltenspflichten ihrer Gesellschafter*, 22 ZEITSCHRIFT FÜR UNTERNEHMENS—UND GESELLSCHAFTSRECHT [ZGR] 512, 525 (1993).

194. ROTH & ALTMEPPEN, *supra* note 46, § 13 cmt. 25 (noting that a manager and a managing member (under GmbHG § 35) may be liable to the company pursuant to GmbHG, section 43, paragraphs 1–2 (stating that managers must, in the affairs of the company, apply the due care of a prudent businessman if they do not conform with the duties described below)).

195. *See supra* Part III.C.1.

196. *See* Stimpel, *supra* note 115, at 609.

197. *See id.*

excessive business risks that cannot be hedged with the corporate capital.[198]

Put more abstractly, violations of the duties of loyalty and care do not stem from the negligent omission to provide the company with additional equity capital, but rather, from careless business pursuits to the equity capital's detriment.[199] From these duties flow the obligation to refrain from any action that visibly endangers the corporation's existence prior to shareholder consent as to its dissolution.[200] Understandably, the threshold of corresponding liability must be high in order to conform to the concept of "limited liability." The determinative test could read as follows: the extraction of capital from a corporation violates the duty of loyalty when the capital remaining in the firm is insufficient to the degree that, in the normal course of business, the probability of the corporation's dissolution, to the detriment of its creditors, evidently rises above any usual business risk.[201] Any intentional violation of this obligation may trigger internal liability to the corporation. By the same token, a risky business pursuit clearly distorting the relation to the firm's capital may also fall under this test.

Taken together, the view proffered above is a preferable modification and a reason to transfer external liability to an *internal concept* of equity holders duties that evades the legal problems involved with piercing the corporate veil. This view can complete the concept of the corporate entity to not only benefit the corporation, but more importantly, to bring about the well balanced discharge of its creditors.[202] It remains to be seen, however, how the discussion regarding additional internal protection of the limited liability company's corporate capital will develop. The majority of commentators still seem to reject the view this Article proffers. Even though the German Supreme

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198. *See id.*

199. Altmeppen, *supra* note 69, at 912.

200. *See* SCHMIDT, *supra* note 15, § 37.III.7 (defining the concept as "liability for the causation of insolvency" (*Konkursverursachungshaftung*)). *See also* Altmeppen, *supra* note 69, at 912; Holger Altmeppen, *Urteilsanmerkung zu BAG ZIP 1999, 878*, 20 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [ZIP] 881, 882 (1999); ROTH & ALTMEPPEN, *supra* note 46, § 13 cmt. 24.

201. *See* Thomas Raiser, *Konzernhaftung und Unterkapitalisierungshaftung*, 24 ZEITSCHRIFT FÜR UNTERNEHMEN—UND GESELLSCHAFTSRECHT [ZGR] 156, 165 (1995) (articulating a similar definition in the context of material undercapitalization).

202. *See* GRUNEWALD, *supra* note 193, at 373.

Court generally denies that a single equity holder has a duty of loyalty to "his or her" (wholly owned) limited liability company,[203] the Court holdings seem inconsistent. In the same decision, the Court tackled, but did not decide, the question as to whether corporate capital must be protected beyond the scope of GmbHG section 30 when a transaction endangers the company's existence.[204]

B. Additional Creditor's Rights in a Lawsuit

It is very unlikely that a company's internal claims against its equity holder(s) will be litigated, except in insolvency proceedings.[205] In the latter case, the receiver will claim additional (re)payments to the corporate funds.[206] Notwithstanding this seemingly protective safeguard, commencement of insolvency proceedings is often denied because of lack of assets (for denial it suffices that the assets will not cover the costs of the insolvency proceedings).[207] Therefore, creditors need protection after the commencement of insolvency proceedings is denied. This can be achieved by granting a creditor secondary standing in a suit against a company's equity holders analogous to sections of the AktG,[208] which allow a creditor standing to litigate a company's claim against its equity holders for damages.[209] Under normal circumstances, an affirmative judgment orders equity holders to make payments to the company, and not to the creditors.[210] Thus, the creditors may proceed directly against the equity holder(s) after denial of the commencement of insolvency proceedings and the company's subsequent dissolution.[211]

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203. *See* BGHZ 122, 333 (336) (F.R.G.).

204. *See id. See also* SCHOLZ, KOMMENTAR ZUM GMBHG *supra* note 12, § 37 cmt. 52 (Uwe H. Schneider ed.).

205. *See* GERD KRIEGER, HANDBUCH KONZERNFINANZIERUNG, § 4 cmt. 4.10 (Marcus Lutter et. al. eds., 1998).

206. *See* § 80 Abs. 1 InsO (F.R.G.).

207. *See* § 26 Abs. 1 InsO (F.R.G.).

208. *See, e.g.*, §§ 93 Abs. 5, 117 Abs. 5, 309 Abs. 4, 310 Abs. 4, 317 Abs. 4, 318 Abs. 4 AktG (F.R.G.).

209. *See* SCHMIDT, *supra* note 15, § 9.IV.5.

210. In any event, the creditors may attach this claim when they levy execution on the company's assets. *See* §§ 829, 835 ZPO (Civil Procedure Act (Zivilprozeßordnung) v. 12.9.1950, BGBl. S. 533)) (F.R.G.).

211. *See* § 60 Abs. 1 GmbHG (F.R.G.).

V. CONCLUSION

The doctrine of piercing the corporate veil triggering equity holders' direct *external* liability to creditors remains an obscure safeguard for corporate creditors placing the concepts of legal entity and separation of funds in danger. Therefore, the analysis strongly suggests that veil piercing should be abolished. In extreme cases, such as those involving the draining of funds or intentional undercapitalization, the equity holders' liability in tort, pursuant to BGB section 826, may help fill the gaps.[212]

It is clear, however, that additional protection of the corporate capital beyond the statutory protection of the stated capital is of paramount importance. As discussed above, the concept of equity holders' *internal* liability to the company efficiently eliminates inequitable corporate risk allocation. Solidly based on a violation of the duty of loyalty, it can prevent the limited liability company's insufficient capitalization that evidently contravenes the company's business pursuit and endangers the company's existence. In addition, special procedural devices furnish creditors with standing to litigate a company's claim against its equity holders for damages.

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212. *See* BGHZ 68, 312 (315) (F.R.G.). *See also* Ehricke, *supra* note 101, at 292–297.